energy API
AMERICAN PETROLEUM INSTITUTE

Eliminating the Ability to Expense Intangible Drilling and Development Costs US Investment

Despite great advances in technology, drilling a well is the only means of determining with certainty the presence of hydrocarbons in reservoir rock or sand. When companies drill they incur intangible drilling costs, which are costs that cannot be recovered, such as site preparation, labor, engineering and design. These intangible costs associated with drilling a well usually represent 60 to 80 percent of the cost of the well.

Since the beginning of the income tax in 1913, tax law has permitted independent producers to deduct 100 percent of IDC in the year incurred. The tax law permits Integrated oil companies to deduct 70 percent of their IDC in the current year and amortize the remaining 30 percent of those costs over 5 years.

While other businesses are able to expense development costs (such as R&D for the pharmaceutical industry) and operating expenses, some proposals support repealing the expensing of IDCs.

- IDCs are a necessary and significant cost of oil and gas exploration and production. These costs effectively represent the industry's research and development costs that must be spent in the pursuit of finding new business opportunities. For other industries, R&D costs are fully deductible in the year incurred and, additionally, qualify for a tax credit. Given that tax regime, there is no sound tax policy basis for Congress to target IDC for non-deductibility.

- According to studies, repealing the IDC deduction would discourage domestic investment and likely result in lower production and less revenue to the government. Specifically, enactment of this proposed tax change, could result in:
    - A potential loss of 3.8 million boe/d of domestic production by 2023.
    - An estimated loss of 20% of expected future US production.
    - Estimated $33 billion in investment is at risk in 2014 alone and almost $407 billion over ten years.

- Additionally, the repeal of IDC and other proposed tax changes for only the US oil and gas industry place thousands of jobs at risk:
    - Over 75,000 direct US jobs could be put at risk.
    - Around 190,000 total direct, indirect and induced US jobs at risk upon enactment and growing to almost 265,000 by 2023.
    - The Rocky Mountains, on-shore Gulf Coast, and the middle of the US have the highest potential jobs at risk.

- The current cost recovery rules for IDC allow our industry to reinvest billions right here in the US:
    - Between 2008 and 2011, America's oil and natural gas industry spent nearly $155 billion each year investing in America's infrastructure.
    - To put this in context, the oil and natural gas industry accounts for more than 14% of all industries capital expenditures during that period.
    - That's 11% more than the capital expenditures of utilities and transportation industries combined.

- Current tax treatment for domestic exploration will help keep the cost of domestic projects competitive with foreign alternatives – a key component to America's energy security. Eliminating or further restricting the ability to expense IDCs would be punishing oil and natural gas producers as compared with other similarly situated industries.

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