

Big Oil, Bigger Giveaways



An analysis of \$32.9 billion in tax breaks, subsidies and other handouts the oil & gas industry will receive by 2013.



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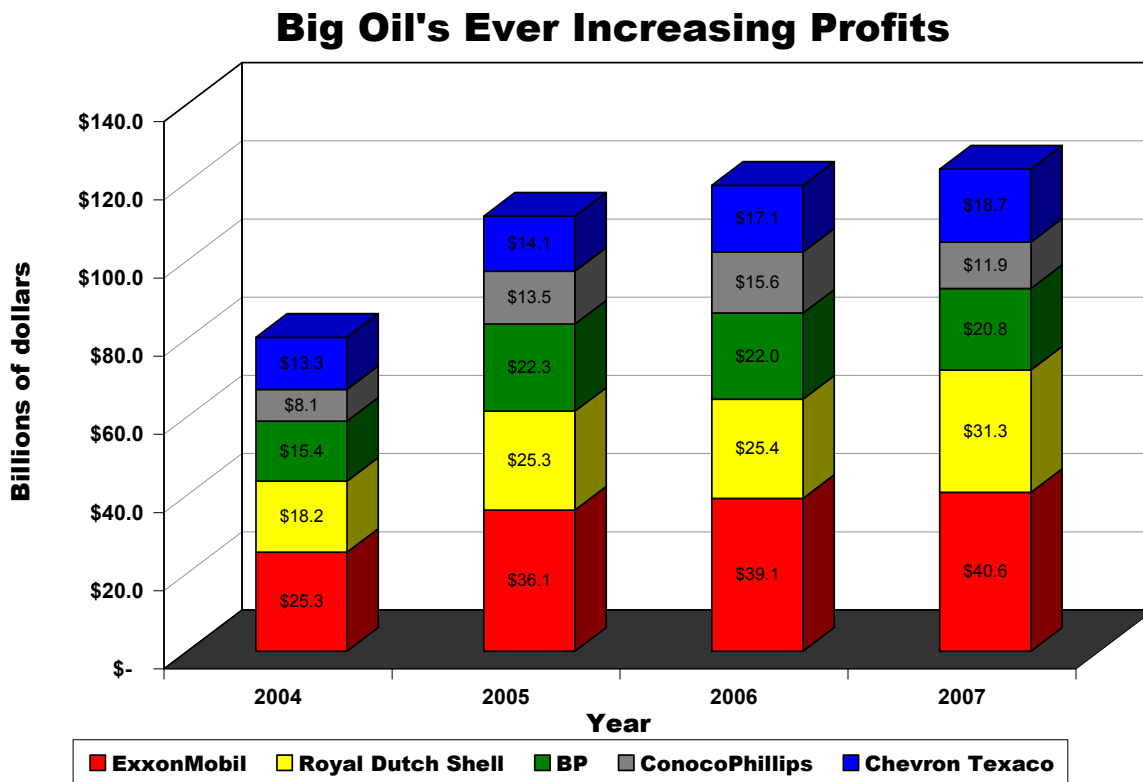
"I will tell you with \$55 oil we don't need incentives to oil and gas companies to explore. There are plenty of incentives."

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

Federal dollars continue to flow toward oil companies that 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 \$32.9 billion in handouts from taxpayers over the next five years.** This figure includes tax benefits, royalty relief, research and development subsidies and accounting gimmicks that benefit the oil industry. The figure could dramatically increase over the next 25 years if current tax breaks are extended and if oil companies win a lawsuit seeking to avoid paying up to \$53 billion in royalty revenue for offshore drilling. Congress should act immediately to end these giveaways to the oil and gas industry.

Oil Company Earnings Skyrocket after 2005 Energy Bill

Big oil companies are swimming in a sea of record-breaking profits at the American public's expense. In 2006, the world's biggest oil companies reported a combined \$119 billion in profits. In 2007, this total rose to \$123 billion¹.



¹ <http://www.exxonmobil.com>, <http://www.shell.com>, <http://www.bp.com>, <http://www.conocophillips.com>, <http://www.chevron.com>

Federal Handouts Lavish Billions on Oil and Gas Companies

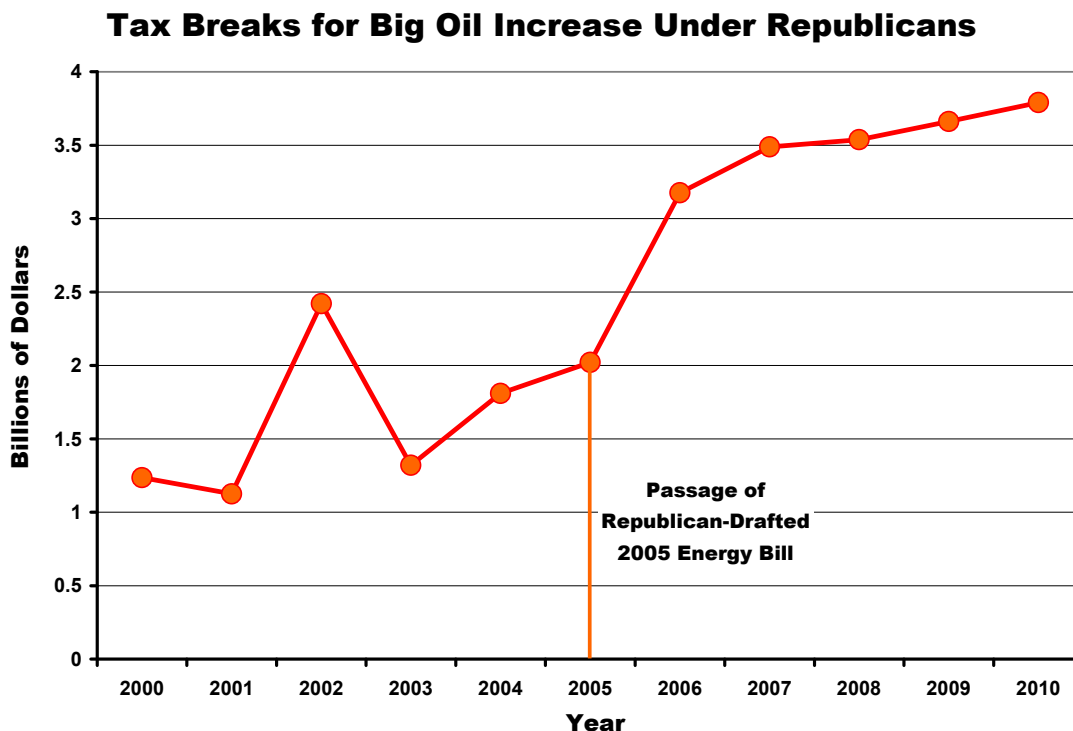
Despite earning record profits, oil and gas companies continue to benefit from billions in handouts courtesy of American taxpayers. Between tax incentives, royalty relief, research and development subsidies and accounting gimmicks, these companies will receive more than \$32.9 billion from the federal government over the next five years. The companies are receiving additional subsidies from federally funded international institutions.

Handout	Cost over Five Years
Tax breaks	\$23.2 billion
Royalty relief	\$3.8 billion
Research and development subsidies	\$1.6 billion
Accounting gimmicks	\$4.3 billion
Total	\$ 32.9 billion

International Subsidies	Cost between 2000-2006
Ex-Im and OPIC Loans	\$15.6 billion

Oil and Gas Tax Breaks

The federal tax code contains more than \$23.2 billion in tax breaks for the oil and gas industry over the next five years. 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 that 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 2007-2011](#). The tax code contains the following oil and gas tax breaks:²³



² Some tax credits that have relatively small costs, such as the Marginal Wells Tax Credits, are not described in this document.

³ For a similar discussion of tax breaks the Congressional Research Service published a report in February 2007 entitled Oil and Gas Tax Subsidies: current Status and Analysis. <http://price.house.gov/issues/uploadedfiles/energy2.pdf>

Graph Assumption: Friends of the Earth believes that this graphic is a conservative assessment of the increase in federal tax breaks for the oil and gas industry. There are several tax breaks, such as the foreign income tax break, that were not included in the graphic because a full 10 year range of data was not available. In regards to the oil and gas benefits under section 199, we averaged the estimates provided by Sen. Kerry and Rep. McDermott's analysis, over the five-year estimate that was provided by the Joint Committee on Taxation. Given recent estimates, we feel we are significantly undervaluing this credit in the graph.

Source data: In creating this graphic, Friends of the Earth utilized data provided in the annual tax expenditure reports written by the Joint Committee on Taxation and the Analytical Perspectives of the Federal Budget submitted to Congress by the Office of Management and Budget dating from 2000 to the present. Where data was not available in these publications, such as in the case of the oil and gas benefits in section 199, we used published data footnoted in this document.

2002 Caveat: In 2002, the Joint Committee on Taxation scored the tax break for intangible drilling costs at approximately \$1 billion greater than the previous and proceeding years. We have a pending request into the Committee to explain an explanation for the \$1 billion jump, which is not sustained in subsequent years.

- **Oil and gas percentage depletion allowance**

Created in 1916, this incentive 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 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 \$5.9 billion over five years.**

- **Manufacturing tax deduction for oil and gas companies**

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. 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 companies to claim billions of dollars of new tax deductions, effectively lowering their tax rate. Initial estimates provided to Sen. John Kerry (D-Mass.) and Rep. Jim McDermott (D-Wash.) by the Joint Committee on Taxation estimated that reclassification would cost the federal government approximately \$3.5 billion over the next 5 years under this deduction.⁴ However, efforts to change this tax benefit, most recently as a part of the H.R. 5351 "The Renewable Energy and Energy Conservation Tax Act of 2008," indicate that denying oil and gas companies this deduction could **raise more than \$5.1 billion in revenue.**⁵

- **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 \$3.5 billion over five years.**

- **Deductions for foreign tax**

The tax code provides a loophole that allows oil and gas companies to under report their taxable foreign income. Foreign countries are converting traditional royalty payments into income tax payments. The U.S. tax code allows approximately 35 percent of a royalty payment to be deducted as a standard business expense. Foreign income tax payments can be deducted at 100 percent. Congress has considered several efforts to modify this deduction over the past 2 years. **According to estimates from the Joint Committee on Taxation, modifying the deduction would have raised \$3 billion over the next five years.**⁶

⁴ <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.

⁵ The cost for this credit was taken from <http://www.house.gov/jct/x-36-07.pdf> the Joint Committee on Taxation's Estimated Revenue Effects of Tax Provisions Contained in H.R. 5351 the "Renewable Energy and Energy Conservation Tax Act of 2008."

⁶ The cost for this credit was taken from <http://www.house.gov/jct/x-36-07.pdf> the Joint Committee on Taxation's Estimated Revenue Effects of Tax Provisions Contained in H.R. 5351 the "Renewable Energy and Energy Conservation Tax Act of 2008."

- **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 \$2.1 billion over five years.**
- **Enhanced Oil Recovery**
This tax break provides oil and gas companies with a 15 percent income tax credit to increase the production 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 the harder to obtain oil and gas out of the well. **This tax break will cost almost \$1.7 billion over five years.**
- **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. 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.⁷ **Given the changes, the tax break is now expected to cost \$1.1 billion over the next 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 \$522 million over five years.**⁸
- **Passive Loss**
This tax break allows owners and investors in oil and gas properties to use losses from the oil and gas business to shelter other income. **This tax break will cost \$130 million over five years.**⁹
- **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 \$2.10 credit per barrel 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.**
- **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 \$18 million over five years.**¹⁰
- **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.**¹¹

⁷ <http://www.house.gov/jct/x-18-06.pdf>

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 with this credit with the broader "Depreciation of equipment in excess of the alternative depreciation system."

⁹ The cost for this credit was taken from the fiscal year 2009 [Analytical Perspectives, Budget of the United States Government, Fiscal Year 2009](#).

¹⁰ 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."

Royalty Holidays

Companies drilling for oil and natural gas in public waters and on public 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, oil-producing states and the federal treasury. **Schemes that relieve oil companies of their obligation to pay these royalties will cost taxpayers at least \$3.8 billion over the next five years.** Short-term and longer-term costs to taxpayers could balloon significantly as a result of an initial oil industry lawsuit win that would eliminate provisions in oil and gas contracts that limit royalty relief through the inclusion of price thresholds.¹²

- **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 failure to include the price thresholds already costs taxpayers \$1 billion in foregone royalty revenue. Using Minerals Management Service data, Friends of the Earth calculated that over **the next five years oil and gas companies drilling in the Gulf of Mexico will receive approximately \$3.8 billion in royalty relief.**¹³

This number is likely to dramatically increase as a result of the successful lawsuit filed by the company Kerr-McGee Oil and Gas, now owned by Anadarko Petroleum Company, challenging the legality of price thresholds in deep-water leases issued between 1996 and 2000. A June 2008 letter from the Government Accountability Office¹⁴ estimated that as a result of the successful lawsuit the federal government could lose as much as \$53 billion over the next 25 years if the lawsuit victory is upheld.

- **Royalty Relief: Energy Policy Act of 2005**

Despite massive losses to taxpayers expected as a result of royalty relief included in past offshore drilling leases, Congress enacted additional royalty relief provisions in the 2005 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 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.

¹¹ 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 estimated for this credit with the broader “Depreciation of equipment in excess of the alternative depreciation system.”

¹² Andrews, Edmund. “Oil industry scores major victory in U.S. court.” International Herald Tribune. November 2, 2007. <http://www.ihf.com/articles/2007/11/02/business/royalty.php>

¹³ Calculation based Gulf of Mexico royalty information provided on page 211 in the Minerals Management Services' Fiscal Year 2009 Budget Justifications and Performance Information. It should be noted that there are several caveats to this figure. First, MMS uses the oil and gas price estimates established by the Office of Management and Budget, which do not represent current market conditions. For example, MMS uses an estimated figure of \$86.35 a barrel of oil. As of the writing of this report oil was hovering around \$130 a barrel. Second, the royalty free production figures assume that price thresholds for most production are currently in effect. Since the publication of MMS' budget justification the U.S. District Court for the Western District of Louisiana ruled that the Department of the Interior has no right to include price thresholds in the deepwater leases awarded under the Deep Water Royalty Relief Act of 1995 between 1996-2000. Updated information demonstrating the estimated 5-year impact of the ruling was not available before publication. <http://www.mms.gov/adm/PFD/FinanceReport2009.pdf>.

¹⁴ Government Accountability Office. Subject: *Oil and Gas Royalties: Litigation over Royalty Relief Could Cost the Federal Government Billions of Dollars*. June 5, 2008. GAO-08-792R Royalty Relief. <http://www.gao.gov/new.items/d08792r.pdf>

- **Relief for marginal producers**
Section 343 of the Energy Policy Act of 2005 provides royalty relief for “marginal property” oil and gas production that produces 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 encompass 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 royalty relief to 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 provision provides royalty relief for up to 30 billion cubic feet of natural gas per 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 at the outer continental shelf that inject carbon dioxide into older, less productive wells. The provision provides royalty relief for up to 5 million barrels of oil per 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.

International Oil & Gas Subsidies¹⁵

The United States is not only the most oil-addicted nation on the planet, we are also the largest pusher. Since 2000, the US Government has been the top provider of international subsidies to the oil industry. According to an Oil Change International report, more than \$15.6 billion has been provided to the oil industry by Congress and distributed via the US Export-Import Bank, the Overseas Private Investment Corporation, the US Trade and Development Agency, the US Agency for International Development, and the United States Maritime Administration.¹⁶ Often these funds are provided in the name of “development assistance” and “poverty alleviation”, although international oil projects typically exacerbate poverty for local residents.

In addition, The World Bank Group, in which the US government is the largest shareholder, has provided roughly more than \$8 billion in project support and other subsidies for the oil industry since 2000. Disturbingly, the World Bank’s private sector arm, the International Financial Corporation

¹⁵ www.endoilaid.org

¹⁶ Steve Kretzmann, “Aiding Oil, Harming the Climate.” December 2007, Oil Change International.
<http://priceofoil.org/2007/12/06/aiding-oil-harming-the-climate/>

(IFC), increased its lending for fossil fuel projects by a staggering 165 percent in FY2008. Taken as a whole, the World Bank Group increased its fossil fuel lending by 60 percent in the same period.¹⁷

Oil and Gas Research and Development Subsidies

Despite substantial oil and gas company investment in research and development programs, Congress is pumping more than \$1.6 billion into research and development.

- **Oil Technology Research and Development Program**

The oil and gas industry received an estimated \$25 million in fiscal year 2008 through the U.S. Department of Energy's Oil Technology Research and Development Program. The program focuses on the exploration and production of crude oil in the United States with 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 2004.¹⁸ Section 965 of the Energy Policy Act of 2005 contains additional authorizations for the program. **Over the next five years, this provision would cost \$100 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 former-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.**¹⁹

For more information:

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¹⁷ "World Bank's lending for fossil fuel skyrockets as it positions itself as the 'climate bank'." July 2008, Bank Information Center.

¹⁸ <http://www.bicusa.org/en/Article.3840.aspx>

¹⁹ http://www.exxonmobil.com/Corporate/Newsroom/SpchsIntvws/Corp_NR_SpchIntvw_RWT_090204.asp

¹⁹ <http://www.house.gov/jct/x-82-05r.pdf>