REMAPPING DEBATE
Asking "Why" and "Why Not"

Calls to end or limit oil and gas subsidies renewed

Original Reporting | By Erik Kroh | Energy, Taxes

May 4, 2011 — Following large first-quarter earnings announcements from major oil companies, President Obama, in his Apr. 30 weekly web address, renewed his call for the elimination of oil and gas industry tax benefits.

The approximately $4 billion per year in oil and gas tax benefits are unnecessary when the largest oil companies recently announced more than $25 billion in profits in the first three months of 2011, Obama said.

> Citizens for Tax Justice said only a small portion of the profits of major oil and gas companies goes toward finding and extracting new sources of fuel, the activities that the tax incentives were designed to encourage.

"When oil companies are making huge profits and you're struggling at the pump, and we're scouring the federal budget for spending we can afford to do without, these tax giveaways aren't right," he said.

The address came shortly after Senate Finance Committee Chair Max Baucus (D-MT) announced plans to introduce legislation to end tax incentives for the largest oil and gas companies, rather than for all oil and gas companies, as in the Obama proposal. Baucus did not release the specifics of his plan, but he said it would include a repeal of a manufacturing deduction for large oil companies and a reduction in the foreign tax credit the companies are allowed to claim for royalty payments to foreign governments (see sidebar for explanation of some of the current tax benefits that flow to oil and gas companies).

Obama has long pushed for ending oil and gas company tax preferences, which allow the companies to recover expenses or receive favorable tax treatment for costs associated with searching for fuel sources, constructing wells, and producing oil and gas. The administration says the tax benefits are costly and do little to incentivize oil and gas production since they represent only a small fraction of the companies' revenues — about 1 percent, according to the president's fiscal 2012 budget.

The Joint Committee on Taxation has estimated that repealing the tax benefits would save some $40.7 billion over 10 years.

Supporters of the oil and gas industry have objected to calls for repealing the tax incentives, asserting that doing so would increase the industry's production costs and lead to higher retail gasoline prices.

Senate Energy and Natural Resources Committee ranking member Lisa Murkowski (R-AK) said in an Apr. 28 statement that repealing the benefits would increase the cost of producing energy, drive up the retail price of gasoline, and result in a loss of oil production.

"What's going to happen is, the oil companies are either going to invest less or they're going to pass that cost on to consumers, so gas prices are eventually going to go higher," an Energy and Natural Resources Committee Republican aide told Remapping Debate.

Asked whether there were any studies or evidence showing that repealing the tax breaks would result in higher gas prices, the aide said, "I can't say for certain because I'm not the company and I can't make those decisions, but more than likely those costs are going to be felt at the pump eventually."

In an Apr. 29 report, Citizens for Tax Justice (CTJ), a tax policy advocacy group, said only a small portion of the profits of major oil and gas companies goes toward finding and extracting new sources of fuel, the activities that the tax incentives were designed to encourage.

Less than 10 percent of the after-tax profits of the largest five oil companies went toward exploration for new oil fields from 2005 to 2009, the report said. Meanwhile, the percentage of after-tax profits that went toward dividends and stock buybacks ranged from 58 percent to 89 percent annually during the same time period, according to the CTJ analysis.

CURRENT OIL & GAS INDUSTRY TAX BENEFITS

The following are some of the largest tax benefits for which oil and gas companies are currently eligible, along with the amount the Joint Committee on Taxation estimates would be saved over 10 years if the policies are changed according to Obama administration proposals.

Domestic Manufacturing Deduction ($15.9 billion)

Oil and gas companies are allowed to claim a domestic manufacturing deduction equal to 6 percent of their taxable income. The rationale for the deduction is encouraging domestic oil and gas production. The Obama administration has proposed repealing the deduction.

Percentage Depletion for Oil and Gas Wells ($10.8 billion)

As the resource being exploited is depleted, owners of natural resources such as oil and gas wells are allowed to calculate a "decline in investment value" based on a "percentage depletion method." This method typically results in a deduction greater than the amount spent to acquire the resource in the first place. The administration has proposed repealing the percentage depletion method for oil and gas wells.

Expensing of Intangible Drilling Costs ($8.3 billion)

Oil and gas companies are allowed to immediately deduct certain costs associated with drilling wells — known as intangible drilling costs — such as those for wages, supplies, fuel and repairs. The administration has proposed to completely repeal the immediate expensing of intangible drilling costs, although those costs would be recoverable in other ways over time.

Foreign Tax Credit Rules (9.2 billion)

Oil and gas companies operating overseas are allowed to claim foreign tax credits for royalty payments made to foreign countries, which can be greater than what they pay in foreign income taxes. The administration has proposed to limit the companies' ability to claim credits beyond what they pay in standard income taxes in foreign countries.

Jeff Hooke, managing director of FOCUS LLC, an investment banking company, and a co-author of the CTJ report, told Remapping Debate "it's just inconceivable to think that a 1 or 2 percent shift [that would be caused by eliminating the benefits] would affect supply or demand or anything else in that industry one way or another."

Stephen Comstock, manager of tax policy for the American Petroleum Institute, an oil and gas industry trade association, said a [2010 study by energy research and consulting firm Wood Mackenzie] claimed that a repeal of oil and gas tax benefits would result in lower production of fuel — up to 1.2 percent of oil production and up to 4.1 percent of gas production. Oil and gas companies could also shift some production outside of the U.S. if they lose tax benefits, Comstock said, but he acknowledged that he was not aware of any studies showing how much production could be shifted overseas if the benefits were repealed.

Hooke questioned the Wood Mackenzie study because it was based on the unrealistic premise that oil prices would never rise above $80 per barrel. Oil producers, he said, are currently yielding more than $110 per barrel, giving them an incentive to produce at higher levels than those claimed by the study.

The oil and gas industry spent about $145.9 million on lobbying in 2010, according to the Center for Responsive Politics, a research group that tracks money in U.S. politics.

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