DECEMBER 2012
FS:12-12-B

Cut Pollution, Save Money, Build a Clean Energy Economy

Cutting wasteful subsidies to the oil and gas industry should be part of any plan to reduce the deficit. These subsidies amount to taxpayer handouts to wealthy, mature companies that do not need government support. Some of the loopholes date back almost a century to a time when oil and gas drilling was a novel activity. These subsidies worsen the deficit while promoting activities that increase pollution and harm our health. This fact sheet describes some of the subsidies that Congress should eliminate.

Ten-year Budget Impacts	
Foreign Tax Credit	$ 9.57 billion
Intangible Drilling Costs	$ 9.53 billion
Refinery Expensing	$ .8 billion (2 Yrs)
Percentage over Depletion (Oil and Gas)	$ 12.10 billion
Percentage over Depletion (Hard Minerals)	$ 1.31 billion
Domestic Manufacturing Deduction	$ 18.17 billion
Geological and Geophysical Cost Amortization	$ .96 billion
Last-In First-Out Accounting for Oil and Gas	$ 25.80 billion
Total	**$ 78.24 billion**

The Foreign Tax Credit for oil and gas production wastes taxpayer money by giving oil and gas companies a special break for overseas operations. This loophole will cost taxpayers $9.57 billion over 10 years.[1]

The tax code allows many companies to claim a credit for taxes paid to foreign governments. This is intended to avoid double taxation of income earned abroad. Oil companies have been able to manipulate royalties paid to foreign governments to get more from this tax credit and lower their tax liability. Excessive Foreign Tax Credits only add to the roughly $1 trillion in profits that the largest oil companies earned over the past 10 years.[2] The President's FY 2013 budget proposes to limit oil and gas companies' credits to the foreign country's standard income tax rate for other industries.[3]

The Section 617 deduction for Intangible Drilling Costs wastes taxpayer money by giving oil and gas companies special treatment for drilling and will cost taxpayers $9.53 billion over 10 years.[4]

Section 617 of the Internal Revenue Code (IRC) allows oil and gas producers to deduct costs related to preparing and drilling wells. These include wages, fuel, repairs to drilling equipment, and other supplies. Allowing these costs to be expensed is an exception to the general rule requiring these types of costs to be deducted in increments over a project's useful life rather than all at once.[5] Taking the full deduction immediately allows these companies to lower their tax bill in the first year, in effect getting an interest-free loan from the government (over 5 years). This provision was originally established in 1916, when energy markets were starkly different. Like other oil and gas subsidies, this outmoded provision should be eliminated; projected oil prices do not justify taxpayer-subsidized drilling.

Section 179C, the Refinery Expensing Option, wastes taxpayer money by giving oil companies special treatment for refinery costs and will cost taxpayers $.8 billion between 2013 and 2014.[6]

Section 179C allows refiners to immediately deduct 50 percent of qualified refinery costs in the year the refinery is placed in service. Like Section 617, it allows oil companies to expense their costs faster than other companies can for similar types of investments.

NRDC

Center for American Progress Action Fund

For more information, please contact:

Franz Matzner
fmatzner@nrdc.org
(202) 289-2365
switchboard.nrdc.org/blogs/fmatzner

www.nrdc.org/policy
www.facebook.com/nrdc.org
www.twitter.com/nrdc

Section 613, the Percentage Depletion Allowance, wastes taxpayer money by subsidizing oil production that is likely to happen anyway. This provision will cost taxpayers $12.1 billion over 10 years.[7]
This tax break, which dates back to the 1920s, allows oil and gas drillers to take a deduction based on how much oil or gas they've extracted from existing wells. It potentially allows the deduction to exceed the capital investment in the original well. In some cases, the depletion allowance can eliminate all federal taxes for these companies.[8]

Section 613, the Percentage Depletion subsidy for hard mineral fossil fuels wastes taxpayer money while worsening air quality and contributing to climate change. This subsidy will cost taxpayers $1.31 billion over 10 years.[9]
Coal companies can also take advantage of the Percentage Depletion allowance described above. This subsidy should be eliminated for coal.

Section 199, the Domestic Manufacturing Deduction, wastes taxpayer dollars by subsidizing production that is likely to happen anyway. This subsidy for oil, gas, and coal will cost taxpayers $18.17 billion over 10 years.[10]
Oil and gas producers can claim a deduction for U.S. oil production under Section 199. This provision, enacted in 2004, applies to many industries and was intended to keep manufacturing in the U.S. The provision makes no sense for oil producers for two reasons. First, these companies do not need encouragement to drill at current oil prices. In 2005, President George W. Bush noted "With $55 oil, we don't need incentives to oil and gas companies to explore. There are plenty of incentives."[11] In 2012, oil prices have greatly exceeded that amount and are predicted to increase for the foreseeable future. Second, oil and gas production decisions are based largely on the location of oil and gas deposits. Oil and gas producers must go where the resource is—something no tax incentive can change. For the same reason, our estimates include eliminating the subsidy for coal and hard rock mineral mining. Eliminating oil producers from this benefit "will have no effect on consumer prices for gasoline and natural gas in the immediate future," and is unlikely to have any effect over the long run, according to a recent report by Congress's Joint Economic Committee.[12]

Section 167(h), the Geological and Geophysical Cost Amortization subsidy, wastes taxpayers' money by encouraging drilling when oil prices already support production. This subsidy will cost taxpayers $.96 billion over 10 years.[13]
This is another provision that allows oil and gas companies to deduct expenses at a quicker rate than other industries. Specifically, the tax code allows geological and geophysical expenditures incurred in connection with oil and gas exploration in the United States to be written off over two years for non-integrated oil and gas companies.[14] These geological and geophysical expenses include the costs incurred for geologists, seismic surveys, and the drilling of core holes. Subsidies intended to encourage investors to finance oil projects are not needed at 2012 oil prices.

Section 472, "Last-in, first-out" (LIFO) accounting wastes taxpayers' money by allowing oil companies to benefit from runaway oil prices. This subsidy for oil companies will cost taxpayers as much as $25.8 billion over 10 years.[15]
A tax accounting method known as "last-in, first-out," or LIFO, provides a significant tax benefit for oil companies, especially when their inventory costs are rising. LIFO allows oil companies to calculate profits based on the cost of the oil they most recently added to their inventory. Using costs incurred for oil most recently added to their inventory can minimize a company's taxable income.[16] Taxpayers do not need to help oil companies become even more profitable when Americans are suffering the most from high oil prices.

Endnotes

1 Joint Committee on Taxation*, Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year2013 Budget Proposal*, March 14, 2012.

2 Taxpayers for Common Sense, "Big Oil Tops $150 Billion in Profits in 2011", March 1, 2012.

3 Robert Pirog, *Oil and Natural Gas Industry Tax Issues in the FY2013 Budget Proposal*, Congressional Research Service, 2012. Note that the revenue effect described above is based on an administration proposal that may include more than oil and gas activities. However, oil and gas production was a focus of that proposal and is expected to represent a very significant share of the number.

4 Joint Committee on Taxation*, Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year2013 Budget Proposal*, March 14, 2012.

5 Seth Hanlon, "Big Oil's Misbegotten Tax Gusher", Center for American Progress, May 5, 2011.

6 This estimate represents taxpayer costs and may be different from the increased revenue intake from closing the loophole. CRS estimates that this subsidy will cost $2.7 billion dollars between 2010 and 2014. For our estimate, we conservatively use $.8 billion to reflect CRS's estimates for years 2013 and 2014 only. Molly Sherlock, "Historical Revenue Losses Associated with Tax Incentives for Oil and Gas", Congressional Research Service, February 2, 2011.

7 Joint Committee on Taxation*, Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year2013 Budget Proposal*, March 14, 2012.

8 Seth Hanlon, "Big Oil's Misbegotten Tax Gusher", Center for American Progress, May 5, 2011.

9 Joint Committee on Taxation*, Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year2013 Budget Proposal*, March 14, 2012.

10 Joint Committee on Taxation*, Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year2012 Budget Proposal*, March 17, 2011.

11 http://www.nytimes.com/2008/03/03/opinion/03mon4.html

12 Joint Economic Committee, "The Proposed Modification of Internal Revenue Code Section 199 Will Not Increase Consumer Energy Prices". Last viewed December 16, 2012 at http://www.jec.senate.gov/archive/Documents/Reports/12.12.07EnergyTaxPackage.pdf

13 Joint Committee on Taxation*, Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year2013 Budget Proposal*, March 14, 2012.

14 Seth Hanlon, "Big Oil's Misbegotten Tax Gusher", Center for American Progress, May 5, 2011.

15 This is the industry estimate of the effect on oil and gas companies of the Administration's proposal to eliminate LIFO as a whole. Because it is based on an Office of Management and Budget score, we assume that the estimate represents revenue effects. See: American Petroleum Institute, "FY2013 Budget Calls for Targeted Tax Increases on America's Oil & Natural Gas Producers" (2012), available at: http://www.api.org/policyandissues/~/media/Files/Policy/Taxes/API_Analysis-of-FY2013-Budget-Feb-2012.ashx.

16 Seth Hanlon, "Big Oil's Misbegotten Tax Gusher", Center for American Progress, May 5, 2011.

NRDC

Center for American Progress Action Fund

Printed on recycled paper

www.nrdc.org/policy