Friends of the Earth

Big Oil, Bigger Giveaways

Ending Tax Breaks, Subsidies and Other Handouts to the Oil & Gas Industry

"I will tell you with $55 oil we don't need incentives to oil and gas companies to explore. There are plenty of incentives."

– President George W. Bush
House Energy Bill Increases Tax Breaks: Legislation at Odds With Bush Proposal
Washington Post, 4/19/2005

We can reduce our dependence on oil, protect the environment and create jobs by investing in the clean energy solutions of the future. But unfortunately, federal dollars continue to flow toward the same oil companies who are earning record profits and fueling our oil addiction. **This analysis of the tax code and federal budget reveals that oil companies are slated to receive more than $31.6 billion in handouts from taxpayers over the next five years.** This figure includes tax benefits, royalty relief, research and development subsidies and accounting gimmicks which benefit the oil industry. It could dramatically increase over the next 25 years if current tax breaks are extended and if an estimated loss of up to $60 billion in royalty revenue from offshore drilling occurs. Congress should act immediately to end these giveaways to the oil and gas industry.

Oil Company Profits Continue to Skyrocket

Big oil companies are swimming in a sea of record-breaking profits while American consumers and taxpayers pay the price. In 2005, the world's biggest oil companies reported a combined $111 billion in profits. In the first three quarters of 2006 they reported more than $94 billion[1]:

Company	2005 Profits	% increase from 2004	1st 9 months of 2006 Profits	% increase from 2005
ExxonMobil	$36.1 billion	43 %	$29.3 billion	15 %
Royal Dutch Shell	$25.3 billion	37 %	$20.2 billion	-4 %
BP	$22.3 billion	30 %	$19.1 billion	3 %
ConocoPhillips	$13.5 billion	66 %	$12.4 billion	25 %
Chevron Texaco	$14.1 billion	6 %	$13.4 billion	34 %
Total	**$111.3 billion**		**$94.4 billion**	

Federal Handouts Lavish Billions on Oil and Gas Companies

Despite earning record profits, oil and gas companies continue to benefit from billions in handouts courtesy of American taxpayers. Between tax incentives, royalty relief, research and

[1] http://www.exxonmobil.com, http://www.shell.com, http://www.bp.com, http://conocophillips.com, http://www.chevron.com

development subsidies and accounting gimmicks, these companies will receive more than $31.6 billion from the federal government over the next five years.

Handout	**Cost over five years**
Tax breaks	$16 billion
Royalty relief	$9.5 billion
Research and development subsidies	$1.8 billion
Accounting gimmicks	$4.3 billion
Total	**$31.6 billion**

Oil and Gas Tax Breaks

The federal tax code contains more than $16 billion in tax breaks for the oil and gas industry. This total represents the creation of seven new tax breaks in the Energy Policy Act of 2005 in addition to a host of incentives that existed prior to passage of the energy bill. Unless otherwise noted, the cost of the tax breaks come from the Joint Committee on Taxation's Estimates of Federal Tax Expenditures for Fiscal Years 2006-2010. The tax code contains the following oil and gas tax breaks.[2]

- **Intangible drilling costs**
  Integrated oil companies such as ExxonMobil are allowed to immediately deduct 70 percent of "intangible drilling costs" such as the cost of wages, supplies, and site preparation, rather than capitalizing them. Smaller, independent oil and gas producers are allowed to immediately deduct all of their intangible drilling costs. **This tax break will cost $5.4 billion over five years.**

- **Oil and gas percentage depletion allowance**
  Created in 1916, this incentive allows independent oil to deduct 15 percent of their sales revenue to reflect the declining value of their investment. This flat deduction bears little resemblance to the actual loss in value over time and companies often end up deducting more than the value of their initial investment. The Energy Policy Act of 2005 modified the percentage depletion, expanding the credit by allowing refiners whose average daily production remains less than 75,000 barrels, instead of 50,000 barrels, to claim it. **This tax break will cost $4.7 billion over five years.**

- **Natural gas distribution lines**
  This tax break was created in the Energy Policy Act of 2005 and accelerates the rate at which companies can deduct the cost of natural gas distribution pipelines, reducing the depreciation time from 20 years to 15 years. **This tax break will cost $386 million over five years.**[3]

- **Geological and geophysical expenditures**
  This tax break was created in the Energy Policy Act of 2005 and allows companies to deduct the costs associated with searching for oil, amortizing the costs over a two-year period.

[2] Some tax credits that currently do not have a cost, such as the Enhanced Oil Recovery and Marginal Wells Tax Credits, are not described in this document.

[3] The cost for this credit was taken from http://www.house.gov/jct/x-59-05.pdf, the Joint Committee on Taxation's Estimated Budget Effects of the Conference Agreement for Title XIII of H.R.6. This estimate was used because the Joint Committee on Taxation has merged the estimates with this credit with the broader "Depreciation of equipment in excess of the alternative depreciation system."

Companies would still be eligible for this deduction even if they discover oil and gas. The credit, which the Joint Committee on Taxation scored at $800 million over five years, was modified in H.R. 4297, the Tax Increase Prevention and Reconciliation Act of 2005. The modification increased the time that integrated oil companies could deduct geological and geophysical expenditures from 2 years to 5 years.[4] **Given the changes, the tax break is now expected to cost $611 million over the next five years.**

- **Deductions for foreign tax**
  The tax code allows oil and gas companies to deduct payments such as taxes and royalty payments made to foreign countries. The Senate Finance committee included a provision in S. 2020, the Tax Relief Act of 2005, that would have created new restrictions on the ability of major oil companies to claim these deductions. Unfortunately, this provision failed to make it into the final tax reconciliation package signed into law. **According to estimates from the Joint Committee on Taxation, modifying the deduction would have raised $325 million over the next five years.[5]**

- **Expensing for refining equipment**
  This tax break was created in the Energy Policy Act of 2005 and allows companies to deduct 50 percent of the cost of certain equipment used at oil refineries to refine liquid fuels. **This tax break will cost $700 million over five years.**

- **Passive Loss**
  This tax break allows owners and investors in oil and gas properties to use loses from the oil and gas business to shelter other income. **This tax break will cost $200 million over five years.[6]**

- **Small Refiners Deduction**
  Originally created in H.R. 4520, the American Jobs Creation Act of 2004, and later modified by the Energy Policy Act of 2005, this tax break allows small refiners to deduct 75 percent of their capital costs to comply with new Environmental Protection Agency sulfur rules, and also provides a .05-cent credit for each gallon of low sulfur diesel fuel produced. The deduction was expanded in the energy bill to allow the tax benefits to be passed through to members of a cooperative. **This tax break will cost $100 million over five years.**

- **Natural gas gathering lines**
  This tax break was created in the Energy Policy Act of 2005 and accelerates the rate at which companies can deduct the cost of natural gas gathering lines, establishing a 7-year depreciation recovery period. **This tax break will cost $10 million over five years.[7]**

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[4] http://www.house.gov/jct/x-18-06.pdf
[5] http://www.house.gov/jct/x-82-05r.pdf
[6] The cost for this credit was taken from the fiscal year 2007 *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2007*.
[7] The cost for this credit was taken from http://www.house.gov/jct/x-59-05.pdf, the Joint Committee on Taxation's Estimated Budget Effects of the Conference Agreement for Title XIII of H.R.6. This estimate was used because the Joint Committee on Taxation has merger the estimated for this credit with the broader "Depreciation of equipment in excess of the alternative depreciation system."

- **Exemption from bond arbitrage rules**
  The provision was created in Energy Policy Act of 2005 and exempts prepayments for natural gas from tax-exempt bond arbitrage rules. **This tax break will cost $14 million over five years.**[8]

- **Manufacturing tax deduction for oil and gas companies**
  H.R. 4520, the American Jobs Creation Act of 2004, contained provisions that reclassified oil and gas production as a manufactured good**. According to a Joint Committee of Taxation estimate requested by Sen. John Kerry (D-Mass.) and Rep. Jim McDermott (D-Wash.), oil and gas companies would gain $3.5 billion over the next 5 years under this deduction.**[9]

Royalty Relief

Companies drilling for oil and natural gas in publicly-owned waters and on publicly-owned lands typically pay royalties, or a percentage of the revenue they generate, to the government. These royalties provide needed resources to the Land and Water Conservation Fund, Historic Preservation Trust Fund, the oil-producing states and the federal treasury**. Schemes that relieve oil companies of their obligation to pay these royalties will cost taxpayers at least $9.5 billion over the next five years.** Longer-term losses to taxpayers could balloon significantly higher if the oil industry wins a recent lawsuit and if oil companies begin benefiting from new royalty relief provisions authorized in the Energy Policy Act of 2005.

- **Royalty Relief: 1995 Deep Water Royalty Relief Act**
  Between 1996 and 2000, the Interior Department awarded offshore drilling leases to companies drilling for oil and natural gas in the Gulf of Mexico. Leases awarded in 1998 and 1999 failed to include "price thresholds," a critical safety valve that ensures royalty relief will end when prices rise above a certain amount. The Minerals Management Service, which manages royalties at the Interior Department, estimates that **over the next five years oil and gas companies in drilling in the Gulf of Mexico will receive approximately $9.5 billion in royalty relief.**[10]

  A draft report from the Government Accountability Office[11] further estimated that taxpayers could lose out on at an additional $60 billion over the next 25 years if the oil industry is successful in a recent lawsuit challenging the Interior Department's authority to set price thresholds under the 1995 Deepwater Royalty Relief Act.

- **Royalty Relief: Energy Policy Act of 2005**
  Despite massive losses to taxpayers expected as a result royalty relief included in past offshore drilling leases, Congress enacted additional royalty relief provisions in the recent

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[8] The cost for this credit was taken from http://www.house.gov/jct/x-59-05.pdf, the Joint Committee on Taxation's Estimated Budget Effects of the Conference Agreement for Title XIII of H.R.6. This estimate was used because the Joint Committee on Taxation has merged the estimates of this credit with the broader "Exclusion of interest on public purpose State and local government bonds."
[9] http://www.house.gov/mcdermott/pr060515.shtml. The press release states that the Joint Committee on Taxation estimates the manufacturing tax deduction costs approximately $700 million annually.
[10] Calculation based Gulf of Mexico royalty information provided on page 169 in the Minerals Management Services' Fiscal Year 2007 Budget Justifications and Performance Information. http://www.mms.gov/PDFs/2007Budget/FY2007BudgetJustification.pdf
[11] http://www.nytimes.com/packages/pdf/business/29lease.pdf

energy bill. The following provisions will allow oil and gas companies to negotiate new leases with the federal government that allow them to drill without paying royalties. **An estimate of the future benefits the oil industry will gain as a result of these provisions does not currently exist, but in order to prevent these future taxpayer losses Congress should repeal the provisions**:

- **Royalty-in-Kind Payments**
  Section 342 of the Energy Policy Act of 2005 codifies the royalty-in-kind payment scheme sought by oil and gas producers in which the federal government is paid in oil and gas instead of cash.

- **Relief for marginal producers**
  Section 343 of the Energy Policy Act of 2005 provides royalty relief for "marginal property" oil and gas production that produce less than 15 barrels a day when prices fall below $15 a barrel.

- **Relief for deep wells in shallow waters of the Outer Continental Shelf**
  Section 344 of the Energy Policy Act of 2005 provides royalty relief for natural gas production from deep wells (greater than 15,000 feet) in shallow waters (less than 400 meters) of the Outer Continental Shelf (OCS) in the Gulf of Mexico. The provision grants royalty relief for leases of no less than 35 billion cubic feet, subject to price thresholds.

- **Relief for deep water wells in the Gulf of Mexico**
  Section 345 of the Energy Policy Act of 2005 continues the federal government's commitment to provide oil and gas companies royalty relief when they drill in waters in the Gulf of Mexico deeper than 400 meters.

- **Relief for offshore production in Alaska**
  Section 346 of the Energy Policy Act of 2005 expands the Outer Continental Lands Act to in offshore oil and gas development in Alaska. The expansion will allow Alaska drillers to receive royalty relief for oil and gas production.

- **Relief for methane gas hydrates in the Outer Continental Shelf and Alaska**
  Section 353 of the Energy Policy Act of 2005 provides oil and gas companies seeking energy from methane gas hydrates. Methane gas hydrates are essentially methane trapped in ice, and can be found in the outer continental shelf and in cold regions such as Alaska. The provisions provides royalty relief for up to 30 billion cubic feet of natural gas per a lease, and is offered in addition to current royalty relief on leases not receiving specific methane gas hydrate relief.

- **Relief for enhanced oil and natural gas production**
  Section 354 of the Energy Policy Act of 2005 offers royalty relief to oil and gas companies operating wells on-shore and the outer continental shelf to inject carbon dioxide into older less productive wells. The provision provides royalty relief for up to 5 million barrels of oil per a lease. The royalty relief in this provision is in addition to the enhanced oil recovery tax credit which provides companies with a 15 percent credit for the cost of enhanced oil recovery.

Oil and Gas Research and Development Subsidies

Despite substantial oil and gas company investment in research and development programs, Congress is pumping more than $1.8 billion into federal research and development.

- **Oil Technology Research and Development Program**
  The oil and gas industry received an estimated $65 million in fiscal year 2006 through the U.S. Department of Energy's (DOE) Oil Technology Research and Development Program.[12] The program focuses on the exploration and production of crude oil in the United States with the goals including the promotion and enhancement of oil drilling in the Alaskan Arctic and the Powder River Basin in Wyoming. ExxonMobil alone spent $600 million in research and development in 2004.[13] Section 965 of the Energy Policy Act of 2005 contains additional authorizations for the program. **Over the next five years, this provision would cost $335 million.**

- **Ultra-deepwater drilling research and development subsidy**
  This provision was added to the Energy Policy Act of 2005 conference report after the conference committee was gaveled closed. It creates **a $1.5 billion oil research and development program** for ultra-deepwater drilling, benefiting an oil consortium in Representative Tom DeLay's home district of Sugarland, TX.

Accounting Gimmicks

For more than 70 years, the oil and gas companies have used an accounting method known as "last in, first out," or "LIFO," to minimize their tax liability. Using LIFO accounting, oil companies can sell the last oil (and currently most expensive) placed into their reserves first, before selling longer-held and cheaper reserves. By using this method, in the current environment of high oil prices companies are able to minimize the value of their reserves and therefore their tax burden. The Senate Finance Committee included a provision in S. 2020, the Tax Relief Act of 2005, that would have repealed this form of accounting for major oil companies. Unfortunately, this provision did not make it into the final tax reconciliation bill. **The Joint Committee on Taxation estimates that repealing the LIFO accounting method for major oil companies would have raised $4.3 billion.**[14]

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[12] http://www.fossil.energy.gov/aboutus/budget/06/FY2006_Budget_.html
[13] http://www.exxonmobil.com/Corporate/Newsroom/SpchsIntvws/Corp_NR_SpchIntrvw_RWT_090204.asp
[14] http://www.house.gov/jct/x-82-05r.pdf