

# Court: Producers responsible for paying natural gas taxes

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Bruce Schreiner | The Associated Press

LOUISVILLE, Ky. — Natural gas producers in Kentucky shoulder all the responsibility for paying severance taxes on the fuel and cannot shift some of the tax burden to landowners, the state's Supreme Court said in a divided ruling Thursday.

Producers may not deduct a portion of severance taxes owed from the royalties paid to owners of the land where gas is extracted, the court said. Exceptions can occur, however, when specified by lease agreements.

In his majority opinion, Justice Bill Cunningham said the natural gas tax is assessed for the "privilege of severing or processing" the gas.

"Absent a clear legislative directive to the contrary, the privilege to deplete this non-renewable resource and bring it to market is most logically bestowed upon the producer — not the passive lessor from whose land the resource is being severed," Cunningham wrote.

The ruling came in a dispute between an eastern Kentucky landowner and EQT Production Co., a natural gas producer.

The landowner, Appalachian Land Co., claims it was underpaid on the royalties owed in exchange for EQT extracting natural gas from its property. The lease stipulated that EQT pay a royalty at the rate of one-eighth of the market price of the gas at the well, the ruling said.

[In related news, Seismologists monitor northeastern Kentucky as companies show interest in fracking Rogersville shale.](#)

In determining that market price, EQT used a calculation factoring in post-extraction processing costs, including severance taxes, Cunningham noted. The landowner argued that EQT should not have deducted severance taxes when determining the market price for royalty purposes.

Cunningham concluded that producers may not deduct severance taxes prior to calculating royalty value, unless permitted by lease agreements.

EQT gained title to the gas "the moment it brought the gas to the wellhead," he said.

"Therefore, even viewing the severance tax as analogous to a property tax, the owner of the property being taxed is EQT, not Appalachian," Cunningham wrote. "As such, whether we interpret the severance tax as a levy on the privilege of producing gas, the business of producing gas, or on the gas itself, the tax burden lies squarely with EQT."

Gas industry supporters argued that applying all the severance tax to producers would hurt small producers. Cunningham was unmoved by the argument, writing: "This time-worn tactic has been used by mineral producers for over a century to plague this embattled region of our commonwealth."

Cunningham was joined by justices David Allen Barber, Michelle Keller, Mary Noble and Daniel Venters. Venters wrote a concurring opinion.

The ruling drew a dissent from Justices Lisabeth Hughes Abramson. She was joined by Chief Justice John D. Minton Jr.

Abramson said natural-gas processors should be able to deduct the portion of the tax attributable to post-production costs when calculating royalties. But they may not deduct the portion of the tax attributable to extracting the gas, she said.

Also Thursday, the state's high court ruled against Harlan County landowners seeking to change the formula for calculating their natural gas royalties.

The landowners claimed they were underpaid by basing their royalties on one-eighth the market price at the well. They said it should reflect the sale once the gas is made marketable.

The Supreme Court sided with prior opinions that said Kentucky law does not embrace the "marketable product" approach to royalty calculation.