The Effect of New Tax Regulations on Hydraulic Fracturing in North Carolina

By Austin Raymond[*]

March 17, 2015 marked a groundbreaking day for North Carolina oil and gas exploration, for it was the day that the moratorium prohibiting hydraulic fracturing permits expired, thus creating a new potential home for oil and gas corporations.[1] The expiration effectively opened North Carolina's natural gas resources—in this instance Marcellus shale deposits—to exploration by outside industries.[2] The permissibility of hydraulic fracturing permits, coupled with North Carolina's 2013 corporate tax reform, indicates the state's interest in becoming another participant in the oil and gas businesses. However, North Carolina's new interest in big oil may yield a troubling future for energy exploration within the state. This article will explore North Carolina's efforts to attract oil and gas corporations through their new fracking regulations and tax reform, while also giving an analysis regarding whether these new regulations will serve as a benefit or a detriment to North Carolina and its residents.

I. Regulations Opening the Door to Hydraulic Fracturing in North Carolina

Senate Bill 786, called the Energy Modernization Act, was signed into law on June 4, 2014.[3] The Bill enabled the issuing of hydraulic fracturing permits after an administrative period took place.[4] Much debate stirred up centered around two interrelated topics: the potential for hydraulic fracturing to pose air pollution effects, and, if so, how such fracturing efforts would be regulated.[5] This debate culminated into an amendment to House Bill 157, entitled Amend Environmental Laws.[6] An amendment to the bill, under "Part VI: Clarify Rulemaking Directive" ordered the Environmental Management Commission to regulate toxic air emissions, if the Commission "determines that the State's current air toxics program and any federal regulations . . . are inadequate to protect public health, safety, welfare, and the environment."[7] Thus, with this regulatory system in place, hydraulic fracturing became a reality as of March 17, 2015.[8]

II. House Bill 998: North Carolina's Tax Reform

House Bill 998, entitled Tax Simplification and Reduction Act was ratified on July 23, 2013, which may have a dramatic effect on the corporate atmosphere of hydraulic fracturing in North Carolina.[9] In an effort to change the corporate tax climate in North Carolina, the tax rate

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[1] John Murawski, *As NC Fracking Moratorium Lifts, Lee County Awaits Wildcatters*, THE NEWS & OBSERVER: BUSINESS (Sept. 28, 2015, 3:46 PM), http://www.newsobserver.com/news/business/article14730470.html.

[2] Barring judicial or legislative intervention.

[3] S.B. 786, 2013-14 Leg. Sess. (N.C. 2013).

[4] *Id.*

[5] Ned Barnett, *In NC Fracking Nears, Ready or Not*, THE NEWS & OBSERVER (Sept. 28, 2015, 4:03 PM), http://www.newsobserver.com/opinion/opn-columns-blogs/ned-barnett/article10178642.html.

[6] H.B. 157, 2015-16 Leg. Sess. (N.C. 2015).

[7] *Id.* at 13-14.

[8] VINSON&ELKINS, http://fracking.velaw.com/north-carolina-fracking-rules-go-into-effect-lifting-moratorium/ (last visited Sept. 28, 2015).

[9] H.B. 998, 2013-2014 Leg. Sess. (N.C. 2013).

for Subchapter C Corporations was lowered from 6.9% to 6%, with the option of further lowering it to 5% in the future.[10] Language within the bill also allows the tax to be lowered by a further 1% in 2016 and a further 1% in 2017, provided certain fiscal targets are met.[11] Additionally, the bill moved North Carolina from a tiered system of income tax levels, with the highest being 7.75%, to a flat 5.75% rate across the board.[12] These corporate friendly changes quickly made North Carolina a more attractive location for C Corporations, as reflected by the State Business Tax Climate Index (SBTCI).[13] The SBTCI is designed to provide comparative analyses and an overall ranking of each state's tax system.[14] Prior to the implementation of the Tax Simplification and Reduction Act, North Carolina ranked 44th in the nation.[15] Under the new tax reform the state now ranks 17th.[16] This significant jump in the SBTCI rankings shows North Carolina's desire to become a more attractive home for corporations in the mining and natural gas sectors.

III. Relative Scarcity of Resources Combined with Economic Pressure

Despite the new legislation allowing the release of fracking permits, North Carolina is not home to a wealth of gas-yielding mineral deposits.[17] Thus, it remains to be seen whether mining and natural gas companies would even be interested in planting its roots in North Carolina. A report presented to North Carolina's Congress by the Department of Environment and Natural Resources contained geologic information showing the key locations of Marcellus Shale, the mineral most likely to contain natural gas for extraction, in the counties of Chatham, Lee, and Moore.[18] These mineral deposits are not overly large, paling in comparison to the larger areas in states like New York or Pennsylvania.[19] Such a relatively small amount of mineral deposits would logically render North Carolina lower in priority to larger energy industries, particularly those that are already working in tandem with established legislative models. The result of this inclination of larger energy industries to gravitate towards a larger body of resources and longstanding legislative tradition is that those corporations will leave room for smaller ones, more willing to take the economic risk for the reward.

In addition to the relative scarcity of mineral resources which yield viable natural gas, the overall demand for natural gas logically wanes with the lowering of gas prices. January 2015

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[10] *Id.* at 8-9.

[11] *Id.* at 9.

[12] *Id*. at 5.

[13] Scott Drenkard, Joseph Henchman, *2013 State Business Tax Climate Index*, TAX FOUNDATION, (Oct. 9, 2012) http://taxfoundation.org/article/2013-state-business-tax-climate-index.

[14] *Id.*

[15] Patrick M. Gleason, *North Carolina Gov. Pat McCrory Signs Historic Tax Reform into Law,* AMERICANS FOR TAX REFORM (July 23, 2013, 10:06 AM), https://www.atr.org/north-carolina-gov-pat-mccrory-signs-a7770.

[16] *Id.*

[17] *North Carolina Oil and Gas Study under Session Law 2011-276,* NORTH CAROLINA DEPARTMENT OF ENERGY AND NATURAL RESOURCES (April 30, 2012), http://ncdenr.gov/c/document_library/get_file?uuid=9a3b1cc1-484f-4265-877e-4ae12af0f765&groupId=14, at 2-3.

[18] *Id.*

[19] *Map: States Where the Fracking Industry is Active*, CITIZENS FOR RESPONSIBILITY AND ETHICS IN WASHINGTON, http://www.citizensforethics.org/pages/map-states-where-the-fracking-industry-is-active (last visited Sept. 30, 2015).

marked the lowest gas prices since 2008.[20] Such low prices would naturally lead to less of a corporate incentive to invest in North Carolina fracking since the return on the corporate investment would be substantially lower. This trend has already proven true in the United Kingdom where lower oil and gas prices negatively affected the interest in hydraulic fracturing resources.[21] While lower gas prices certainly pleases consumers, both abroad and in the United States, it also strains the hydraulic fracturing corporations' expansion plans, which are already at war with the trendy environmentally friendly alternatives, like solar, wind, or geothermal energy.[22]

IV. The Totality of Factors Considered

When taken in combination, the relatively small amount of available resources, the beneficial tax environment, new legislative mechanisms, and a lack of demand for natural gas as opposed to petroleum, the hydraulic fracturing future of North Carolina looks uncertain. On the one hand, a welcoming corporate tax code may entice a larger energy corporation to enter North Carolina and begin the mining process, however, on the other hand, it seems more likely that smaller corporations, more mobile and less reliant on out of state authority, would be more willing to set up operations in order to maximize their potential gain in an area without competition. That said, it would be surprising to see a large energy corporation expand to North Carolina despite the state's effort to make the search for natural resources more corporate friendly.

[20] *See Historical Gas Prices*, http://www.northcarolinagasprices.com/retail_price_chart.aspx (last visited Sep. 30, 2015) (follow link to "11 Years").

[21] Terry Macalister, *Low oil price means high anxiety for Opec as US flexes its muscles*, THE GUARDIAN (Oct. 18, 2014), http://www.theguardian.com/business/2014/oct/19/oil-price-us-opec-brinkmanship-shale-gas.

[22] *Id.*