# Proposed Tax Changes on US Oil and Gas Producers

Posted by Nate Hagens on May 21, 2009 - 9:35am
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Last week, the government released a lengthy document, General Explanations of The Administrations 2010 Revenue Proposals, which includes a 12 page segment titled *"Eliminate Oil and Gas Company Preferences"*. I've excerpted some of these below the fold. It strikes me that the authors of these rules do not grasp that oil has peaked, and we can't continue business as usual nor pay back our financial debts by importing 70%+ of our oil. My thoughts follow the excerpts.

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## Eliminate Oil and Gas Company Preferences

**LEVY TAX ON CERTAIN OFFSHORE OIL AND GAS PRODUCTION**
**Current Law**
No Federal tax is imposed on the production of oil and gas on the Outer Continental Shelf (OCS).

**Reasons for Change**

According to the Government Accountability Office, the return to the taxpayer from OCS production is among the lowest in the world, despite other factors that make the United States a comparatively good place to invest in oil and gas development. An excise tax on OCS production would advance important policy objectives, such as providing a more level playing field among producers, raising the return to the taxpayer, and encouraging sustainable domestic oil and gas production.

**Proposal**
The Administration is developing a proposal to impose an excise tax on certain oil and gas produced offshore in the future. The Administration will work with Congress to develop the details of this proposal

**REPEAL CREDIT FOR ENHANCED OIL RECOVERY (EOR) PROJECTS**

**Current Law**

The general business credit includes a 15-percent credit for eligible costs attributable to EOR projects. If the credit is claimed with respect to eligible costs, the taxpayer's deduction (or basis increase) with respect to those costs is reduced by the amount of the credit. Eligible costs include the cost of constructing a gas treatment plant to prepare Alaska natural gas for pipeline transportation and any of the following costs with respect to a qualified EOR project: (1) the cost of depreciable or amortizable tangible property that is an integral part of the project; (2) intangible drilling and development costs (IDCs) that the taxpayer can elect to deduct; and (3) deductible tertiary injectant costs. A qualified EOR project must be located in the United States and must involve the application of one or more of nine listed tertiary recovery methods that can reasonably be expected to result in more than an insignificant increase in the amount of crude oil which ultimately will be recovered. The allowable credit is phased out over a $6 range for a taxable year if the annual average unregulated wellhead price per barrel of domestic crude oil during the calendar year preceding the calendar year in which the taxable year begins (the reference price) exceeds an inflation adjusted threshold. The credit was completely phased out for taxable years beginning in 2008, because the reference price ($66.52) exceeded the inflation adjusted threshold ($41.06) by more than $6.

**Reasons for Change**

The credit, like other oil and gas preferences the Administration proposes to repeal, distorts markets by encouraging more investment in the oil and gas industry than would occur under a neutral system. To the extent the credit encourages overproduction of oil, it is detrimental to long-term energy security and is also inconsistent with the Administration's policy of reducing carbon emissions and encouraging the use of renewable energy sources through a cap-and-trade program. Moreover, the credit must ultimately be financed with taxes that result in underinvestment in other, potentially more productive, areas of the economy.

**Proposal**

The investment tax credit for enhanced oil recovery projects would be repealed for taxable years beginning after December 31, 2010.

**REPEAL DOMESTIC MANUFACTURING DEDUCTION FOR OIL AND GAS PRODUCTION**

**Current Law**

A deduction is allowed with respect to income attributable to domestic production activities (the manufacturing deduction). For taxable years beginning in 2009, the manufacturing deduction is equal to 6 percent of the lesser of qualified production activities income for the taxable year or taxable income for the taxable year, limited to 50-percent of the W-2 wages of the taxpayer for the taxable year. For taxable years beginning after 2009, the deduction is computed at a 9 percent rate, except that the deduction for income oil and gas production activities is computed at a 6 percent rate.

Qualified production activities income is generally calculated as a taxpayer's domestic production gross receipts (i.e., the gross receipts derived from any lease, rental, license, sale, exchange, or other disposition of qualifying production property manufactured, produced, grown, or extracted by the taxpayer in whole or significant part within the U.S.; any qualified film produced by the taxpayer; or electricity, natural gas, or potable water produced by the taxpayer in the U.S.) minus the cost of goods sold and other expenses, losses, or deductions attributable to such receipts.

The manufacturing deduction generally is available to all taxpayers that generate qualified production activities income, which under current law includes income from the sale, exchange or disposition of oil, natural gas or primary products produced in the United States.

**Reasons for Change**

The manufacturing deduction effectively provides a lower rate of tax with respect to a favored source of income. The lower rate of tax, like other oil and gas preferences the Administration proposes to repeal, distorts markets by encouraging more investment in the oil and gas industry than would occur under a neutral system. To the extent the lower tax rate encourages overproduction of oil and gas, it is detrimental to long-term energy security and is also inconsistent with the Administration's policy of reducing carbon emissions and encouraging the use of renewable energy sources through a cap-and-trade program. Moreover, the tax subsidy for oil and gas must ultimately be financed with taxes that result in underinvestment in other, potentially more productive, areas of the economy.

**Proposal**

The proposal would exclude from the definition of domestic production gross receipts all gross receipts derived from the sale, exchange or other disposition of oil, natural gas or a primary product thereof for taxable years beginning after December 31, 2010.

US Oil production peaked 39 years ago. We have moderated the decline by adding regional production from Alaska and Gulf of Mexico. We import around 70% of our oil - the above measures a) make it more difficult to procure oil from a region where it was already more expensive than the world average b) take us further away from a the goal of 'energy independence' by making 'overproduction of oil' punitive, c) do not give one mention of conservation, sacrifice, reduced energy use, etc. Enhanced Oil Recovery (EOR) which uses technology to go back into old fields and extract a higher percentage of original oil is also having its credit removed. This all strikes me as pent up 8 year political backlash against the oil industry in general that ignores current energy realities. I am not a particular fan of the oil and gas industry, (or any industry for that matter)--but we cannot put handcuffs on our 'drug procurers' before we are at least in rehab, and better yet until after we've recovered. It is pretty clear that ignoring reducing consumption with a focus on reducing production is fragmented policy.

Energy and natural resources are what we have to spend. But to spend them we have to invest in them. Reducing incentives to develop the small remaining US reserves by US junior companies means pushing investment in oil and gas to the international arena. It will have no impact on scaling alternative energy, reducing energy imports (which in the face of this will continue to increase, but faster), reducing emissions, and all the other political hype. On the bright side it keeps oil and gas in the ground for the future, when we might better use it. As such, measures like these would be welcome after a demand paradigm shift, and only appropriately accompanied by an across the board belt tightening and new 'ends', not as stand alone energy handicaps. Until that time comes we have to wisely prioritize or will be left with fewer and fewer energy options.

Half measures like these are not a means to an end, they are just a means to a smaller means.

Anyone with more details/information on what this means of oil/gas industry and energy landscape please post below...

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