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The Impact of the Decline of Coal and the Rise of Natural Gas on Local Severance Tax Revenue

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The severance tax is not only an important source of revenue for the state's budget; it also provides a substantial amount of revenue to local governments in West Virginia. In FY 2011, approximately \$43.8 million in severance tax revenue was distributed to county and municipal governments throughout the state, including \$37.7 million in coal severance tax revenue and \$6.1 million in oil and natural gas severance tax revenue.¹

While future projections of declining coal production have raised concerns about potential declines in local severance tax revenue, recent legislative changes and rising natural gas production should keep local severance tax revenue stable and growing in the coming years.

There are five separate funds with different methods for distributing severance tax revenue to local governments in West Virginia.

- **County Coal Revenue Fund** – West Virginia's five percent severance tax rate on coal production is actually two separate rates; a 4.65 percent rate for the state and a 0.35 percent rate for the local dedication (0.65 percent and 0.35 percent for the reduced rate on thin seam coal).² Of the revenue raised by the 0.35 percent tax rate, 75 percent is distributed to West Virginia's coal-producing counties, based on their share of total coal production, through the County Coal Revenue Fund. In FY 2011, \$28.3 million was distributed through the County Coal Revenue Fund to 29 coal-producing counties.³
- **All Counties and Municipalities Coal Fund** – The remaining 25 percent of the coal severance tax revenue raised by the 0.35 percent local rate is distributed to all counties and municipalities and the state, based on population, through the All Counties and Municipalities Coal Fund. In FY 2011, \$9.4 million was distributed to local governments through the fund.⁴
- **Coal County Reallocated Severance Tax Fund** – Beginning in FY 2013, one percent of total coal severance tax collections will be distributed back to the state's coal-producing counties, in addition to County Coal Revenue Fund distributions. The percentage distributed back to the coal-producing counties will increase by one percent each year until reaching five percent in FY 2017 when the amount distributed will be capped at \$20 million.⁵
- **Oil and Gas County Revenue Fund** – Ten percent of oil and natural gas severance tax revenue is distributed to local governments in West Virginia. 75 percent of the local dedication is distributed to oil and gas producing counties, based on their share of total oil and natural gas production, through the Oil and Gas County Revenue Fund. In FY 2011, \$4.6 million was distributed to 46 oil and gas producing counties.⁶
- **All Counties and Municipalities Oil and Gas Fund** – The remaining 25 percent of the ten percent of oil and gas severance tax revenue reserved for local governments is distributed to all counties and municipalities in the state, based on population. In FY 2011, \$1.5 million was distributed through this fund.⁷

Projections of future coal and natural gas production suggest changes to the make-up of the local dedication of severance tax revenue. While coal production is projected to fall, rising coal prices should keep revenue stable. The County Coal Revenue Fund is projected to fall from \$24.8 million in 2010 to \$20.6 million in 2020, before rebounding to \$28.7 million in 2035. While the County Coal Revenue Fund is projected to stay flat, West Virginia's coal-producing counties will see significant increases in severance tax revenue through the Coal County Reallocated Fund, which will send approximately \$4.3 million in revenue to coal-producing counties in FY 2013, and will reach \$20 million annually by 2027 (**Figure 1**).

The amount of coal severance tax revenue that is split by all local governments is also projected to remain relatively flat, falling from \$8.3 million in 2010 to \$6.8 million in 2020, before rising back to \$9.6 million by 2035 (**Figure 1**).

Unlike coal severance revenue, severance tax revenue on natural gas is projected to grow every year. Revenue distributed from the Oil and Gas County Revenue Fund to the state's oil and gas producing counties is projected to increase from \$3.9 million in 2010 to \$22.4 million in 2035, while the revenue split by all local governments from the All Counties and Municipalities Oil and Gas Fund is projected

to increase from \$1.3 million in 2010 to \$7.5 million in 2035 (**Figure 1**).

Overall the amount of severance tax revenue distributed to local governments in West Virginia is projected to increase from \$38.3 million to \$88.1 million from 2010 to 2035, with the growth coming from increased natural gas revenue and the new local dedication for coal-producing counties (**Figure 1**).

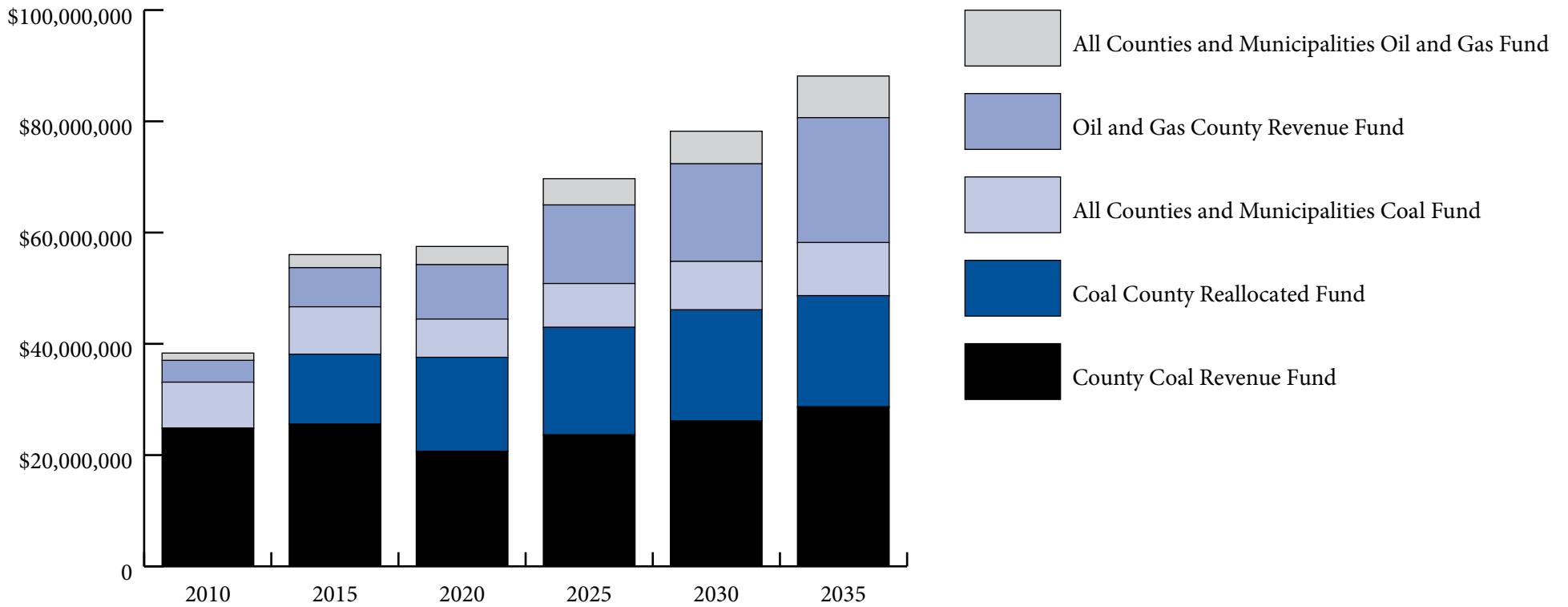
As with any projections, these estimates of severance tax revenues are subject to a degree of uncertainty, and could, in fact, be too optimistic. If coal revenues fall more sharply than expected or if natural gas revenues do not grow as much as projected, the state could consider scaling back or eliminating a number of tax expenditures that currently reduce severance tax revenue.

These tax expenditures include the reduced rate for thin seam coal, which costs the state \$75 million per year in forgone revenue, as well as several tax credits against the severance tax, including the Manufacturing Investment Tax Credit, the Coal Loading Facility Tax Credit, and the Annual Severance Tax Credit, which reduce severance tax collections by several million dollars each year.⁸

Endnotes

- 1 West Virginia State Treasurer's Office, Coal Severance Tax Distributions.
- 2 West Virginia Code §11-13A.
- 3 West Virginia State Treasurer's Office, Coal Severance Tax Distributions.
- 4 Ibid.
- 5 West Virginia Legislature, 2011 1st Special Session, Senate Bill No. 1002 – Final Version.
- 6 West Virginia State Treasurer's Office, Oil and Gas Severance Tax Distributions.
- 7 Ibid.
- 8 West Virginia Tax Department, 2012 West Virginia Tax Expenditure Study.

FIGURE 1
Projected Severance Tax Local Dedication, 2010-2035



Source: WVCBP analysis of U.S. Energy information Administration 2012 Annual Energy Outlook, WV Tax Department, and WV Treasurer's Office data.