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Getting the Facts on Oil & Gas Preferences

Big oil has benefited from every reconciliation bill in modern day history. This time let’s get it right. Century-old oil and gas policies that threaten our climate goals must go.

The time has come to clean up the code and stop oil and gas companies from skirting their climate liabilities. With $80/barrel oil, and climate liabilities piling up, taxpayers can’t afford another round of industry giveaways.

Over the years we’ve dug into the details of all federal oil and gas subsidies. Below is a summary of what we’ve found and where reform is needed.

Needless Century-Old Tax Breaks Remain on the Books

Preferences for oil and gas producers baked into the tax code date back to 1916 and allow the industry to recover their capital costs unlike any other, tabulate inventory in ways that defy reality, and skirt taxes on foreign income. Together the provisions cost taxpayers more than $61 billion over the last decade. Below is a brief description of some of these tax breaks:

Percentage Depletion Allowance (PDA) (26 U.S.C. §613)

Created in 1926, the Percentage Depletion Allowance (PDA) enables independent oil and gas producers to deduct 15% of their revenue (up to 25% for marginal wells) from their gross income before taxes are calculated. It was meant to allow companies to recover their investment costs in a well, but because they can take the deduction as long as the well generates income, total deductions typically exceed the original investment. In effect, PDA provides oil and gas companies an ongoing production subsidy.

JCT estimated cost from FY2011 – FY2020: $8.52 billion.

Expensing of Exploration and Development Costs (26 U.S.C. §263)

Businesses constructing a property, plant, or equipment must capitalize their costs (deduct them) over the life of the asset. But oil and gas companies can fully deduct these costs from taxable income as they are incurred. Specifically, oil and gas producers can fully expense (deduct) intangible drilling costs (IDCs) like wages, fuel and drilling site preparations. The subsidy has existed since 1916.

JCT estimated cost from FY2011 – FY2020: $10.1 billion.
Master Limited Partnerships Exemption (26 U.S.C. §7704)

In 1986, Congress closed a loophole in the tax code by requiring businesses organized as partnerships but selling equity interests, like stock, on a public exchange to be treated as corporations for tax purposes. Except, these publicly traded partnerships, or “master limited partnerships” (MLPs), can avoid corporate income tax if at least 90% of their income comes from qualifying sources, like oil and gas production and transportation. As of 2017, 82% of the MLPs that can duck corporate taxes are energy and natural resources companies, with a total market capitalization of over $390 billion, according to the Master Limited Partnership Association.

JCT estimated cost from FY2011 – FY2020: $5.8 billion.

Amortization of Geological and Geophysical Expenditures (26 U.S.C. §167)

Companies use geological and geophysical (G&G) assessments to locate new oil and gas deposits, often as the first step in developing a new well. Instead of deducting the G&G costs like capital costs over the life of the well as normal tax rules dictate, oil and gas producers can amortize over 2-7 years, depending on the company.

JCT estimated cost from FY2011 – FY2020: $1.14 billion


Passive business activity refers to any activity in which a taxpayer has an economic interest but does not "materially participate" in normal business activities. Normally, taxpayers can deduct losses from passive activities (passive losses) up to but not over their total amount of passive income. Working interests in oil or gas wells, however, are exempt from the passive loss limitation. This allows oil and gas companies to deduct their passive losses in excess of their active income from normal business activities.

JCT estimated cost from FY2011 – FY2020: $167 million

Other tax breaks enable oil and gas companies to reduce their taxes further: Some allow companies to recover their capital costs through tax deductions quicker than other businesses can. These include:

- Election to expense 50% of qualified property to refine liquid fuels (26 U.S.C. §179C)

Others simply reward certain activity, like production from marginal (low producing) wells or the use of injectants and other methods to stimulate more production from existing wells.

- Credit for Production from Marginal Wells (26 U.S.C. §45I)
- Credit for Enhanced Oil Recovery (EOR) (26 U.S.C. §43)

Lastly, some take the form of obscure accounting rules that govern how much foreign tax can be deducted or how to tabulate the cost of inventory.
• Deductions for Foreign Tax – Dual Capacity (26 U.S.C. §901)
• Last-In First-Out Accounting (26 U.S.C. §472)

Endless Deferral and Immediate Cost Recovery Cost Taxpayers

The U.S. tax system allows oil and gas companies to use immediate cost recovery to defer taxes that ultimately never come due. The U.S. tax system is so generous, that even deferred taxes are often minimal or negative – they expect to get credits in the future that totally eliminate tax liability.

• Cumulative U.S. taxes incurred by the top 20 U.S. E&P companies in 2019 (current and deferred), was -$1.3 billion

The Oil Industry Is Exerting Influence to Keep Their Subsidies

The oil and gas industry has one of the largest lobbying forces in U.S. politics, employing hundreds of lobbyists with connections on Capitol Hill and in federal agencies, and donating hundreds of millions of dollars to congressional candidates. And that’s just what is disclosed. More influence is exerted through extensive dark money networks. Below is a recap of the oil and gas industry’s political footprint:

• In 2020, the O&G industry spent **$113 million** on lobbying and hired **688 lobbyists, 467** of which are revolving door personnel
• In 2020, the O&G industry spent **$139 million on campaign contributions**, a 22.7% increase over last presidential election cycle despite being hit by the pandemic
• Over the last decade, the O&G industry spent **$1.9B** on lobbying and campaign contributions
• Campaign contributions have grown by **25%**, on average, every presidential election cycle since Citizens United vs. FEC

And benefitting from billions in subsidies...

• TCS estimates the O&G industry receives **$3.1 billion** through preferential tax treatment and **$1.7 billion** through sweetheart terms in oil and gas leasing system EACH YEAR
• Over the last decade, the O&G industry received at least **$93 billion** in federal subsidies

While Raking in Profits despite the pandemic...

• Top 20 U.S. O&G companies reported combined profits of **$23.5 billion** during the first 2 quarters of 2021, **$1 billion** more than their profits over the same period in 2019, before the pandemic started.
• The energy sector earning in Q2 2021 increased by **$25.5B** compared to Q2 2020. Exxon Mobil and Chevron, the top 2 oil giants account for the lion share of this recovery— **$17.32B** of the $25.5B year-over-year improvement
• Although some of the top 20 companies recorded losses due to derivative losses, almost all of the companies doubled their revenue compared the same period in 2020, mostly thanks to soaring oil and gas prices
• With the economy opening up, higher demand and rising prices is helping O&G companies recover from the pandemic; production has also followed suit

Big Oil also cashed in on the pandemic after winning big in the 2017 Tax Act and paid little consequence for reckless financial moves that would have been disastrous for other industries.

• The 2017 Tax Act provided a windfall to the oil and gas industry that had been deferring taxes for decades, thanks to provisions described above. Twenty of the top U.S. oil and gas producers reported $15.5 billion in immediate book gains because of the bill.
• The boost to the industry was largely due to remeasurement of deferred tax liabilities. The Tax Act erased more than 30 percent of the net deferred tax liabilities on the books of top producers by taxing it at the new lower corporate rate.
• The deficit-financed subsidies were not enough to reverse the sector’s structural decline. During the five years from 2015 through 2019, this group of companies reported massive losses — with total U.S. pretax income of negative $120.6 billion, or an average combined loss of $24.1 billion per year.
• When companies did report U.S. profits, their accumulated losses and tax advantages made their current tax rates negative. In 2018, the group posted nearly $30 billion in U.S. earnings before tax, but incurred negative $171 million in current-year taxes on those earnings.
• In 2018, ExxonMobil reported $4.4 billion in pre-tax domestic earnings over the last three years, more than any other producer, yet reported total federal taxes of negative $8 billion. Largely due to the Tax Act, the company ran up relatively low tax bills in the present and gained the ability overall to reduce its taxes later by $8 billion.

Time to Enact Real Reforms

To end subsidies for oil and gas companies, Congress must tackle both the slew of preferences in the tax code and the below-market terms that let companies produce oil and gas on federal lands and waters for cheap.

Leasing reform

• Royalty Rates The federal onshore oil and gas royalty rate is set at 12.5 percent, well below the offshore rate of 18.75% and the rates charged on state lands. If we had been collecting the offshore rate on every barrel of oil and cubic foot of gas produced from federal lands over the last decade, taxpayers could have received up to $12.35 billion more.
• Rental Rates The current rental rates are set at $1.50/acre for the first half of the lease term and $2.00/acre for the second half of the lease term. The rates were set in 1987 and have not
been adjusted for inflation since then. Had the rates kept up with inflation, taxpayers would have received roughly $330 million more in rental revenues from FY2011 to FY2020.

- **Minimum Bids in Lease Sales** Like rent, the minimum amount companies can bid at auctions for federal oil and gas leases hasn’t been updated since 1987. It remains at $2/acre, and bidders take full advantage. Of the 544,000 acres sold at auction in 2020, roughly 200,000 got the minimum bid. From FY2011 to FY2020, taxpayers would have received $5 million more had minimum bids been adjusted for inflation.

- **Noncompetitive Leasing** In 1987, Congress created the competitive leasing system to get more revenue from leasing valuable federal land. But the process has a significant loophole: the day after a competitive auction, a company (or land speculator) can avoid paying a bid by submitting a noncompetitive offer for anything that didn’t sell the day before. Oil and gas companies have disproportionately used the noncompetitive system to avoid paying the $2/acre minimum bid on parcels with more acreage. Over the last 10 years, 2.3 million acres – an area roughly twice the size of Rhode Island – have been leased with no bid.

- **Reclamation Bonding** If not reclaimed timely and properly, orphaned oil and gas wells can pose environmental and public health risks. The GAO found 84 percent of bonds covering 99.5 percent of all wells are not enough to cover even the low-end estimate of reclamation costs. The bonding minimums have not been adjusted for inflation since the 1950s and 1960s. Adjusted for inflation, today’s $10,000 minimum bond for an individual lease was the equivalent of $87,436 in coverage when it was set in 1960. The rate of $25,000 for statewide bonds originally provided the equivalent of $240,531 in coverage in 1954, and the $150,000 nationwide bond minimum provided $1,443,184 in coverage. Low bond minimums incentivize operators not to reclaim wells when it is more costly to clean up well sites than simply forfeit the minimum bonded amount.

**Reforms Won’t Raise Prices at the Pump**

Despite what some may claim, enacting the leasing reforms above will NOT affect gasoline prices, which depend on the global price of oil, consumer demand, and NOT changes in federal leasing policy.
Higher royalty rates will increase taxpayer revenue with little or no effect on oil and gas production.

- Officials in Texas and Colorado report no reduced demand for leases after implementing higher royalty rates for leases on state lands.
- CBO estimates that the effects on production from an onshore royalty of 18.75% would be "negligible."

Reforms will have no impact on gas pump prices

- Increasing the onshore royalty rate would have **no impact on current leases or current production**. Higher rates would only kick in for new leases, which usually take years to develop.
- Roughly half of onshore oil & gas royalty receipts in 2013 came from leases issued more than 50 years prior. Just 6% of oil & gas royalty payments came from leases issued in the last 10 years.

If...

- Congress increases the royalty rate for leases on federal lands from 12.5% to 18.75%,
- 6% of onshore oil production is subject to the new rate in 10 years,
- The entire supply chain is able to pass on the increased royalty cost via a 7.69% price increase,
- That price increase affects just 7.6% of all U.S. crude oil used to make gasoline, and
- The price of crude oil affects 52% of the price at the pump,

Then...

- A gallon of gas costing $3.00 would suddenly cost $3.00055.