

March 2026

Oil and Gas Allowances and Deductions



Oil and gas wells in California | John Ciccarelli, BLM

The Federal Oil and Gas Leasing System

Federal lands and waters contain vast reserves of oil and natural gas. To facilitate the development of these valuable natural resources, the federal government auctions off the right to lease parcels of federal land to private entities. In return for the right to drill and profit, producers pay bonus bids at competitive auctions, rent for using federal real estate, royalties on the market value of the oil and gas they extract, and other fees to cover the government's management costs.

The federal leasing system generates significant revenue for taxpayers. From FY2015-2024, the Office of Natural Resources Revenue reported collecting \$94.2 billion from the oil, gas, and natural gas liquids produced on federal lands and waters, representing 88% of all revenue from federally owned natural resources.¹ Royalties make up the bulk of that revenue. All federal leases carry a statutory royalty of 12.5% for onshore production and 18.75% for offshore.

Transportation and Processing Allowance

Before a royalty—12.5% for onshore leases and 18.75% for offshore leases—is charged on the value of oil and gas, producers are eligible for certain deductions. Unfortunately for

taxpayers, this has resulted in billions of dollars in revenue left on the table every year and kept taxpayers from getting a fair return on the development of taxpayer-owned oil and gas.

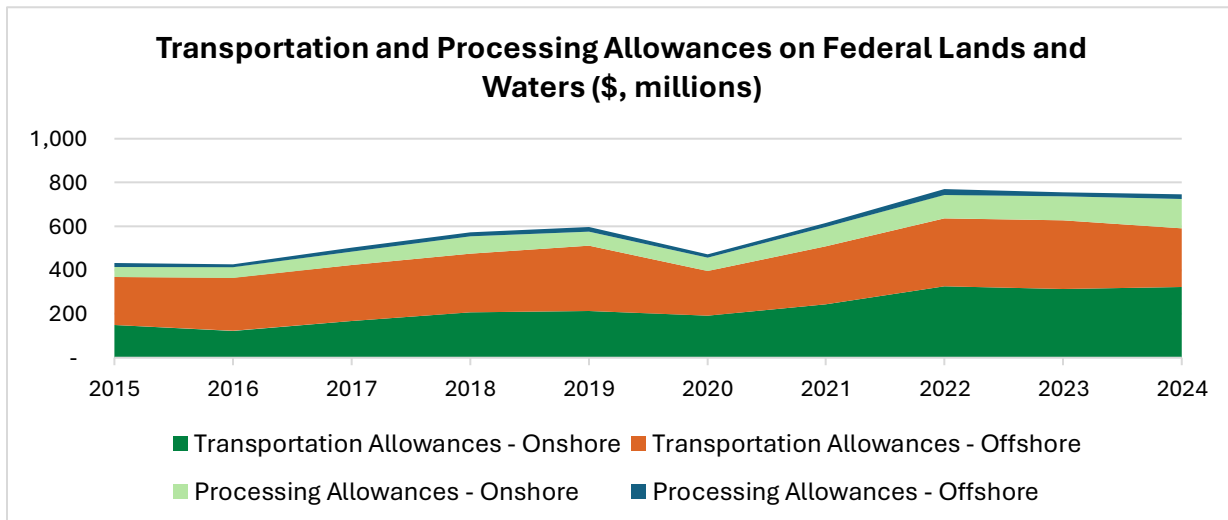
Deductions are regulatory allowances given to lessees for “reasonable, actual costs” of production²—mainly, the transportation and processing costs.

- Transportation allowances let operators reduce the royalty value by up to 50% to offset the costs to transport federal oil and gas from the lease.
- Processing allowances let operators reduce the royalty value by up to 66.67% for “reasonable” costs to process federal gas.

If both transportation and processing allowances were maximized, the full royalty that would otherwise be owed to the Federal Government could be significantly reduce—down from 12.5 percent to effective royalty rate of 2.08 percent.³

For example, if a lease produces \$1,000,000 of natural gas and was charged a 12.5% royalty, the royalty value would be \$125,000. If the lessee used the maximum 50% transportation allowance (\$62,500 of the royalty value) and maximum 66.67% processing allowance (\$41,670 of the royalty value less transportation allowance), the result would be a royalty value of \$20,830 — an effective royalty rate of 2.08%.

Over the last decade, 2015-2024, companies have claimed \$5.9 billion in transportation and processing allowances on the development of oil, gas, and natural gas liquids—\$3 billion on federal lands and \$2.8 billion in federal waters.⁴



Regulatory History of Deductions

For decades, the transportation allowance was capped at 50% of the sales value of federal oil and gas before royalties were calculated. Similarly the processing allowance was capped at 66.7% of the sales value of federal gas. However, producers could apply to ONRR to waive these caps. The 2016 Federal Oil and Gas Transportation Allowance Rule (2016 Rule) eliminated these exceptions, turning the "soft caps" into "hard caps."

The 2016 rule also tightened the gathering allowance. In 1999, the Minerals Management Service issued guidance to operators that 'gathering costs' for leases operating in water more than 200 meters deep could be included as transportation allowances. The 2016 Rule prohibited operators from taking a transportation allowance for the movement of oil or gas produced on the Outer Continental Shelf (OCS) from the wellhead to the first platform.

In 2017, ONRR postponed implementation and eventually repealed the 2016 Rule. Federal courts later ruled that both moves were illegal under the Administrative Procedures Act, and ONRR was forced to re-issue the original 2016 Rule with one small exception in October 2020. In the same month, however, ONRR also proposed a new rule ("2020 Rule") repealing many provisions of the 2016 Rule.

The 2020 Rule, which became final in January 2021, maintained the 50% hard cap on transportation allowances and 66.7% hard cap processing allowances. However, it did reinstate the ability of producers to apply for "extraordinary processing allowances." The rule also allowed producers to incorporate gathering costs in transportation allowances. In November 2021, ONRR withdrew that 2020 Rule.

Conclusion

Revenues from the collection of royalties represent one of the largest non-tax income sources for the federal government. Fair and accurate collection is necessary to ensure taxpayers are receiving what they are owed. Transportation and processing are a cost of doing business. Allowing companies to deduct these well known and expected costs before being charged a royalty is yet another subsidy to a highly profitable industry. Transportation and processing allowances should be eliminated or, at a minimum, be capped at 30% or lower to better ensure taxpayers receive a fair return from the development of our valuable resources.

¹ Taxpayers for Common Sense analysis of revenue data provided by the Office of Natural Resources Revenue (ONRR). Source: ONRR, "Revenue Data," accessed July 2, 2025. <https://revenue.data.doi.gov/query-data/?dataType=Revenue>.

² 30 § 1206.110 "What general transportation allowance requirements apply to me?"

³ U.S. Department of the Interior Office of Inspector General, "The U.S. Department of the Interior Does Not Analyze Effective Royalty Rates," June 2023. https://www.doi.ig.gov/sites/default/files/2021-migration/Final%20Inspection%20Report_EffectiveRoyaltyRates_Public.pdf

⁴ Office of Natural Resources Revenue, "Calendar year federal sales data, 2013 – 2024," accessed February 2026. <https://revenue.data.onrr.gov/downloads/federal-sales/>