New Natural Gas and Oil Taxes Would Crush America's Clean Energy and Energy Security

Natural gas and oil provide 65 percent of America's energy. New wind energy and solar energy require new natural gas turbines to run when the wind doesn't blow and the sun doesn't shine. American natural gas is essential to meeting any clean energy agenda associated with global climate. American natural gas and oil are essential to any energy security plan.

America's independent natural gas and oil producers develop 90 percent of US wells, produce 82 percent of US natural gas and produce 68 percent of US oil. Independent producers reinvest over 100 percent of American oil and natural gas cash flow back into new American production. Lower natural gas and oil prices and the tight credit market are limiting investment capital; drilling activity is down over 25 percent since a year ago.

The Obama Administration's budget request would strip essential capital from new American natural gas and oil investment by radically raising taxes on American production. American natural gas and oil production would be reduced. It runs counter to the Administration's clean energy and energy security objectives.

Intangible Drilling and Development Costs (IDC) – IDC tax treatment is designed to attract capital to the high risk business of natural gas and oil production. Expensing IDC has been part of the tax code since 1913. IDC generally include any cost incurred that has no salvage value and is necessary for the drilling of wells or the preparation of wells for the production of natural gas or oil. Only independent producers can fully expense IDC on American production. Eliminating IDC expensing would remove over $3 billion that would have been invested in new American production.

Percentage Depletion – All natural resources minerals are eligible for a percentage depletion income tax deduction. Percentage depletion for natural gas and oil has been in the tax code since 1926. Unlike percentage depletion for all other resources, natural gas and oil percentage depletion is highly limited. It is available only for American production, only available to independent producers, only available for the first 1000 barrels per day of production, limited to the net income of a property and limited to 65 percent of the producer's net income. Percentage depletion provides capital primarily for smaller independents and is particularly important for marginal well operators. Eliminating percentage depletion would remove over $8 billion that would have been invested in maintaining and developing American production.

Geological and Geophysical (G&G) Amortization – G&G costs are associated with developing new American natural gas and oil resources. For decades, they were expensed until a tax court case concluded that they should be amortized over the life of the well. In 2005 Congress set the amortization period at two years. Later, Congress extended the amortization period to five years for large major integrated oil companies and then extended the period to seven years. Early recovery of G&G costs allows for more investment in finding new resources. Extending the amortization period would remove over $1 billion from efforts to find and develop new American production.

Marginal Well Tax Credit – This countercyclical tax credit was recommended by the National Petroleum Council in 1994 to create a safety net for marginal wells during periods of low prices. These wells – that account for 20 percent of American oil and 12 percent of American natural gas – are the most vulnerable to shutting down forever when prices fall to low levels. Enacted in 2004, the marginal well tax credit has not been needed, but it remains a key element of support for American production – and American energy security.

Enhanced Oil Recovery (EOR) Tax Credit – The EOR credit is designed to encourage oil production using costly technologies that are required after a well passes through its initial phase of production. For example, one of the technologies is the use of carbon dioxide as an injectant. Given the increased interest in carbon capture and sequestration, carbon dioxide EOR offers the potential to sequester the carbon dioxide while increasing American oil production. Currently, the oil price threshold for the EOR tax credit has been exceeded and the oil value is considered adequate to justify the EOR efforts. However, at lower prices EOR becomes uneconomic and these costly wells would be shutdown.

Manufacturing Tax Deduction – Congress enacted this provision in 2004 to encourage the development of American jobs. All US manufacturers benefitted from the deduction until 2008 when the oil and natural gas industry was restricted to a six percent deduction while other manufacturers will grow to a nine percent deduction. While many producers' deductions are capped by the payroll limitation in the law, it is another tax provision that provides capital to America's independent producers to invest in new production.

Excise Tax on Gulf of Mexico Production – American independent producers hold 90 percent of the OCS leases in the Gulf of Mexico. Offshore federal lands produce 27 percent of America's oil and 15 percent of America's natural gas. Producers pay royalties as high as 16.67 percent on their production. A portion of this production is produced without royalty payments until it reaches a set volume that was designed to encourage – and effectively so – development of deep water areas. Creating a new tax designed to add a $5 billion burden on US offshore development will drive producers from the US offshore reducing new American production of natural gas and oil.

Passive Loss Exception for Working Interests in Oil and Gas Properties – The Tax Reform Act of 1986 divided investment income/expense into two baskets – active and passive. The Act exempted working interests in oil and natural gas from being part of the passive income basket and the treatment of IDC's, in particular, was deemed to be an active loss that could be used to offset any type of active income as long as the investor's liabilities were not limited in any way. If, in the future, income/loss, arising from the ownership of oil and natural gas working interests, is treated as passive income/loss, the primary income tax incentive for individuals to risk an investment in oil and natural gas working interests would be significantly diminished.

Taken together, these tax changes would strip over $30 billion from US natural gas and oil production investment. As President Obama has said:

> The energy challenges our country faces are severe and have gone unaddressed for far too long. Our addiction to foreign oil doesn't just undermine our national security and wreak havoc on our environment – it cripples our economy and strains the budgets of working families all across America.

America needs an energy policy that recognizes the roles that all forms of energy supply can play. American natural gas and oil are essential elements – natural gas should be part of any clean energy initiative; natural gas and oil should be part of any energy security strategy. The Administration's budget request could cripple the American producers that are pivotal in developing US natural gas and oil.