President Obama's Call to End Corporate Handouts for the Fossil Fuels Industry

FACT SHEET

In his State of the Union Address President Obama called for the end of approximately $4 billion in subsidies to the fossil fuels industry. The President has supported ending many fossil fuels handouts in the past: In both his FY' 10 and FY' 11 budgets he proposed cutting the giveaways below. He also called for the elimination of wasteful fossil fuels subsidies at the G20 summit in Pittsburgh in 2009. Congress should follow his lead and act immediately to end these giveaways for some of the world's most profitable corporations, saving taxpayers more than $13 billion in FY' 12 and $68 billion over the next 5 years.

Fossil Fuel Giveaways

- **Last in, first out accounting** *26 USC §472* ($4.171 billion)[1]
  For more than 70 years, 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, when oil prices are high companies are able to minimize the value of their reserves and therefore their tax burden. Repealing the LIFO accounting method would save consumers $36.1 billion over five years[2].
- **Expensing of intangible drilling costs** *26 USC §263* ($2.359 billion)
  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. Repealing this tax giveaway will save the treasury $8.19 billion over five years.
- **Levy excise tax on Gulf of Mexico oil and gas**[3] ($1.3 billion)
  In the late 1990s leases in the Gulf of Mexico were purchased by oil and gas producers that waived the payment of royalty fees to the federal government, allowing producers to extract public resources without payment. This provision was included to incentivize offshore drilling at a time when oil prices were low. In an oversight the leases did contain any clause, typical in royalty leases, ending the waiver when oil and gas prices are high. President Obama's FY 10 budget called for an excise tax of 13 percent on Gulf of Mexico oil and gas production and allows producers credit against the tax for royalties paid, allowing the government to recoup the losses from these lease giveaways. This is modeled after a plan proposed by Senate Energy and Natural Resources Chairmen Jeff Bingaman (D-NM). President Obama proposed this excise tax in his FY' 10 budget but did not include it as part of his FY' 11 budget. The federal government is poised to lose $6.9 billion over the next five years from royalty- free leases.
- **Domestic manufacturing tax deduction for oil and gas companies**
  26 USC §199 ($1.277 billion)
  In 2004, Congress passed the American Jobs Creation Act of 2004. The intent of the bill was to bring U.S. export subsidies into compliance with global trade laws. During the legislative process, provisions were added to the bill that classified oil and natural gas production as a manufactured good. The change allowed oil and gas

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[1] The majority of this savings would come from oil and gas companies, but not all of it would.
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[3] This was proposed in President Obama's FY' 10 budget, but not his FY' 11 budget

companies to claim billions of dollars of new tax deductions, effectively lowering their tax rate. Eliminating this deduction would return more than $7 billion to the federal treasury over five years.

- **Percentage depletion allowance for oil and gas**

  26 USC §613 A ($886 million)
  The oil and gas percentage depletion allowance allows independent oil companies 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 capital invested for acquisition and development. Closing this tax loophole will save taxpayers $4.7 billion over five years.

- **Deductions for foreign tax – dual capacity tax deduction**

  26 USC §901 ($749 million)
  This loophole allows oil and gas companies to under report their taxable foreign income. Foreign countries are converting traditional royalty payments into income tax payments even though in many cases these countries do not have any corporate income taxes. The U.S. tax code allows foreign income tax payments to be deducted at 100 percent while only roughly 35 percent of a royalty payment can be deducted as a standard business expense. By classifying royalty payments as foreign taxes these companies are cheating the treasure out of billions of dollars. Congress has considered several efforts to modify this deduction. President Obama's proposal would close this loophole for countries that have no corporate income tax, saving taxpayers $3.1 billion over the next five years. Even more money could be saved if the fix were modified slightly to allow the U.S. not to classify any money paid as taxes beyond the income tax rate that country charges to other industries.

- **Domestic manufacturing deduction for coal and other hard mineral fossil fuels** *26 USC §199* ($176 million)
  In 2004, Congress passed H.R. 4520, the American Jobs Creation Act of 2004. The intent of the bill was to bring U.S. export subsidies into compliance with global trade laws. Extraction of coal qualifies for this provision, allowing coal companies millions of dollars of tax deductions and effectively lowering their tax rate. Eliminating this deduction would return almost $990 million to the federal treasury over five years.

- **Amortization of geological and geophysical expenditures**
  26 USC §167 ($165 million)
  This tax break was created in the Energy Policy Act of 2005 and allows non-vertically integrated oil companies, many of whom have hundreds of millions of dollars in gross receipts, to amortize incidental drilling costs over 2 years. President Obama's budget increases the amortization period for non-vertically integrated producers from 2 to 7 years. This would save taxpayer $744 million over five years.

- **Percentage depletion for hard mineral fossil fuels**

  26 USC §613 ($79 million)
  This provision of the tax code allows coal companies to deduct 10 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. Fixing this tax break will save taxpayers $465 million over five years.

- **Expensing of exploration and development costs for hard mineral fuels** *26 USC §617* ($47 million)
  In 1951 Congress passed this provision to encourage mining, and expanded it in 1966 to include mine exploration. This handout allows firms engaged in mining to expense (to deduct in the year paid or incurred) rather than capitalize (i.e., recover

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such costs through depletion or depreciation) certain exploration and development costs. This treatment is an exception to general tax rules and if allowed to remain, will cost taxpayers $215 million over the next 5 years.

- **Passive loss exception for working interests in oil and gas properties** *26 USC §469* ($25 million)
  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. If it is not fixed this tax break will cost taxpayers $120 million over five years.
- **Deduction for tertiary injections** *26 USC §193* ($7 million)
  The deduction for tertiary injections allows oil and gas companies to receive a deduction equal to any cost or expense for advanced oil recovery. Getting rid of this giveaway will save taxpayers $35 million over five years.
- **Royalty taxation of coal** *26 USC §631* ($33 million)
  In 1951 the tax code was changed to allow owners of coal mines to treat income from coal mines as a capital gain to increase coal production. Because of the graduated individual rate structure, the flat capital gains tax rate is most beneficial for those who make a higher income. The current maximum rate is 15%, less than half the top individual income tax rate of 35%. Fixing this tax break would save taxpayers $290 million over five years.
- **Enhanced oil recovery** *26 USC §43* ($0)
  This tax break provides coal companies with a 15 percent income tax credit to increase the production of oil and gas production from older wells. To qualify for the credit, companies can force water, steam, carbon dioxide or other chemicals into the reservoir to force harder-to-obtain oil and gas out of the well. Because of high oil prices companies are not projected to be able to claim this credit; however, there is no reason that we should be incentivizing this dirty and dangerous practice.
- **Marginal wells tax credit** *26 USC §45I* ($0)
  The marginal well tax credit gives up to $9 per well per day for marginal wells. With the current high prices of oil this credit is not estimated to kick in; however, we should not be subsidizing the production of oil and gas from inefficient wells or offering them insurance in the case of price decreases.

Fossil Fuel Giveaways

With our country facing some of the most difficult economic times in its history it is more important than ever that we spend our money wisely. We cannot afford to waste billions of federal dollars on giveaways corporations that are earning record profits and pushing us down the road towards a climate disaster. President Obama wisely called for an end to subsidies for fossil fuels in his State of the Union. Congress should act immediately to save taxpayers over $68 billion by ending these giveaways to the oil and gas industry.

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