Report Highlights

Severance Tax Suspension for Horizontal Wells

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Why We Conducted This Audit

The *Louisiana Tax Study, 2015* offered the legislature several proposed changes to taxes in Louisiana. Among those changes was the recommendation to eliminate or substantially reduce the severance tax exemption for horizontal drilling. This report provides additional information on this exemption, including its impact on the state's budget and whether or not other oil- and gas-producing states have similar exemptions.

What We Found

Although Louisiana levies a severance tax on most oil and gas wells, the legislature temporarily suspended horizontally-drilled oil and gas wells from this tax in 1994. According to Louisiana Revised Statute 47:633.7(c)(iii), a horizontally-drilled well shall have its severance tax suspended for up to 24 months or until the payout of the well is achieved. Since 1994, the Department of Natural Resources (DNR) has certified 3,025 wells as horizontal, which qualifies them for the severance tax suspension. Most horizontal wells are located in the Haynesville Shale in the northwestern part of the state, as shown in Exhibit 1. Our review of Louisiana's horizontal well suspension found the following:

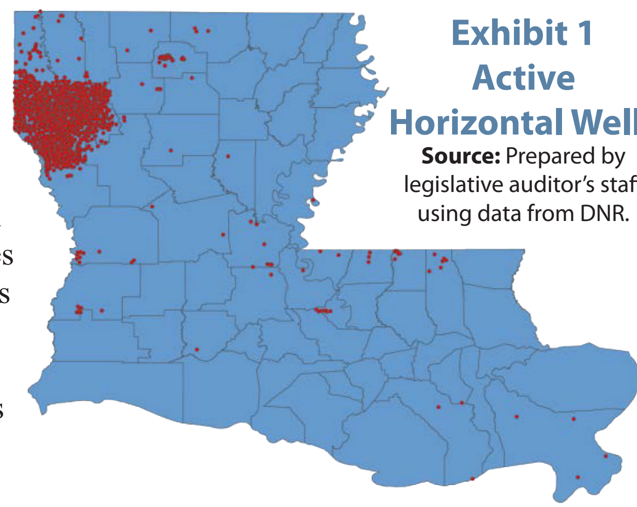


Exhibit 1
Active Horizontal Wells
Source: Prepared by legislative auditor's staff using data from DNR.

Louisiana's severance tax suspension for horizontal wells has resulted in significant revenue loss for the state. According to the Louisiana Department of Revenue's (LDR) annual Tax Exemption Budget, Louisiana has lost more than $1.1 billion in additional revenue from severance tax suspensions for horizontal wells from fiscal years 2010 to 2014, as shown in Exhibit 2.

Exhibit 2
Revenue Loss from Horizontal Well Severance Tax Suspension

Fiscal Year	Oil	Gas	Total
2010	$291,000	$238,748,000	$239,039,000
2011	1,241,000	234,884,000	236,125,000
2012	7,098,472	264,674,120	271,772,592
2013	7,667,963	227,564,460	235,232,423
2014	25,962,354	140,447,512	166,409,866
Total	**$42,260,789**	**$1,106,318,092**	**$1,148,578,881**

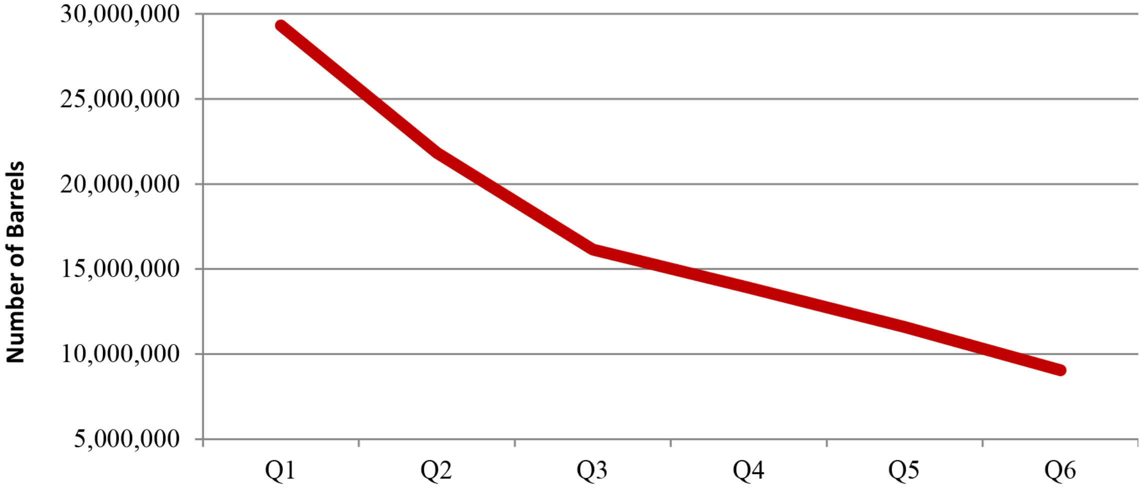
Source: Prepared by legislative auditor staff using LDR's Tax Exemption Budget.

Continued on next page

What We Found (Cont.)

Exhibit 3
Quarterly MCF Production for Horizontal Gas Wells (50-well sample)

Source: Prepared by legislative auditor's staff using data from DNR.



Louisiana is forfeiting potential revenue from horizontal gas wells during the most productive period of a well's life, as production from these wells significantly declines during the suspension period. According to DNR, all of the Haynesville Shale horizontal wells' best production is in their first two years. Because production dwindles significantly after the first two years, some operators may never pay severance taxes. According to data analyzed on 50 wells, the production for each well decreased by an average of 69% by the sixth quarter of production and more than 50% by the first year. Exhibit 3 above shows the quarterly production of these 50 wells.

Oklahoma and West Virginia previously suspended horizontal well severance taxes, similar to Louisiana, but in recent years have eliminated the exemption.

Louisiana is the only top-producing oil and gas state with horizontal drilling that currently grants a severance tax suspension for horizontal wells. There are currently no other states that allow tax suspensions on horizontal wells, and four other states grant rate reductions for these wells. In Montana, Texas, and Oklahoma, horizontal wells are subject to a temporary reduced rate. In North Dakota, horizontal wells are subject to a reduced rate, and a suspension may be granted if the price per barrel of oil is $35.50 or less; however, barrel prices have not reached this price in more than 10 years. Oklahoma and West Virginia previously suspended horizontal well severance taxes, similar to Louisiana, but in recent years have eliminated the exemption.