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AMERICAN PETROLEUM INSTITUTE

Setting the Record Straight on Industry Tax Treatment

Critics claim that certain provisions in the tax code provide unique benefits to the oil and natural gas industry. This is not the case. These frequently criticized provisions are the same as or analogous to those used by other industries. To set the record straight, we have prepared an explanation of these provisions that have been erroneously characterized as special treatment for the industry.

Domestic Manufacturer's Deduction – Section 199

- This deduction is available to all taxpayers engaged in manufacturing, producing, growing or extraction in the United States.
- While most industries are eligible for a deduction equal to 9%, the oil and natural gas industry is the only industry with a reduced deduction equal to 6%.
- *All other US manufacturing – even some you may not think of – qualify for the full 9% deduction.*

Intangible Drilling Costs (IDCs)

- This is a deduction for labor and related costs to drill a well.
- Independent producers can deduct these costs in year one while integrated oil companies can only deduct 70% in year one and amortize the remainder over five years.
- *This treatment is analogous to the research deduction, Section 179 expensing, and the deduction of advertising costs.*

Last-In, First-Out (LIFO) Accounting

- This accounting mechanism is available to all industries as a way to value inventory.
- There is *nothing* unique about the use of LIFO in the oil and natural gas industry.
- *LIFO is commonly used by grocers, wineries and distillers, car dealers, and wholesalers.*

Foreign Tax Credit – Dual Capacity Rules

- In order to avoid double taxation, the U.S. tax rules allow taxpayers to credit foreign taxes paid on overseas income against U.S. taxes on that same income.
- Like all other taxpayers, the oil and natural gas industry must prove that the amounts they pay to foreign governments are actually income taxes in order to claim a corresponding credit.
- *The dual capacity rules impose additional steps, scrutiny, and burdens – beyond those applied to other industries – to prove the amounts paid are creditable income taxes.*

Percentage Depletion

- Depletion – like depreciation – is an accounting method that allows taxpayers to recover their capital investment in a mineral interest over time. Percentage depletion is a simplified method of computing depletion that may permit deductions in excess of cost.
- As applied to oil and gas production, royalty owners and small producers are the primary beneficiaries of this method because it is restricted to a limited volume and is not available at all for integrated producers.
- *Percentage depletion is available, without any restrictions, to all other extractive industries like hard rock mining of gold and iron ore as well as quarrying other natural deposits.*