AMERICAN PETROLEUM INSTITUTE

FY2013 Budget Calls for Targeted Tax Increases on America's Oil & Natural Gas Producers

The Administration's FY2013 Budget proposal includes over $85 billion in tax increases on the U.S. oil and natural gas industry. Studies have shown that these tax increases would discourage oil and natural gas production, lead to fewer well-paying American jobs, increase our reliance on foreign imports and potentially contribute to higher energy costs for consumers. Further, these tax provisions are in no way "taxpayer subsidies" and are not unique to our industry. They constitute standard business deductions (some available to all other industries) and mechanisms of cost recovery – a fundamental and necessary component to a national income tax system.

America's oil and natural gas industry already returns more than $86 million to the federal Treasury every day, pays taxes at far higher effective rates than most other industries, and is one of the few industries that have created jobs throughout the economic downturn. Increasing the industry's taxes would push oil and natural gas investment elsewhere, diminish job-creation and stifle economic activity here at home. After a handful of years, we would see less domestic energy production – particularly of natural gas – more imports, fewer new jobs, and eventually depressed tax, royalty, and other revenues.

Below are the specific provisions targeted in the FY2013 Budget:

Targeted repeal of Sec. 199 for only Oil and Natural Gas Companies ($11.6B) – This deduction was established in 2004 as part of the "American Jobs Creation Act" to help U.S. manufacturers maintain and create well-paying U.S. jobs. This deduction is available to all qualifying income from all domestic manufacturers at 9%; however the oil and natural gas industry is already penalized at only 6%. Repealing this deduction for just the oil and gas industry (rather than all taxpayers), places hundreds of thousands of jobs at risk and undermines efforts to reduce our dependence on foreign oil.

Repeal Expensing of Intangible Drilling Costs ($13.9B) – When companies drill they incur intangible drilling costs, which are costs that cannot be recovered, such as site preparation and labor, representing 60 to 80 percent of the cost of the well. Since 1913, companies have been able to expense these costs, much like the Research & Development deduction enjoyed by other industries. Cost recovery is an essential part of all business models and IDC, just like R&D, serves identical policy goals: innovation, development, and growth. Eliminating the IDC deduction would discourage innovation in the energy sector, jeopardizing additional valuable advances in oil and gas exploration, high paying jobs, and America's energy security.

Modifications of Dual Capacity Rule ($10.7B) – The Budget's international provisions include a proposal to modify rules for dual capacity taxpayers. This modification will subject only U.S. headquartered companies to double taxation on income earned overseas and greatly impact both foreign and domestic investment. Studies indicate U.S. based oil and gas companies will be significantly restricted from growing and expanding in the world marketplace - costing US revenues and US jobs that support overseas operations.

Repeal of LIFO ($25.8B[i]) – The "last-in, first-out" or LIFO accounting method is not a "gimmick" or tax loophole. It is a well-established way to determine book and taxable income for companies that anticipate inflation or rising prices over the course of their operations used by many industries. Repealing LIFO would require companies to redirect cash or sell assets in order to cover the tax payment – potentially destroying some businesses.

Repeal Deduction for Tertiary Injectants ($100M) – Similar to IDC, this is simply a cost recovery provision. Changing how these costs are recovered could force producers to shut in older fields and significantly impact local economies. In addition, this deduction supports using carbon dioxide in enhanced oil recovery projects, one of the primary methods by which carbon dioxide is stored to prevent its release into the atmosphere.

Increase G&G Amortization Period ($1.4B) – Geological and geophysical costs are those expensed in the process of using technology to locate what companies hope will be recoverable oil and natural gas deposits – however, there is no certainty. Efforts to find oil and gas reserves in the U.S. can be very expensive and recovering those costs for tax purposes is important to keeping domestic oil and gas production strong. Increasing the amortization period for these exploration costs undermines that effort and jeopardizes the goal of reducing our dependence on foreign oil reserves.

Reinstate Superfund Taxes ($10.5B[ii]) – The proposal to reinstate Superfund taxes would impose additional taxes on crude oil and petroleum products unfairly. These products do not account for a substantial portion of the Superfund liability yet would be responsible for most of the taxes. Accordingly, such taxes are unfair and do not ensure that remediation or cleanup will happen sooner.

Repeal of Percentage Depletion ($11.5B) – For over a century small mineral right owners have been able to avoid the complexity associated with recovering their investment costs as the underlying mineral is produced by using percentage depletion. Requiring cost depletion will add costs and confusion to individual taxpayers and small companies.

The API opposes these targeted tax increases outlined in the Administration's FY2013 Budget and considers them punitive and harmful to an industry that continues to provide stable, high-paying American jobs.

There is a choice when it comes to the policies that will help shape America's energy future. Sound energy policies consisting of oil and natural gas development – unfettered by the kind of tax increases the administration is proposing – could create one million new jobs in just seven years and increase revenue to the federal government by $127 billion by 2020 and $800 billion by 2030. For the industry, our nation's economy, and the American people, the choice seems clear.

For more information, visit www.api.org/tax.

---

[i] Estimated oil and natural gas industry share of total OMB FY2013 Budget score.
[ii] *Ibid.*