Cut tax subsidies for oil and gas companies: $40 billion over 10 years

The Idea: Oil and gas companies have been receiving federal tax breaks for years. The three largest tax breaks, worth almost $40 billion over 10 years, were created to help make drilling a less risky endeavor. However, oil and gas companies are more profitable than ever, with the three largest earning tens of billions of dollars in profits per year. Removing these tax breaks would help lower the deficit while taking away a subsidy oil and gas companies simply do not need.

The Rationale: As petroleum-based energy sources began to fuel the U.S. economy at the end of the 19th century, and oil fields were drilled across large swaths of the country, the industry became ever more concentrated and the wealth of American oil producers exploded. (The head of Standard Oil, John D. Rockefeller, was the wealthiest man on the planet at the turn of the century.) As the wealth of oil magnates grew, so did their political power. In the early 1900s, they began to exercise their power in the political sphere, winning many concessions and favorable tax treatment. One of the most important was the oil depletion allowance, passed in 1913, which allowed oil companies to shield up to 27.5 percent of their profits from taxation.

Today, there are a wide range of oil and gas subsidies. The three largest subsidies cost the federal government almost $4 billion a year. All three allow oil and gas companies to deduct normal business expenses from their profit margins, reducing the taxes they pay.

The *domestic manufacturing deduction* benefits many American businesses and is not specific to oil and gas companies. It allows companies to deduct a certain amount of income for manufacturing goods in the United States. Beginning in 2004, Congress changed the tax code so that oil production could be considered a manufacturing activity (rather than an extractive industry). This allowed oil companies to suddenly deduct up to six percent of their net income from taxation. Expanding this subsidy to the oil industry costs the government $1.1 billion a year – or $11.6 billion over ten years.[1]

1742 Connecticut Ave. NW
Washington, DC 20009

tel: 202.234.8494
fax: 202-234.8584

email: ombwatch@ombwatch.org
web: http://www.ombwatch.org

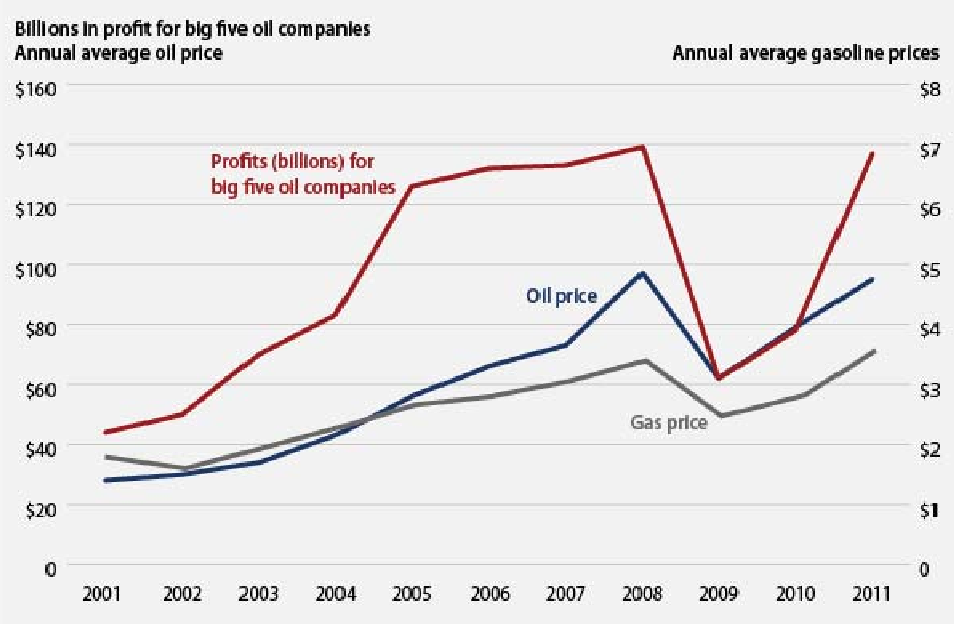
A second major fossil fuel subsidy allows oil and gas companies to expense *intangible drilling costs*. This deduction allows oil companies to deduct a range of non-drilling costs, such as surveying, well development preparation, and wages leading up to drilling. Since 1986, this deduction has allowed major oil companies to deduct 70 percent of the basic expenses of doing business. The Congressional Research Service, Congress' nonpartisan research arm, notes that this expensing "allows for a quicker return of invested funds through reduced tax payments," thus making drilling itself a less risky investment. Expensing intangible drilling costs the U.S. almost $14 billion in revenue over ten years.[2]

The third subsidy is the *percentage depletion allowance*. Similar to the intangible drilling expensing, percentage depletion allows companies to recover the cost of their capital investments by deducting 15 percent of the revenue from the sale of oil and gas from their gross income (essentially depreciating oil fields as a manufacturing firm would depreciate a piece of capital equipment). Eliminating the deduction would give the government another $11.5 billion over ten years.[3]

FIGURE 1

Higher prices help Big Oil

Big five oil companies' profits versus oil and gas prices



*All figures in 2011 dollars **2010 profits lower due to BP's Gulf oil spill, decreasing the company's profits by tens of billions of dollars

Sources: EIA and company profit reports

Source: Center for American Progress

With oil and gas companies reaping record profits, it is becoming hard to justify the continuation of these subsidies. As the Obama administration has noted, “In 2011 alone, the three largest American oil companies made a combined profit of more than $80 billion, or more than $200 million per day.” And despite these record profits, the oil and gas industry laid off more than 11,000 workers between 2005 and 2010. A recent poll showed that 73 percent of Americans supported the proposal to end federal subsidies for oil and gas companies, making it one of the most popular budget and revenue options polled.

Support for the Idea: The Obama administration has repeatedly called for eliminating many fossil fuel subsidies, including the three listed above. In early 2012, the Senate voted on the Repeal Big Oil Tax Subsidies Act (S. 2204) by Sen. Robert Menendez (D-NJ), which would have repealed six subsidies for the five largest oil and gas companies, saving $24 billion over ten years. While the bill failed to pass, it fell only a few votes short. In 2007 and 2009, Sen. Chuck Schumer (D-NY) introduced similar bills, which never made it to the floor for a vote.

Of the plans reviewed for this revenue project, the following plans support eliminating the three subsidies: President Obama's *2013 budget* and Rep. Mike Quigley's *Reinventing Government.* The following plans support eliminating the domestic manufacturing deduction by itself: Center for American Progress' *Budgeting for Growth* and the Congressional Progressive Caucus' *People's Budget*.

---

[1] “Oil and Natural Gas Industry Tax Issues in the FY2012 Budget Proposal,” Congressional Research Service, 2011, http://budget.house.gov/UploadedFiles/CRSR42374.pdf
[2] Ibid
[3] Ibid