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

President Obama's FY '12 budget calls for the elimination of subsidies for the fossil fuels industry that would save taxpayers more than $5 billion in FY '12 and $49.9 billion over the next five years. This follows the President's State of the Union Address calling for the end of subsidies to the oil industry. The President also pledged to end wasteful fossil fuel subsidies at the G20 summit in Pittsburgh in 2009.

Below, we itemize the giveaways proposed for elimination in the President's budget. Congress should act immediately to end these giveaways for some of the world's most profitable corporations, as well as additional subsidies for fossil fuels not proposed for elimination in the President's budget.

## Fossil Fuel Giveaways

- **Last in, first out accounting** *26 USC §472* ($25.4 billion over 4 years)[1]
  For more than 70 years, oil and gas companies have used an accounting method known as "last in, first out," or "LIFO," to free themselves from paying taxes on profits made because the value of oil they are holding increases. LIFO allows oil companies to claim that they are selling the last oil (and currently most expensive) placed into their reserves first, before selling longer-held and cheaper reserves. This allows oil companies to greatly reduce their tax burden. President Obama has proposed eliminating LIFO starting in FY '13. Repealing the LIFO would save consumers $3.8 billion in FY '13 and $25.4 billion over the four years in the President's budget.[2]

- **Domestic manufacturing tax deduction for oil and gas companies** *26 USC §199* ($6.6 billion over 5 years)
  In 2004, Congress passed the American Jobs Creation Act of 2004. The bill's intent 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 allows oil and gas companies to claim billions of dollars of tax deductions, effectively lowering their tax rate. Eliminating this deduction would return $761 Million in FY '12 to the federal treasury and more than $6.6 billion over the next five years.

- **Expensing of intangible drilling costs** *26 USC §263, 291* ($6.2 billion over 5 years)
  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 (with the other 30 percent amortized over 5 years). Non-integrated oil and gas producers, many of them still multi-billion dollar corporations, are allowed to immediately deduct all of their intangible drilling costs. Repealing this tax giveaway will save the treasury $1 billion in FY '12 and $6.2 billion over five years.

- **Percentage depletion allowance for oil and gas** *26 USC §613 A* ($4.6 billion over 5 years)
  The oil and gas percentage depletion allowance allows independent oil companies to deduct 15 percent of their sales revenue to reflect the declining

1 The majority of this savings would come from oil and gas companies, but not all of it would.
2 Id.

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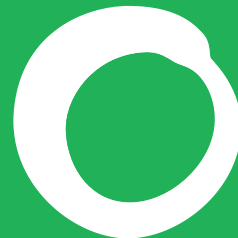

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value of their investment. This flat deduction bears little resemblance to the actual loss in value of wells over time and companies are often able to deduct more than the capital invested for acquisition and development. Closing this tax loophole will save taxpayers $605 million in FY ’12 and $4.6 billion over five years.

- **Deductions for foreign tax – dual capacity tax deduction** *26 USC §901* ($3.8 billion over 5 years)
  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. In many cases these countries do not have any corporate income taxes. So as not to impose a double tax the U.S. tax code allows foreign income tax payments to be deducted at 100 percent. 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 able to cheat the treasury out of billions of dollars. Congress has considered several efforts to modify this deduction. President Obama’s proposal would save taxpayers $341 million in FY ’12 and $3.8 billion over the next five years.

- **Domestic manufacturing deduction for coal and other hard mineral fossil fuels** *26 USC §199* ($921 million over 5 years)
  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 $95 million to the federal treasury in FY ’12 and return almost $921 million over five years.

- **Amortization of geological and geophysical expenditures** *26 USC §167* ($796 million over 5 years)
  This tax break was created in the Energy Policy Act of 2005 and allows non-vertically integrated oil companies, many of which 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 taxpayers $44 million in FY ’12 and $796 million over five years.

- **Percentage depletion for hard mineral fossil fuels** *26 USC §613* ($557 million over 5 years)
  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 would save taxpayers $71 million in FY ’12 and $557 million over five years.

- **Royalty taxation of coal** *26 USC §631* ($264 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 percent, less than half the top individual income tax rate of 35 percent. Fixing this tax break would save taxpayers $27 million in FY ’12 and $264 million over five years.

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- **Expensing of exploration and development costs for hard mineral fuels** *26 USC §617* ($240 million)
  In 1951 Congress passed this provision to encourage mining, expanding 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 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 $85 million in FY '12 and $240 million over the next five years.

- **Passive loss exception for working interests in oil and gas properties** *26 USC §469* ($99 million)
  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. If it is not fixed this tax break will cost taxpayers $11 million in FY '12 and $99 million over five years.

- **Deduction for tertiary injections** *26 USC §193* ($38 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 $7 million in FY '12 and $38 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 even open the door to incentivizing this dirty and dangerous practice.

- **Marginal wells tax credit** *26 USC §45I* ($0)
  The marginal wells 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 allow possible future subsidies to remain for production from marginal wells or offering them insurance in the case of price decreases.

## Ending 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 to corporations that are earning record profits and pushing us down the road toward climate disaster. President Obama wisely proposed the elimination of billions of dollars worth of subsidies for fossil fuels in his budget. Congress should act immediately and save taxpayers more than $49.9 billion by ending these giveaways and then should save even more by eliminating additional fossil fuel handouts that are not included in the President's budget.

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