

**DEPARTMENT OF TAXATION
2013 Fiscal Impact Statement**

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| <p>1. Patron Ryan T. McDougle</p> <p>3. Committee Senate Finance</p> <p>4. Title Local Coal Severance Taxes</p> | <p>2. Bill Number <u>SB 1111</u></p> <p>House of Origin:
<u> X </u> Introduced
<u> </u> Substitute
<u> </u> Engrossed</p> <p>Second House:
<u> </u> In Committee
<u> </u> Substitute
<u> </u> Enrolled</p> |
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5. Summary/Purpose:

This bill would impose the local gas severance tax, the local gas road improvement tax, and the additional local gas severance tax on the fair market value of natural gas severed from the earth, measured at the time it is produced at the wellhead. Fair market value would be defined as the gross receipts from the first sale by the taxpayer or its related parties to a nonrelated party, less all reasonable, actual costs of moving and processing the gas from the wellhead to the point of sale. Such costs would include, but not be limited to, depreciation, compression, marketing, overhead, maintenance, processing, transportation, property taxes, and return on investment. The bill would also require the Tax Commissioner to develop uniform reporting forms after consultation with counties, cities, and severance taxpayers.

Currently, the local gas severance tax, the local gas road improvement tax, and the additional local gas severance tax are imposed on the gross receipts from the sale of gases severed from the earth. Gross receipts are defined as the fair market value measured at the time the coal or gases are utilized or sold for utilization in the locality or at the time they are placed in transit for shipment from the locality.

Under current law, *Va. Code* § 58.1-3703.1 provides uniform ordinance provisions for the BPOL tax. The statute includes provisions for license requirements, due dates and penalties, situs of gross receipts, limitations and extensions, administrative appeals, judicial review, and rulings. Currently, ordinances levying a license tax must include provisions substantially similar to *Va. Code* § 58.1-3703.1(A) to be valid.

This bill would be declarative of existing law.

6. **Budget amendment necessary:** No.
7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

8. Fiscal implications:

Administrative Costs

The Department considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

To the extent that localities are currently not allowing deductions for processing and moving the gas from the wellhead to the point of sale, this bill would result in a revenue loss to the locality, the magnitude of which is unknown. According to the Auditor of Public Account's Comparative Report of Local Government Revenues and Expenditures, local revenues from the coal, oil, and gas taxes totaled \$51.2 million in Fiscal Year 2009, \$43.3 million in Fiscal Year 2010, and \$59.8 million in Fiscal Year 2011.

9. Specific agency or political subdivisions affected:

Department of Taxation
Localities imposing gas severance taxes

10. Technical amendment necessary: No.

11. Other comments:

BPOL Tax Uniform Ordinance Provisions

The Business, Professional and Occupational License (BPOL) tax is a tax on businesses for the privilege of engaging in business at a definite place of business within a Virginia locality. The measure or basis of the BPOL tax generally is the gross receipts of the business. The BPOL tax is a tax on gross receipts, not net income.

Virginia Code § 58.1-3703.1 provides uniform ordinance provisions for the BPOL tax. *Virginia Code* § 58.1-3703.1(A) sets forth the limitations and requirements of the BPOL tax, including provisions for license requirements, due dates and penalties, situs of gross receipts, limitations and extensions, administrative appeals, judicial review, and rulings. Ordinances levying a license tax must include provisions substantially similar to *Va. Code* § 58.1-3703.1(A) to be valid.

Local Severance Taxes

Under current law, localities are generally prohibited from imposing a license tax or fee on any person engaged in the business of severing minerals from the earth for the privilege of selling the severed minerals at wholesale at the place of severance.

However, localities are authorized to levy a severance tax that is capped at one percent of the gross receipts from the sale of coal or gases severed within such county. The gross receipts are the fair market value measured at the time the coal or gases are utilized or sold for utilization in the locality or at the time they are placed in transit for

shipment from the locality. In calculating the fair market value, no person engaging in the production and operation of severing gases from the earth in connection with coal mining is permitted to take any deductions, including but not limited to, depreciation, compression, marketing fees, overhead, maintenance, transportation fees and personal property taxes. The City of Norton and the Counties of Buchanan, Dickenson, Lee, Russell, Scott, Tazewell, and Wise all impose the severance tax at a rate of one percent.

Those localities that comprise the Virginia Coalfield Economic Development Authority may also impose a local coal and gas road improvement tax that is capped at a rate of one percent of the gross receipts from the sale of coal and gases severed within the locality. The revenues generated from this tax are allocated as follows: 75% are paid into a special fund in each locality called the Coal and Gas Road Improvement Fund, where at least 50% are spent on road improvements and 25% may be spent on new water and sewer systems within the locality; and the remaining 25% of the revenue is paid to the Virginia Coalfield Economic Development Fund. The Virginia Coalfield Economic Development Authority is comprised of the City of Norton, and the Counties of Buchanan, Dickenson, Lee, Russell, Scott, Tazewell, and Wise.

In addition, a county or city may allocate 25% of the revenue in the Coal and Gas Road Improvement Fund to the construction, repair, or enhancement of water and sewer systems; however, if this option is initiated by the county or city, it must develop and adopt by resolution an annual plan for such projects and their funding. 2004 House Bill 1426 (Chapter 871, 2004 Acts of Assembly) provided that any revenues dedicated for water and sewer systems would be distributed directly to the local public service authority.

A county or city may also levy an additional license tax on every person engaging in the business of severing gases from the earth at a rate not to exceed one percent of the gross receipts from the sale of gases severed within such locality. The revenue received from the tax is paid into the general fund, except for the localities that comprise the Virginia Coalfield Economic Development Authority. In those localities, 50% of the revenues are paid to the Virginia Coalfield Economic Development Fund.

Valuation of Gas

In a 1999 Ruling of the Tax Commissioner, Public Document ("PD") 99-306 (November 29, 1999), the Department of Taxation ruled in a case regarding gas severance taxes that expenses representing the value added to the gases at, and subsequent to, the time they are placed in transit for shipment must be deducted. As none of the gases severed by the Taxpayer were used or sold for use within the County, the Tax Commissioner held that the gases must be valued when they were placed in transit for shipment and determined that the gases were placed in shipment at the wellhead. As the gases were valued at the wellhead, expenses that add value to the gas between the wellhead and the point of sale were deductible from the gross receipts.

In 2002, Senate Bill 78 (2002 Acts of Assembly, Chapter 433) was subsequently enacted that limited the ruling. The legislation prohibited persons engaged in severing gases from the earth in connection with coal mining from taking deductions, including but not limited to, depreciation, compression, marketing fees, overhead, maintenance, transportation fees and personal property taxes when calculating the fair market value.

The issue of whether expenses that add value to the gas between the wellhead and the point of sale may be deducted by persons severing gases not in connection with coal mining was again ruled on by the Attorney General (OAG 10-110, August 5, 2011) as well as the Department of Taxation (PD 12-44, April 18, 2012). Both the Attorney General and the Tax Commissioner again held that gross receipts from sale may be used as a starting point when determining the value of the gases at the time they are placed in transit for shipment. Expenditures that represent value added to the gases at, and subsequent to, the time they are placed in transit for shipment may be deducted. Such expenses may include processing, transportation and marketing expense.

Severance Tax Study and Pending Lawsuits

Legislation in the 2012 General Assembly Session required the Tax Commissioner to convene a working group consisting of representatives of the localities levying severance taxes and the coal and gas companies subject to the tax. The working group reviewed the methodology for determining gross receipts subject to the severance taxes and such other issues related to the imposition of severance taxes. The Tax Commissioner was also given the discretion to review with the working group such other tax issues as may be in dispute between the localities and the industry representatives. The working group was asked to identify any changes to current law, regulation, or policy that it considers desirable when addressing the issues. During the study, representatives of the coal industry and local governments reached an agreement regarding the valuation of coal and the imposition of the local coal severance taxes. Legislation has been introduced to codify the terms of the agreement. Representative of local governments and the gas industry have not been able to reach an agreement.

Lawsuits were filed by a gas company in both Wise County Circuit Court and Dickenson County Circuit Court in December of 2011 regarding local severance tax assessments. Neither case has been heard.

Proposal

This bill would impose the local gas severance tax, the local gas road improvement tax, and the additional local gas severance tax on the fair market value of natural gas severed from the earth, measured at the time it is produced at the wellhead. Fair market value would be defined as the gross receipts from the first sale by the taxpayer or its related parties to a nonrelated party, less all reasonable, actual costs of moving and processing the gas from the wellhead to the point of sale. Such costs would include, but not be limited to, depreciation, compression, marketing, overhead, maintenance, processing, transportation, property taxes, and return on investment. The bill would also require the Tax Commissioner to develop uniform reporting forms after consultation with counties, cities, and severance taxpayers.

This bill would be declarative of existing law.

Similar Legislation

House Bill 1771 and **House Bill 1846** are identical to this bill.

House Bill 1804 and **Senate Bill 919** would impose a state license tax on every person engaged in the business of severing uranium from the earth at a rate of three percent of the gross receipts from the sale of the uranium. Gross receipts would be defined as the fair market value measured at the time the uranium is utilized or sold for utilization in the Commonwealth or at the time the uranium is placed in transit from the Commonwealth.

House Bill 2100 and **Senate Bill 918** would reduce the rates of the local coal severance tax on coal and the local coal road improvement tax severed from the earth by small mines from one percent to 0.75 percent. The bill would also provide that gross receipts for the purpose of the local coal severance taxes is defined as the purchase price received by a producer for the sale of coal to an unaffiliated purchaser in an arm's length transaction.

cc : Secretary of Finance

Date: 1/22/2013 AM
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