Unconventional Oil and Natural Gas Production Tax Rates: How Does Oklahoma Compare to Peers? (Major Findings)

Prepared by Headwater Economics in Conjunction with Oklahoma Policy Institute, August 2013
For the full study, go to: http://tinyurl.com/oilandgastaxrates

This report compares Oklahoma's oil and natural gas tax policies to other leading oil and natural gas producing states. Oil comparison states are Colorado, Montana, New Mexico, North Dakota, Texas, and Wyoming. Natural gas comparison states are Arkansas, Louisiana, New Mexico, Pennsylvania, Texas and Wyoming.

Our analysis applies state tax policies to average production data for typical unconventional oil and natural gas wells to determine comparable effective tax rates. Both unconventional oil and natural gas wells typically feature high initial rates of production that decline steeply and quickly, and eventually stabilize at relatively low levels. The respective production profiles for unconventional oil and natural gas wells are consistent enough across shale plays to offer a sound basis for comparing how states tax policies raise revenue from these new resources.

The findings are summarized here followed by a detailed discussion of methods, findings, and data sources.

Major Findings:

Oklahoma currently has a low effective tax rate compared to peer states.

- Oklahoma's effective tax rate on unconventional oil production is 3.3 percent, the lowest of seven peer oil-producing states (Figure 1).
- Oklahoma's effective tax rate on unconventional natural gas is 2.6 percent, ranking fifth lowest of seven peer natural gas-producing states (Figure 2).

Oklahoma's low effective tax rate results from a four-year production tax "holiday" that reduces the tax rate for newly completed horizontal wells from seven to one percent.

- The use of tax holiday incentives varies widely among states. Oklahoma is one of only two oil-producing states reviewed in this study with a tax holiday incentive for oil. Four of the seven natural gas producing states offer tax holiday incentives.

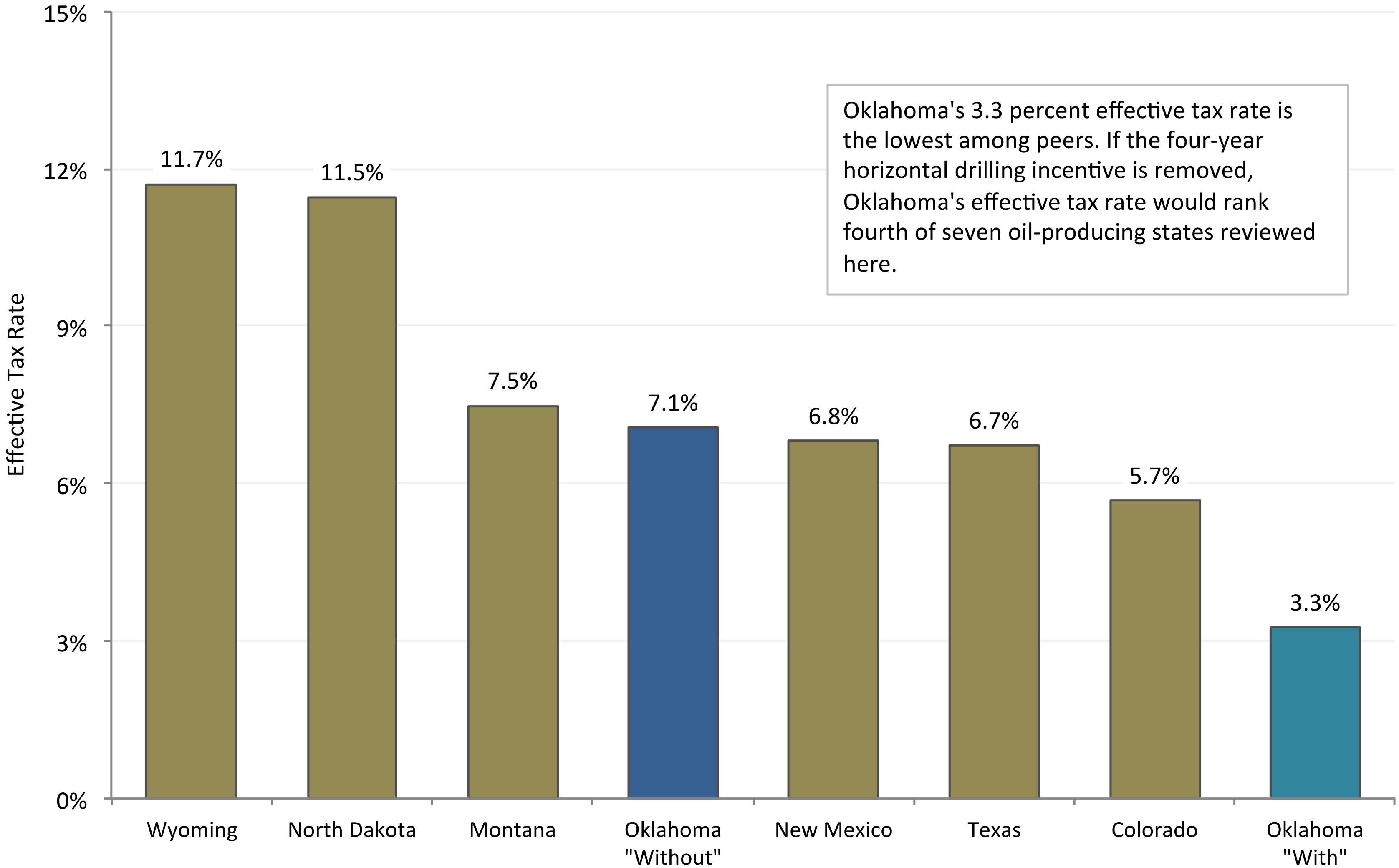
Removing the tax holiday incentive would increase Oklahoma's effective tax, but the state would retain a modest effective tax rate compared to peers.

- Oklahoma's effective oil production tax rate would rank fourth among seven peer oil-producing states without the tax holiday.
- Oklahoma's effective natural gas production tax rate would rank third (along with Texas) among seven natural gas-producing states without the tax holiday incentive.

The combination of unconventional wells and tax breaks directly impact Oklahoma's fiscal situation.

- For a typical unconventional oil well, nearly two-thirds (64 percent) of cumulative production over the first ten years will come in the first 48 months after a well is completed (Figure 4).
- As a result, cumulative gross production tax revenue over ten years will be $630,000, which is less than half of what the state would collect ($1.4 million) without the tax break (Figure 7).

Figure 1: Effective Tax Rate on a Typical Unconventional Oil Well After 10 Years of Production



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