TAXPAYERS FOR COMMON SENSE
MAKING GOVERNMENT WORK

Subsidy Gusher:
Despite record profits, industry continues to demand taxpayer handouts

In 1916, US taxpayers provided the oil and gas industry with its first federal tax break. Over the decades, more lucrative tax breaks have been added, helping the industry to prosper. The latest installment came with the passage of the 2005 Energy Policy Act, which included another $2.6 billion in subsidies for oil & gas companies. In all, oil and gas companies are expected to receive more than $20 billion in subsidies over the next five years, according to this new analysis.

When reports of the oil and gas industry's record profits hit the news, you didn't have to look hard to see why. Prices at the pump have soared and taxpayers' heating bills are not far behind. With taxpayers' pocketbooks hit hard, high profits and the irresponsible practices of the oil and gas industry have garnered significant attention. Current prices and future forecasts only promise more of the same. Now is the time to end all subsidies for the oil and gas industry.

After more than a century to establish itself, the oil and gas energy sector should clearly be able to stand on its own two feet without taxpayer handouts. Congress must act to end the siphoning of taxpayer dollars to powerful energy companies. The federal government cannot continue to perpetuate an endless cycle of subsidies.

A Wealthy Industry

In 2007, the oil and gas industry raked in more than $150 billion dollars in profits while continuing to receive generous federal subsidies.[1] According to the Energy Information Administration the oil and gas industry received more than $2 billion in tax breaks in 2007 alone.[2]

In the last decade profits for the top 25 oil and gas companies have increased more than 250%.

Despite several attempts in Congress to end these giveaways, oil and gas companies continue to receive billions in tax breaks and royalty relief. A quick look at the top producers of 2007 and 2008, shows total profits were up more than $10 billion since 2005 with profits rising more than 250%[3] in the last decade. In 2007, Exxon recorded the largest annual profit ever recorded by an American company -- more than $40 billion in profits.

[1] Calculation based on net income of top 25 North American and British oil and gas companies in 2007
[2] Federal Financial Interventions and Subsidies in Energy Markets 2007. April 2008. Energy Information Administration. 12 Jun 2008 <http://www.eia.doe.gov/oiaf/servicerpt/subsidy2/index.html
[3] Calculation based on percentage change in net income from 1997 to 2007

It should be no surprise these companies are doing so well. Since 2002, crude oil prices have increased more than 300% and natural gas prices are up more than 70%.[4]

Oil and Gas Industry Subsidies

The oil and gas industry takes advantage of tax breaks and other subsidies worth billions of dollars each year. In 2008, oil and gas companies will receive more than $2 billion in tax breaks and from 2006-2010 these companies will receive a total of more than $23 billion in tax breaks and other subsidies.

Table 1. Tax Credit or other Government Support (in millions)	2006-2010
Intangible Drilling Costs	3,690[5]
Passive Loss	150
Credit for Enhanced Oil Recovery Costs[6]	--
Percentage Depletion Allowance (excess of percentage of cost depletion)	3,910
Expensing for refining equipment	659
Geological and Geophysical Costs Tax Credit	282[7]
Natural gas distribution lines	383
Small Refiners Deduction	103
Royalty Relief	7,689[8]
LIFO (Last in – First out) accounting	4,322[9]
Deductions for Foreign Tax Credit	325[10]
Natural gas gathering lines	10[11]
Exemption from bond arbitrage rules	14[12]
Manufacturing tax deduction for oil and gas companies	1,499[13]
Liberalize the definition of independent producer	73[14]
Total	23,109

The earliest of the subsidies provided to the industry came in 1916 with the establishment of the intangible drilling costs tax credit; other tax breaks including the geological and geophysical tax break were enacted as recently as the Energy Policy Act of 2005 (EPACT05). For a list of subsidies the oil and gas industry receives please see Appendix One.

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[4] Calculations based on prices provided by the Energy Information Administration

[5] Unless otherwise noted estimates provide in table 1 are from Office of Coal, Nuclear, Electric, and Alternate Fuels. "Chapter 2. Tax Expenditures and Direct Expenditures." Federal Financial Interventions and Subsidies in Energy Markets 2007. April 2008. Energy Information Administration. 12 Jun 2008 <http://www.eia.doe.gov/oiaf/servicerpt/subsidy2/index.html

[6] This credit did not apply in 2007

[7] This assumes changes to the current law to 2-year amortization in 2005, 5-year in 2006, and 7-year amortization in 2007.

[8] "Budget Justifications and Performance Information." Minerals Management Service. 6 Feb 2006. U.S. Department of Interior. 18 Jun 2008 <http://www.mms.gov/PDFs/2007Budget/FY2007BudgetJustification.pdf>.

[9] "Estimated Revenue Effects of the Tax Provisions Contained in S. 2020 Fiscal Years 2006 - 2015 the "Tax Relief Act of 2005,"." JCX-82-05 R. 29 Nov 2005. Joint Committee on Taxation. 18 Jun 2008 <http://www.house.gov/jct/x-82-05r.pdf>.

[10] Estimated Revenue Effects of the Tax Provisions Contained in S. 2020 Fiscal Years 2006 - 2015 the "Tax Relief Act of 2005,"." JCX-82-05 R. 29 Nov 2005. Joint Committee on Taxation. 18 Jun 2008 <http://www.house.gov/jct/x-82-05r.pdf>.

[11] "Estimated Budget Effects of the Conference Agreement for Title XIII. OF H.R. 6, The "Energy Tax Incentives Act of 2005"." JCX-59-05. 27 July 2005. Joint Committee on Taxation. 18 Jun 2008 <http://www.house.gov/jct/x-59-05.pdf>.

[12] Ibid

[13] Congressional Budget Office, H.R. 6,The Clean Energy Act of 2007; http://www.cbo.gov/ftpdocs/77xx/doc7728/hr6prelim.pdf

[14] http://www.house.gov/jct/x-59-05.pdf

The subsidies included in Table 1 (above) cover a range of tax breaks and other government support for the oil and gas industry.

Colorado Oil and Gas

Colorado is the 11th largest producer of oil in the nation;[15] oil and gas constitute a $23 billion a year industry in the state.[16] Colorado has over 27,000 producing wells distributed statewide.[17] Over the last five years, oil production in Colorado increased by more than 15% and natural gas production more than 45% (see Table 2).

Colorado oil and gas companies include some of the largest producers in the world, including BP, Chevron and Anadarko. Like other top producers in the oil and gas industry, these companies saw significant increases in profits over the last decade. BP has seen profit nearly double from $11 billion in 2000 to more than $20 billion in 2007. Chevron's profits are up from $7.7 billion in 2000 to more than $18.6 billion in 2007. See Appendix two for a brief description on the top oil and gas producers in the state.

Table 2. Colorado Oil and Gas Production

Year	Total Colorado Production of Oil[18] (thousands of barrels)	Total Colorado Production of Natural Gas[19] (MMcf*)
2000	19,967	1,106,787
2007	23,029	1,615,266
% change from 2000 to 2007	**15.33%**	**45.94%**

* MMcf= millions of cubic feet

[15] "Office of Economic Development and Trade." State of Colorado, 2008. <http://www.colorado.gov/cs/Satellite/OEDIT/OEDIT/1167928421260>
[16] McDonald, Lisa et. al. "Oil and Gas Economic Impact Analysis." Colorado Energy Research Institute, Colorado School of Mines, 2007. <http://ceri-mines.org/documents/CERIOilGas.pdf>
[17] "COGIS- Production Data Inquiry."Colorado Oil and Gas Conservation Commission, 2008. <www.oil-gas.state.co.us>
[18] Ibid.
[19] "COGIS- Production Data Inquiry."Colorado Oil and Gas Conservation Commission, 2008. <www.oil-gas.state.co.us>

Table 3. Colorado's Top Oil Producers in 2007; Production in the Past 5 Years

(in thousands of barrels)

Company	2003	2004	2005	2006	2007
Chevron USA INC	5,360	5,223	5,398	5,342	5,386
Kerr-McGee Oil and Gas Onshore LP	2,711	3,015	2,889	3,306	3,011
Noble Energy Production Inc	0.426	14	2,844	4,501	2,686
EnCana Oil and Gas (USA)	409	649	1,546	1,277	1,423
Noble Energy Inc	X	X	2	77	1,366
Petroleum Development Corp	757	982	1,212	1,254	1,185
Petro-Canada Resources (USA) Inc	498	629	698	778	786
Citation Oil and Gas Corp	X	X	876	878	772
Mull Drilling Company Inc	910	895	841	764	702
Merit Energy Company	766	736	611	515	450

Colorado's Top Natural Gas Producers in 2007; Production in the Past 5 Years

(in MMcf)

Company	2003	2004	2005	2006	2007
Kinder Morgan CO_2 Company LP	284,013	319,821	343,846	354,436	353,442
BP America Production Company	271,176	267,046	257,486	245,744	227,776
Williams Production RMT Company	82,025	97,859	136,669	179,882	206,533
EnCana Oil and Gas (USA) Inc	67,394	104,244	169,348	171,873	165,196
Pioneer Natural Resources USA Inc	X	18,272	71,945	78,058	82,893
Kerr-McGee Oil and Gas Onshore LP	79,806	73,927	68,037	67,909	60,873
Red Willow Production Co.	60,894	61,116	55,433	49,062	44,912
Samson Resources Production Company	26	16	25,774	34,109	44,588
XTO Energy Inc	24,814	32,270	36,940	40,418	40,586
Noble Energy Production Inc	5	146	40,989	64,058	39,250

Appendix One: Oil and Gas Subsidies Summary

The following is a brief description of the oil and gas subsidies based on the EIA Report "Federal Financial Interventions and Subsidies in Energy Markets 2007"[20], the Joint Committee on Taxation's explanation of the Energy Tax Incentives Act of 2005[21], and the Congressional Research Service's report on oil and gas tax subsidies.[22]

Intangible Drilling Costs (Expensing of exploration and development costs):
Created in 1916, intangible drilling costs (IDCs) include all expenditures made for wages, fuel, repairs, hauling, supplies, etc that are incident to the drilling of wells and the preparation of wells for the production of oil and gas. While most costs that bring future benefits must be capitalized according to the Internal Revenue Code, IDCs are an exception that can be expensed in the period the costs are incurred. Special rules are provided for intangible drilling and development costs so that these costs can either be expensed (current deduction) or capitalized (current law). When the decision is made to "expense" the IDCs, the taxpayer deducts the amount of the IDCs as an expense in the taxable year the cost is paid or incurred. If the IDCs are capitalized, they are generally recovered through either depreciation or depletion.[23]

Passive Loss
Passive loss activity refers to any activity that does not constitute a taxpayer being "materially involved" in a business activity. This is defined as not having a working interest in an oil or gas property – in other words, not being regularly involved in the operations of the activity. The amount of the credits cannot exceed the regular tax liability of the taxpayer.[24]

Credit for Enhanced Oil Recovery Costs
The Enhanced Oil Recovery tax credit allows oil companies to qualify for a 15 percent tax credit of certain costs attributable to qualified enhanced oil recovery projects. A qualifying EOR project would be any project that involves the application of one or more "tertiary recovery" methods, which generally include, among others, the following methods: steam-drive injection, cyclic-steam injection, alkaline flooding, or any other method approved by the IRS. When prices reach above $39/barrel (2007 dollars) in the year prior to claiming the credit, the claimant can no longer apply for the credit. Because prices in 2007 were above this threshold the oil and gas companies could not receive it.[25]

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[20] Office of Coal, Nuclear, Electric and Alternative Fuels, Energy Information Administration, April 2008
[21] Committee on Joint Taxation, July 2005
[22] Congressional Research Service, Salvatore Lazarri, February 2007
[23] Staff of the Joint Committee on Taxation. "Description and Technical Explanation of the Conference Agreement of H.R. 6, Title XIII, The "Energy Tax Incentives Act of 2005"." JCX-60-05. 28 July 2005. Joint Committee on Taxation. 19 Jun 2008 <http://www.house.gov/jct/x-60-05.pdf>.
[24] Ibid
[25] Ibid

Section 29 Alternative Fuel Production Credit
Created in 1980, the Alternative Fuel Production tax credit applies to certain non-conventional fuels, such as fuels produced from biomass or shale. The value of the credit depends upon the current market price of oil, and oil companies can claim the credit when they produce fuel from "non-conventional sources" including coal, tar sands, or shale.[26]

Percentage Depletion Allowance (excess of percentage of cost depletion):
Enacted in 1926, the Percentage Depletion Allowance permits 27.5% of revenue to be deducted for the cost of the depletion of the mineral deposit. The percentage depletion allowance is a tax break given to independent oil and gas producers and can exceed capital costs.[27]

Geological and Geophysical Costs Tax Credit:
Included in the Energy bill and modified in the Tax Increase Prevention and Reconciliation Act of 2005, this tax credit provides a deduction for all costs incurred while searching for oil and gas deposits.[28]

Expensing for refining equipment
Established in 2005 by the Energy Policy Act of 2005, the Temporary 50-Percent Expensing of Equipment Used in the Refining of Liquid Fuels Deferral allows companies to deduct 50% of the cost of applicable equipment used to refine liquid fuels.[29]

Small Refiners Deduction
As provided for in the Energy Policy Act of 2005, the Expensing of Capital Costs with Respect to Complying with Environmental Protection Agency Sulfur Regulations Deferral allows small refiners to deduct 75% of qualified capital costs related to complying with EPA sulfur regulations.[30]

Natural gas distribution lines
As established by the Energy Policy Act of 2005, the Natural Gas Distribution Pipelines Treated as 15-Year Property Deferral 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.[31]

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[26] Staff of the Joint Committee on Taxation. "Description and Technical Explanation of the Conference Agreement of H.R. 6, Title XIII, The "Energy Tax Incentives Act of 2005"." JCX-60-05. 28 July 2005. Joint Committee on Taxation. 19 Jun 2008 <http://www.house.gov/jct/x-60-05.pdf>.
[27] Ibid
[28] Ibid
[29] Office of Coal, Nuclear, Electric, and Alternate Fuels. "Chapter 2. Tax Expenditures and Direct Expenditures." Federal Financial Interventions and Subsidies in Energy Markets 2007. April 2008. Energy Information Administration. 12 Jun 2008 <http://www.eia.doe.gov/oiaf/servicerpt/subsidy2/index.html
[30] Ibid
[31] Ibid

Royalty Relief

Oil and gas companies that drill on public lands or off-shore pay for the oil and gas they remove in the form of royalties. Because of out-dated energy policy, oil and gas companies often pay little or no royalties to the owners of the resources—U.S. taxpayers. Energy companies over the next five years are likely to extract $65 billion in oil and gas from leases without paying the full royalty.[32]

LIFO

Last In, First Out (LIFO) accounting allows oil companies to count the most recently acquired, barrel of oil in their inventories as being sold first. Considering the last barrel is the most expensive barrel due to high prices and inflation, oil companies are able record older, cheaper, recovered oil as being in inventory. This reduces the value of the inventory and thus, reduces the company's tax burden.

Deductions for Foreign Tax Credit

The foreign tax credit serves to prevent double taxation of income earned abroad by U.S. residents and corporations. This credit unfairly benefits U.S. oil companies because many of the countries in which they conduct business impose levies that are not really income taxes. Because of this, in some cases the foreign tax credit actually leads to a reduction of taxes on domestic source income.[33]

Natural gas gathering lines as a 7 year property

With the enactment of the Energy Policy Act of 2005, the recovery period for all natural gas gathering lines became 7 years, as opposed to some which were 15 years, for the Modified Accelerated Cost Recovery System depreciation deduction.[34]

Exemption from bond arbitrage rules

Tax-exempt, bond-financed prepayments violate the tax code's arbitrage restrictions. EPACT 2005 created an exemption to that general rule. Arbitrage is the practice of profiting by investing the profits from tax-exempt bonds in higher yielding instruments. Generally, under arbitrage rules, these proceeds must be rebated back to the U.S. treasury. Under the EPACT 2005 provision, a prepayment financed with tax-exempt bond proceeds for the purpose of obtaining a supply of natural gas for service area customers of a governmental utility would not be subject to the general arbitrage rule.[35]

[32] Staff of the Joint Committee on Taxation. "Description and Technical Explanation of the Conference Agreement of H.R. 6, Title XIII, The "Energy Tax Incentives Act of 2005"." JCX-60-05. 28 July 2005. Joint Committee on Taxation. 19 Jun 2008 <http://www.house.gov/jct/x-60-05.pdf>.
[33] Lazzari, Salvatore . "Oil and Gas Tax Subsidies: Current Status and Analysis." CRS Report for Congress. 27 Feb 2007. Congressional Research Service. 13 Jun 2008 <http://www.cnie.org/NLE/crs/abstract.cfm?NLEid=1812>.
[34] Ibid
[35] Ibid

Manufacturing tax deduction for oil and gas companies

The domestic production deduction benefits oil and gas companies to the extent that their products are “manufactured, produced, or extracted in whole or in significant part in the United States.” The deduction was 3% of income for 2006, rising to 6% between 2007 and 2009, and 9% thereafter; it is subject to a limit of 50% of the wages paid that are allocable to domestic production during the taxable year.[36]

Liberalize the definition of independent producer

The Energy Policy Act of 2005 redefined an independent producer as producing no more 75,000 barrels a day on average for a year, as opposed to the earlier ceiling of 50,000 barrels calculated based on actual daily production.[37]

[36] Ibid

[37] Lazzari, Salvatore . "Oil and Gas Tax Subsidies: Current Status and Analysis." CRS Report for Congress. 27 Feb 2007. Congressional Research Service. 13 Jun 2008 <http://www.cnie.org/NLE/crs/abstract.cfm?NLEid=1812>.

Appendix Two: Profile of Colorado Oil and Gas Companies

The following is a brief description of the companies operating in the oil and gas industry in Colorado.

Anadarko Petroleum Corp bought **Kerr-McGee Oil and Gas Onshore LP** for $16.4 billion and Western Gas Resources for $4.7 billion in 2007. Anadarko operates internationally, with access to 17 million net acres of land in the US, 2.7 million net in the Gulf of Mexico, and more than 40 million gross acres internationally. Anadarko has set out a $4.9-$5.1 billion budget for capital and exploration in 2008.[38] Anadarko operates natural gas and oil wells in Wattenburg in Colorado. In the third quarter of 2007, Anadarko produced 164 MMcf per day of natural gas; in the fourth quarter, Anadarko produced 172 MMcf per day.[39] In 2007, Anadarko produced 79 million barrels (MMbls) of oil.

BP is a multi-national energy corporation based in London. BP operates in more than 100 countries and has net assets worth more than $200 billion. BP has garnered 3% of the oil and gas production market, making it one of the largest integrated oil companies in the world. BP America is the largest oil and gas producer in the United States and the largest non-US company on the US stock exchange.[40] BP America has 330 natural gas wells operating in North America and produces 218 thousands of barrels of natural gas equivalent/day in the Western Basins in Colorado, New Mexico, and Wyoming.[41]

Chevron, based in San Ramon, California, is the second largest integrated energy company in the US and one of the largest energy companies in the world. Operating in more than 100 countries, Chevron plans to invest $22.9 billion in capital and exploration in 2008.[42]

Citation Oil and Gas is a privately held company based in Houston, Texas. Citation drills onshore in the United States particularly in the Permian Basin, Rocky Mountain, and Southern Oklahoma regions. In Colorado, Citation operates oil wells in the Little Buffalo basin, Notches Dome, Dallas Dome, and South Casper Creek.[43]

EnCana Oil and Gas is a multi-national corporation based in Canada. EnCana is one of the largest natural gas producers in North America, with operations in the US and Canada. Natural gas constitutes 80% of EnCana's production. EnCana considers Piceance Basin, CO one of its

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[38] "Operations." Anadarko.2008<http://www.anadarko.com/SiteCollectionDocuments/PDF/1Q08_operations_report.pdf>, "2007 Anadarko Fact Sheet." Anadarko. 2007. <http://www.anadarko.com/SiteCollectionDocuments/PDF/APC_CorpFactSheet_08.pdf>, "Pure Performance: 2007 Annual Report." Anadarko, 2007. <http://www.anadarko.com/SiteCollectionDocuments/PDF/APC_2007_10k.pdf>

[39] "Operations Report: 4th quarter 2007." Anadarko, 2007. <http://www.anadarko.com/PDF/4Q07OpsRprt020408.pdf>

[40] "Key Facts and Figures." BP,2008. <http://www.bp.com/extendedsectiongenericarticle.do?categoryId=9021229&contentId=7039276>

[41] "Annual Report and Accounts." BP, 2006. <http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/home_assets/ara_2006_annual_report_and_accounts.pdf>

[42] "Chevron Fact Sheet." Chevron, 2008. <http://www.chevron.com/documents/pdf/corporatefactsheet.pdf>

[43] "Operations." Citation Oil and Gas Company, 2007. <http://www.cogc.com/operations/index.html>

high potential fields operating 286 natural gas wells in Piceance basin in 2007, up from 220 in 2006.[44]

Kinder Morgan is one of the largest gas and oil pipeline companies in the United States, with more than 37,000 miles of pipeline. Valued at $20 billion, the Kinder Morgan companies include Kinder Morgan Energy Partners, L.P., Kinder Morgan Management, LLC, and Knight Inc, a private company. In Colorado, Kinder Morgan drills 920 natural gas wells in the Ignacio Blanco Field in the San Juan Basin.[45]

Merit Energy Company is a private company operating out of Dallas, Texas. Merit Energy has $4 billion in assets and more than $4 billion in committed equity capital.[46]

Mull Drilling Company Inc is a private company operating out of Wichita, Kansas. Mull drills for oil in the Mid-Continent and Rocky Mountain regions, particularly in Kansas and Eastern Colorado.[47]

Noble Energy Production Inc, based in Texas, operates internationally. In Colorado, Noble Energy drills in the San Juan, Wind River, and Piceance basins and the Niobrara fields.[48]

Petro-Canada Resources (USA) Inc is a subsidiary of Petro-Canada, a Canadian oil company. One of the largest oil and gas companies in Canada, Petro-Canada increased production by 21% in 2007. Petro-Canada plans capital expenditures of $5.3 billion in 2008.[49]

Petroleum Development Corp is headquartered in Bridgeport, West Virginia and operates in the Rocky Mountain region, the Appalachian Basin, and the Forth Worth Basin. In Colorado, PDC drills for oil in the Piceance Basin, the Denver Basin, and the DJ Basin. PDC is growing steadily, with a 67% production growth in 2007.[50]

Pioneer Natural Resources is a multi-national company based in Texas with net assets of $8.7 billion as of 2007. Pioneer is the largest driller for natural gas in the Raton Basin in South Eastern, CO. Pioneer also drills for natural gas in the Sand Wash Basin in NW Colorado.[51]

Red Willow Production is a private company run by the Southern Ute Indian Tribe. Operating out of Ignacio, Colorado and Houston, Texas, Red Willow drills in New Mexico, Colorado, and

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[44] "Exploration and Production." Conoco Philips, 2008 <http://www.conocophillips.com/about/worldwide_ops/country/north_america/lower48.htm>

[45] "2006 Kinder Morgan Annual Report—Financials." Kinder Morgan, 2006. <http://www.kindermorgan.com/investor/kmi_2006_annual_report_financials.pdf>

[46] "About Merit." Merit Energy Company, 2005. <http://www.meritenergy.com/detail.aspx?page=About%20Merit>

[47] "Mull Drilling Co., Inc." Mull Drilling Co., Inc. <http://www.mulldrlg.com/>

[48] "Noble Energy Inc. 2007 Annual Report." Noble Energy, 2007. <http://thomson.mobular.net/thomson/7/2653/3165/>

[49] "Fast Facts." Petro-Canada, 2008. <http://www.petro-canada.ca/en/media/282.aspx#nang>

[50] "Operations." The Petroleum Development Corp, 2007.<http://www.petd.com/operations.cfm>

[51] "2007 Annual Report." Pioneer Natural Resources, 2007. <http://www.cstproxy.com/Pioneer/2008/AR2007/HTML1/pioneer_ar2007_0087.htm>

Texas and has non-operated interests in Colorado, New Mexico, Texas, the Gulf of Mexico, and Alberta, Canada.[52]

[52] "Red Willow Production Company." Red Willow Production Company, 2008. <http://www.rwpc.us/>