Statement of API Chairman J. Larry Nichols on behalf of the American Petroleum Institute Subcommittee on Energy, Natural Resources, and Infrastructure of the Committee on Finance Hearing on "Oil and Gas Tax Provisions: A Consideration of the President's FY10 Budget Proposal"

September 10, 2009

I am J. Larry Nichols, Chairman and Chief Executive Officer of Devon Energy Corporation, an "independent" oil and gas company, and Chairman of the American Petroleum Institute. I appreciate the opportunity to present the industry's views on the potential impact of the oil and natural gas tax proposals contained in the Administration's budget. I also want to thank Chairman Bingaman for his leadership in promoting greater access to our domestic oil and natural gas reserves.

The budget calls for more than $80 billion over the next 10 years in new taxes on the oil and natural gas industry. These proposals are based upon myths rather than fact – reaction rather than considered reflection.

Here's an example of what I mean by that: Lower demand in the current economy has reduced natural gas prices more than 75 percent and crude oil prices by 50%. Now the Administration's proposals seek to further weaken an industry that has suffered along with other vital sectors of the economy.

Incredibly, the Administration states that its tax proposals are aimed at reducing domestic development of oil and natural gas. It does so – as if that is a good thing – at a time when we need all sources of domestic energy to help our economy recover and grow.

The Administration also states that the current tax treatment of our industry's normal business expenses somehow distorts investment – while not recognizing that other taxpayers in other industries get similar treatment for their business expenses.

These proposals are aimed at crippling our industry – a fact borne out in the Administration's own words. [Hold up Green Book] It's right here in the Treasury Green Book. On Page 63 it boldly states that the current tax treatment "encourages overproduction of oil and gas," which, it says, is "detrimental to long-term energy security."

This is absurd.

At a time when every respected energy study agrees on the need to increase all sources of domestic energy, it makes absolutely no sense to discourage production of our leading sources, oil and natural gas. Moreover, this counter-productive approach is at odds with the administration's own carbon reduction policy because it would discourage production of natural gas, our cleanest fossil fuel. When these proposals are combined with the House-passed Waxman-Markey climate legislation, they will lead to less U.S. refining capacity and more reliance on imported gasoline without any reduction in worldwide carbon emissions.

Yet the President's tax proposals appear to be based on a myth that tax increases will have no adverse effect – that somehow companies will just absorb them without much impact. That assumption is naïve and misleading. Increased taxes represent real increases in the cost of doing business. That means less exploration, fewer wells, and less production; which historically has led to higher costs for consumers.

API companies have a record of reinvesting their profits to get the oil and natural gas our economy needs. In fact, from 1996 to 2007 our companies invested more in new projects than we made in net income. This has been a driving force contributing to domestic supply growth for both crude oil and natural gas.

This growth has largely come from the development of new shale programs where each well can cost 3 to 9 million dollars and deepwater Gulf of Mexico projects.
[Hold up shale sample].

Basing tax policy on myths leads to the wrong choices for the long term.

For example, a new excise tax on Gulf of Mexico production would raise money for the government in the short run, but cost money in the long run. The increased cost to find and develop U.S. offshore resources would reduce production of domestic offshore oil and gas – which generate royalty, bonus and tax income to the government.

The current ability to expense Intangible Drilling Costs -- the real costs of drilling wells -- recognizes that they are business expenses that serve as the foundation of our ongoing exploration and production operations. That is why the deduction has been available since the inception of the Tax Code. Repealing it would significantly raise the cost of drilling and development in the U.S., for a company like mine it would reduce our capital budget by nearly 25%, in the first year alone. This would result in less drilling, less revenue to the government, higher energy costs and fewer U.S. jobs.

As another example: The Section 199 deduction was established to encourage U.S. manufacturers to maintain and create well-paying U.S. jobs. The oil and natural gas industry directly and indirectly supports 9 million workers and their families. The proposed repeal of this deduction would specifically impose a higher tax rate on this industry (when our effective rates are already higher than the rest of manufacturing) and indicate to those workers that they are not valued the same as the rest of the workforce by Washington.

I also want to mention two of the broad business tax proposals that would have a negative impact on our industry. The proposal to modify the rules governing the creditability of foreign taxes paid by dual capacity taxpayers would lead to double taxation and compromise our ability to operate abroad. The other proposal hits refiners by repealing the LIFO accounting method, a well-established method for determining book and taxable income.

The stark reality is that these proposals are anti-jobs, anti-consumer, and anti-energy. They will depress investment in new domestic oil and natural gas projects, weaken the nation's energy security and make it more difficult to achieve economic recovery.

Instead of these proposals, we must adopt policies that reflect the realities of America's energy challenges. We need a multi-pronged approach that includes renewable energy, increased energy efficiency and oil and natural gas. It is clear to me that crippling an important sector like ours is wrong.

API and the people of America's oil and natural gas industry stand ready to work with you to address the urgent concerns facing our nation with positive polices, not punitive ones.