AMERICANS FOR TAX REFORM
ENERGY TAX ANALYSIS
FEBRUARY 2010

The President's Fiscal Year 2011 budget calls for hundreds of billions of dollars in new taxes, fees and regulations on energy producers and every American family that uses energy. Americans for Tax Reform (ATR) created this informative document which analyzes the following specific niche issues with an energy-tax focus in mind.

Authored by Federal Affairs Manger, Brian M. Johnson, MPA & Federal Affairs Associate, Chris Prandoni.

- OVERALL FY2011 ENERGY TAX REVIEW
- AMORTIZATION RATES
- CELLULOSIC BIOFUEL TAXATION
- DEFERRED INTEREST DEDUCTION
- FOREIGN SOURCED INCOME TAXATION
- INTANGIBLE DRILLING COST
- LIFO EXPLAINED
- USE IT OR LOSE IT
- MARGINAL WELL TAXATION
- PASSIVE LOSS REPEAL
- PERCENTAGE DEPLETION
- IRS SEC. 199 REPEAL EXPLAINED
- SUPERFUND EXPLAINED
- TERTIARY INJECTANTS

Americans for Tax Reform (ATR) is a non-partisan national coalition of taxpayers and taxpayer groups who oppose a federal, state, and local tax increases. ATR is a non-profit 501(c)(4) lobbying organization.

Energy Tax Analysis 2010
2010 Americans for Tax Reform

Published by:
Americans for Tax Reform
722 12th Street NW, Suite 400
Washington, D.C., 20005

Phone: (202) 785-0266
Fax: (202) 785-0261

www.atr.org

For more information contact ATR Communications Director, John Kartch
jkartch@atr.org

Brian Johnson, MPA & Christopher Prandoni, Authors

ATR is a nonprofit, 501(c)(4) lobbying organization. Contributions to Americans for Tax Reform are not tax deductible. The Americans for Tax Reform Foundation is a 501(c)(3) research and educational organization. All contributions to the Americans for Tax Reform Foundation are tax deductible to the extent provided for in federal law.

722 12th Street N.W.
Fourth Floor
Washington, D.C.
20005
T: (202)785-0266
F:(202)785-0261
www.atr.org

ATR ENERGY TAX HIKE SERIES
OBAMA 2011 BUDGET ANALYSIS

Overall Energy Tax Review

Obama Energy Tax Proposals[1]

The President's FY 2011 budget contains hundreds of billions of dollars worth of new taxes on energy production and consumption. These taxes will result in higher prices at the pump, increased utility bills and less American energy jobs as companies flee the U.S. to avoid these industry crippling taxes. Below is a breakdown of some of energy taxes Obama supports:

	FY 2011	FY 2011-2020	Industry Impact
Increase Amortization Period	$44 million	$1 billion	$1 billion
Modify Cellulosic Biofuel Credit	$7 billion	$24 billion	$24 billion
Deferred Interest Deduction	$2 billion	$26 billion	$3 billion
Taxing of Foreign Earned Income	$3 billion	$59 billion	$8.5-12 billion
Repeal Percentage Depletion:			
o Oil and Natural Gas	$522 million	$10 billion	$10 billion
o Hard Minerals	$57 million	$1 billion	$1 billion
Repeal Intangible Drilling Cost	$1 billion	$8 billion	$8 billion
IRS Sec. 199 Repeal:			
o Oil and Natural Gas	$851 million	$17 billion	$17 billion
o Hard Minerals	$3 million	$57 million	$57 million
Repeal Tertiary Injectants	$5 million	$67 million	$67 million
Superfund	$1 billion	$18 billion	$17 billion
LIFO	$3 billion*	$59 billion	$23-26 billion
Passive Loss	$20 million	$180 million	$180 million

* Data for FY 2012. 2011 calculations were not available.

That's an energy tax increase of over $220,000,000,000 by 2020!

ATR Recommendations[2]

Congress should adopt the Senate's proposed "No Cost Stimulus Act," an alternative to the "Jobs Bill" that creates jobs without spending one cent. If this bill was made law, it would:

- Create 1.2 million long-term jobs by opening offshore mineral lease areas
- Provide more than $2.2 trillion in incremental tax receipts
- Extends state boundaries to 12 miles so states have control over their offshore areas
- Opens ANWR areas to create 730,000 American-based jobs
- Streamlines the nuclear licensing process to add 610,000 jobs to the economy
- Saves 500,000 per year by preventing the EPA from regulating CO2

[1] Visit www.atr.org for detailed information about each specific tax provision. All numbers were taken directly from the FY 2011 budget.

[2] Projections taken from provisions in the "No Cost Stimulus Act of 2010," introduced by Rep. Bishop (R-UT) and Senator Vitter (R-LA)

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES
OBAMA 2011 BUDGET ANALYSIS

Amortization Period Increase

Current Law
According to IRS Publication 535, "Business Expenses", the current law states: You can amortize the cost of geological and geophysical expenses paid or incurred in connection with oil and gas exploration or development within the U.S.

These costs can be amortized over a 24-month period beginning on the mid-point of the tax year in which the expenses were paid or incurred. For major integrated oil companies (as defined in section 167(h)(5)) these costs must be amortized ratably over a 5-year period for costs paid or incurred after May 17, 2006 (a 7-year period for costs paid or incurred after December 19, 2007).

Obama 2011 Budget
Increase the amortization period to seven years will result in a **$44 million tax increase for energy companies in 2011 and a $1.1 billion tax increase by 2020.**

ATR Analysis
Raising taxes on oil companies by increasing the amortization period of geological and geophysical (G&G) expenditures makes U.S. oil and natural gas exploration projects less competitive globally, thereby discouraging new U.S. production and increasing the nation's reliance on imported oil. Almost all large oil and gas companies are publicly-traded entities, whose shares are owned by millions of investors through their 401(k) plans, retirement plans and pension funds. Taxing away the earnings of those companies negatively impacts the ability of hard-working Americans to achieve a more financially secure future.

Further, this tax will be passed on to every American family in the form of higher energy costs.

Increasing the amortization period results in A CORPORATE INCOME TAX INCREASE and is therefore a PLEDGE VIOLATION *unless* the increase is offset completely with other income tax cuts.

34 Senators and 172 Congressmen have signed the Taxpayer Protection Pledge. In so doing, they promised to their constituents and the American people that they would "oppose any net reduction or elimination of deductions or credits…"

> Note: Budget neutrality (which is concerned with deficits) has no role in determining applicability of the Pledge. Rather, tax revenue neutrality (as scored by the JCT) is the only relevant metric for the purposes of the Pledge.

AMERICANS for TAX REFORM

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2011 BUDGET ANALYSIS

Modify Cellulosic Biofuel Credit

Current Law

Taxpayers who produce and use cellulosic biofuel are eligible for a tax credit. Cellulosic biofuel is defined as "any liquid that is produce from any ignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis and meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency under section 211 of the Clean Air Act. (Obama budget)"

Obama 2011 Budget

This Obama budget has proposed to change the requirements necessary to receive the aforementioned tax credit. Many paper companies produce a biofuel that qualifies them for the cellulosic tax credit, the Obama budget seeks to rescind this credit raising taxes on paper companies by **$6.569 billion in 2011 and 24 billion by 2020.**

ATR Analysis

When wood is turned into pulp to make paper the process creates a byproduct called black liquor. Black liquor, an extremely energy efficient fuel, is used by paper companies to power their mills. Eligibility for the tax credit, which was 50 cents per gallon, was predicated on mixing at least 0.1% diesel fuel with black diesel.

The paper and pulp industry in the United States is a relatively small earning $68 billion in 2006.[1] In 2011 alone, Obama's budget proposals represent a 9.5% increase on paper and pulp companies, an enormous amount.

[1] http://en.wikipedia.org/wiki/Pulp_and_paper_industry_in_the_United_States

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR Energy Tax Hike Series
Obama 2011 Budget Analysis

Deferred Interest Deduction for Energy Companies

Current Law
In the simplest of terms, energy companies based in the United States who have foreign operations are allowed to claim a income tax deduction on their US taxes for foreign expenses.

This allows companies to deduct their expenses in the year they were incurred.

Traditionally, oil producers have been able to deduct approximately 15% of their income while coal producers have deducted 10%. Comparatively, sulphur and uranium producers have been able to deduct 22%.

Obama 2011 Budget
The Presidents proposed budget will prevent companies from being able to deduct expenses related to foreign activity until profits from those activities are repatriated to the US.

This forces the companies to realize their profits first before they can deduct expenses.

ATR Analysis
In this instance, a deduction delayed is a deduction denied. By waiting until the foreign earned profits are repatriated, inflation has eaten away at the real value of the deduction.

For example, assuming a historical inflation rate of 3 percent, a $10,000 tax deduction would only be worth $5,000 in less than 25 years. Many of the investments made by energy companies overseas are long-term projects whereby real profits may not realized until years later.

The impact on the oil and gas industry is expected to be $2.6 billion – a cost that will be passed onto consumers in the form of higher energy prices.

AMERICANS for TAX REFORM

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2011 BUDGET ANALYSIS

Taxing of Foreign Earned Income

Current Law

When company X's subsidiary earns income in a country not the United States, the subsidiary's income is subject to the countries system of taxation that it was earned in. When company X wants to bring the subsidiaries earnings back to the US, the subsidiary's profits, which were already taxes by a foreign country, are then taxed again by the US government.

Obama 2011 Budget

The Obama budget includes provisions to modify how dual capacity taxpayers report income and reform the rules allowing deferral of certain foreign income. By changing common accounting techniques these new provisions will raise taxes on American energy companies by **$8.5-12 billion by 2020.**

ATR Analysis

Tax disincentive efforts focus on the punitive measures against foreign operations of U.S. based oil and gas companies. Subjecting American energy companies to double taxation will greatly impact foreign and domestic investments putting American companies at a competitive disadvantage.

The Obama tax increase has two components: it looks to determining tax credits on a pooling basis and prevent the splitting of foreign income and foreign takes.

Currently, foreign sourced income is taxed according to two separate categories: general and passive. While it differs slightly country by country, 'passive income is income from capital gains, dividends, investments and so forth. 'General' income is all other income and is taxed at a higher rate than passive income. The Obama budget proposes to end the present distinction between passive and general income. Conflating the two categories, passive and general, results in a net tax increase because the majority of income earned is general and is taxed at a much higher rate.

The second way this year's budget looks to raise money is by "splitting" creditable foreign taxes from associated foreign income. As such, a tax credit could be allowed for foreign taxes on income not subject to U.S. federal income tax.

AMERICANS for TAX REFORM

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2011 BUDGET ANALYSIS

Repeal Expensing of Intangible Drilling Costs

Current Law

To encourage companies to continue developing oil deposits, they have the option to expense intangible drilling costs (IDC). Expensing IDC has proved vital in attracting investment in large up-front-risk projects, such as oil and natural gas exploration. Expensing costs include: labor, fuel, repairs, hauling, and supplies necessary for drill preparation and well construction.

Obama 2011 Budget

Obama's budget repeals IDC expensing which increases taxes by **$1.202 billion in 2011 and $7.839 billion by 2020.**

ATR Analysis

Since drilling costs are not liquid, a company cannot sell a hole, mining operations have been allowed to deduct these costs as first year expenses. Otherwise, oil explorers recover their initial investment over the lifespan of the property through its depreciation allowance. As such, explorers in failed mining operations will never recover their drilling costs deductions.

IDC remains relevant because although technology has advanced, concurrently has the difficulty of drilling operations. So while technology has opened up the potential for Lower Tertiary Trend mining it remains a precarious investment. Should IDC be repealed many American oil reserves could remain untapped, it would be too risky to develop them. Considering how much oil and natural gas Americans consume, it would be imprudent to discourage investors looking to develop and cultivate American oil reserves.

Repealing IDC undermines domestic oil production and increases American reliance on foreign oil. Decreased American oil production will inevitably lead to higher unemployment as fewer oil ventures will be undertaken. Similarly, less oil production will have the unintended consequence of decreasing government revenue. It is for all of these reasons that well-established IDC practices should remain in place.

AMERICANS for TAX REFORM

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2010 BUDGET ANALYSIS

LIFO Explained

Current Law

When companies purchase items to sell later, they are accumulating an "inventory." When a good is sold, the profit is the sales price minus the inventory cost. Since 1938, companies have had a choice when determining which parts of their inventory they report to calculate the profit on a good sold. Under "first-in, first-out" (FIFO), the oldest parts of the inventory are what are used to make this determination. Many companies, however, choose to use the "last-in, first-out" (LIFO) method, whereby the newest inventory purchased is what's used in the profit calculation.

The LIFO method is most valuable for companies that see the prices of their inventory rise over time. Let's say I have a $10 item I bought several years ago, and a $12 item I bought this year. I want to sell an item for $15. FIFO inventory gives me a profit of $5 ($15-$10). LIFO inventory gives me a profit of $3 ($15-$12). I would only pay taxes on $3 of profit, not $5.

The difference between the FIFO profit ($5) and the LIFO profit ($3) is $2. This $2 becomes part of a "LIFO reserve." Companies must keep track of this LIFO reserve, which in recent years has been the target of tax increase proposals by members of both political parties.

Obama 2011 Budget

The FY 2011 Administration Budget calls for **$60 billion over ten years in new taxes.** This impact directly raises taxes on the oil and gas industry by **$23-26 billion in new taxes.**

ATR Analysis

Companies should not have to pay taxes merely on inflation. Yet that is exactly what forcing companies to use FIFO would do. At the very least, companies using a long-standing and perfectly-reasonable inventory accounting standard should not be punished after the fact by being taxed on phantom "reserves."

LIFO is used most often by energy companies. **Taxing LIFO reserves is a clear attempt to slap an unfair tax on energy manufacturers merely to exact a political price. The economic price will be borne by the American people, who will end up paying this "inventory tax" in the form of higher energy prices.** The most likely scenario is that taxing LIFO reserves and requiring FIFO going forward will be imposed strictly on energy manufacturers. It's the ultimate goal of tax increasers, though, to repeal LIFO altogether.

AMERICANS for TAX REFORM

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2011 BUDGET ANALYSIS

Marginal Well Tax Credit Repeal

Current Law

Marginal oil wells are those which produce 15 barrels of heavy oil or less per day or those that produce less than 95 percent water and 25 barrels per day or less. Marginal gas wells are those which produce 90 Mcf or less in one day.

The tax credit is $3/barrel for the first three barrels of daily production and $0.50 per Mcf tax credit for the first 18 Mcf of natural gas. The tax credit phases in and out in equal increments as prices fluctuate. Price triggers are based on average annual wellhead prices.

Obama 2011 Proposal

The FY 2011 Administration Budget, approved and submitted by President Obama, calls for a full repeal of the tax credit for oil and gas produced from marginal wells.

ATR Analysis

The benefits of this tax credit to smaller producers cannot be overstated. The Department of Energy estimates that **the repeal of this tax credit will cost 140,000 barrels of oil per day or a loss of $10.5 million per day**. Despite the smaller production from these wells, there are an estimated 650,000 marginal oil & gas wells in the United States employing millions of people. Raising taxes on energy production will cost jobs and increase the price of energy.

America's marginal oil wells produce the amount equivalent to 50 percent of the amount imported from Saudi Arabia – increasing this tax credit will hurt domestic supply.

Repealing this tax credit without offsetting tax relief is a net tax increase and a Taxpayer Protection Pledge violation. This tax credit is not a spending program, and eliminating it is not a reduction of government spending—it is a tax increase. 34 Senators and 172 Congressmen have signed the Taxpayer Protection Pledge. In so doing, they promised to their constituents and the American people that they would "oppose any net reduction or elimination of deductions or credits…"

Repealing the Section 199 deduction IS A CORPORATE INCOME TAX INCREASE and is therefore a PLEDGE VIOLATION *unless* the increase is offset completely with other income tax cuts.

> Note: Budget neutrality (which is concerned with deficits) has no role in determining applicability of the Pledge. Rather, tax revenue neutrality (as scored by the JCT) is the only relevant metric for the purposes of the Pledge.

722 12th Street N.W.
Fourth Floor
Washington, D.C.
20005
T: (202)785-0266
F:(202)785-0261
www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2011 BUDGET ANALYSIS

Passive Loss Exception Repeal

Current Law

A generation ago, "tax shelters" were popular and legal tax-avoidance strategies. The most common form a tax shelter took back then was for someone to become a limited partner in a partnership that had losses year after year. These losses would be passed along to the partner-investor, who would use them to offset other income. There were few restrictions on this practice.

That all changed in 1986 with the passage of the Tax Reform Act. Congress required "passive losses" (losses incurred by businesses in which the taxpayer didn't have any material participation) to be carried forward, not used against other income. The losses from the passive activity now can only be realized if the activity eventually turns a profit, or when the investor sells his interest in the activity. This legislative change drove a stake through the heart of the tax shelter industry.

Congress made several exceptions to the passive loss rule, though. One of these was a working interest in an oil or gas property. For these investments, the rules are much like they were before 1986.

Obama 2011 Budget

Repealing the passive loss exception for working interests in oil and gas properties will result in a **$20 million tax increase in 2011 and $180 million tax increase by 2020.**

ATR Analysis

This is a clear and blatant attempt to increase taxes on America's energy manufacturing sector. **The policy rationale behind the passive loss exception in current law is debatable, but repealing it should only be done in the context of further tax reform.** <u>If the federal government is going to be a full partner in your profitable years, and a deferred partner in your losing years, then you ought to at least get lower tax rates out of the deal. Under no circumstances should this exception be repealed in the context of a net tax hike.</u>

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR Energy Tax Hike Series

Obama 2011 Budget Analysis

Repeal of Percentage Depletion

Current Law

The IRS defines depletion as "the using up of natural resources by mining, quarrying, drilling, or felling. The depletion deduction allows an owner or operator to account for the reduction of a product's reserves." For over a century there have been two ways to calculate deductions: cost depletion and percentage depletion.

The preferred method of deduction, percentage depletion allows the producer to deduct the gross income derived from extracting fossil fuels or other minerals. Originally implemented to encourage domestic development of natural resources, percentage depletion allows for producers to collect a percentage, depending on the resource being mined, of their income tax-free.

Traditionally, oil producers have been able to deduct approximately 15% of their income while coal producers have deducted 10%. Comparatively, sulphur and uranium producers deduct 22%.

Obama 2011 Budget

- Impact on oil and natural gas: Repealing percentage depletion will raise taxes by **$522 million in 2011 and 10.026 billion by 2020**
- Impact on hard mineral fossil fuels (coal): – Repealing percentage depletion will raise taxes by **$57 million in 2011 and $1.062 billion by 2020.**
- Total impact: **$579 million tax increases in 2011 and 11.088 billion in tax increases by 2020**

ATR Analysis

Mining natural resources continues to be one of the riskiest investments and requires enormous amounts of capitol. Furthermore, it may take years to recuperate investments because resource extraction does not begin immediately. Percentage depletion has gone a long way to alleviate the concerns of investors and small companies, its repeal will only add uncertainty to already weary producers.

While producers of other minerals (gravel, clay, gold, etc) will be allowed to continue percentage depletion discounts, oil, natural gas and coal producers will face enormous tax increases.

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2011 BUDGET ANALYSIS

IRS Sec. 199 Repeal

Current Law

The Internal Revenue Code (IRC) Section 199, the Domestic Production Activities Deduction, benefits all companies who produce goods on American soil – yet only energy companies are targeted for the cuts in deduction rates.

Prior to harmful energy legislation passed last Congress, businesses engaged in a qualifying production activity were eligible to take a tax deduction of 3% of the profits from this qualifying activity in tax years 2005 and 2006. The deduction increases to 6% of profit in 2007, 2008, 2009, totaling 9% in years 2010 and beyond.

However, the Pelosi-Reid energy agenda has implemented a Sec. 199 "freeze" at 6% - only for energy companies, thus further carving out their niche for non-traditional energy.

Obama 2011 Budget

- Impact on oil and natural gas: Repealing Sec. 199 will result in a **$851 million corporate income tax increase in 2011 and a $17.314 billion tax increase by 2020**
- Impact on hard mineral fossil fuels (coal): Repealing Sec. 199 will result in a **$3 million corporate income tax increase in 2011 and a $57 million tax increase by 2020**
- Total impact: Repealing Sec. 199 will result in a **$854 million tax increase by 2011 and a $17.371 billion tax increase by 2020.**

ATR Analysis

Culling America's most productive energy sources for the purposes of taxation can only lead to higher energy prices for Americans. Energy companies will not pay the tax increase a repeal of Sec. 199 prompts, consumers will. This tax will be passed on to every domestic manufacturer, business, and American. Furthermore, a repeal of Sec. 199 undermines the 6 million workers that makeup the oil and natural gas industry in the U.S. as it effects only domestic oil production.

Repealing the Section 199 deduction IS A CORPORATE INCOME TAX INCREASE and is therefore a PLEDGE VIOLATION *unless* the increase is offset completely with other income tax cuts.

34 Senators and 172 Congressmen have signed the Taxpayer Protection Pledge. In so doing, they promised to their constituents and the American people that they would "oppose any net reduction or elimination of deductions or credits…"

> Note: Budget neutrality (which is concerned with deficits) has no role in determining applicability of the Pledge. Rather, tax revenue neutrality (as scored by the JCT) is the only relevant metric for the purposes of the Pledge.

722 12th Street N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F:(202)785-0261

www.atr.org

ATR ENERGY TAX HIKE SERIES

OBAMA 2011 BUDGET ANALYSIS

Superfund Explained

Current Law

Superfund excise taxes were imposed in years before 1996. They included a tax on domestic crude oil and imported petroleum products at a rate of $9.7 per barrel; a tax on hazardous chemicals at a varying rate of $0.22 to $4.87 per ton; and a tax on imported substances that use hazardous materials in their production.

The Superfund Environmental Income Tax refers to a corporate environmental income tax imposed before January 1, 1996 at a rate of 0.12 percent for corporations whose incomes exceeded $2 million.

The revenue from these taxes was assigned to the Hazardous Substance Superfund Trust Fund. Money from the Superfund Trust Fund was available for expenditures related to hazardous substances released into the environment.

Obama 2011 Budget

The Obama budget reinstates the **Superfund taxes which are expected to cost approximately $19 billion over 10 years.**

ATR Analysis

Superfund was initially conceived as a way to target companies as potential victims of trial lawyer activists. Companies who have been accused of alleged improper hazardous waste disposal are not only targeted by bureaucrats, but trial lawyers milking the Superfund with extraneous lawsuits, trolling for potential "victims" of the alleged environmental violation.

Not only are the owners of said company liable for alleged damages, so is anyone who was operating or working at the site at the time, any worker or non-employee who took part in arranging the alleged improper disposal, or any person who transported any material to the site.

Simply put, if you are the unfortunate worker who happened to be transporting materials or signed a shipping order on the day the trial lawyers show up, not only could you lose your job, but face a massive EPA-backed lawsuit.

Superfund is nothing more than a slush-fund for trial lawyers by which they use the tools of the government to identify potential "victims".

722 12th Street N.W.
Fourth Floor
Washington, D.C.
20005
T: (202)785-0266
F:(202)785-0261
www.atr.org

ATR ENERGY TAX HIKE SERIES
OBAMA 2011 BUDGET ANALYSIS

Raises Taxes on Tertiary Injectants

Current Law

In order to mine inaccessible oil reserves, oil producers often inject liquids and gasses into an oil well's surrounding area, a process called tertiary injection. Domestic oil producers deduct the costs incurred from the tertiary injection process. Expenses that oil companies claim as deductions are: the cost of acquiring or producing the tertiary injectants, the costs associated with injecting, reinjecting, and recovering the purchased and produced tertiary injectants.

Obama 2011 Budget

The administration has proposed to repeal tertiary injectants deductibility status. Doing so would raise taxes on energy producers by **$5 million in 2011 and $67 million by 2020.**

ATR Analysis

Changing how tertiary injections are listed under the tax code, from deductible to capital, will raise the initial investment required by producers looking to extract oil. Section 193 of the IRS code states that oil producers should be able to deduct "costs related to injecting a substance with a transitory *effect on production*" and "costs of producing and reinjecting gas or hydrocarbon liquids utilized in a recycling process." Thus, if tertiary injectant deductions bolstered oil production, as the IRS code explicitly states, then rescinding it will have the oppose effect – stifling production.

The purpose of the deduction was to help producers pay for the high costs associated with tertiary injection. Changing how producers recover their initial investment could force companies to shut in older fields which would adversely affect local economies. In many tertiary injection projects carbon dioxide is the gas used to gain access to oil deposits. Utilizing carbon dioxide in enhanced oil recovery projects is one of the primary ways to prevent carbon dioxide from escaping into the atmosphere; keeping deductions for tertiary injectants would encourage this process.

Considering America's oil and natural gas industry is one of the largest, supporting more than 9 million jobs, increases the cost of energy for every American family.

Americans for Tax Reform (ATR) opposes all tax increases as a matter of principle.

We believe in a system in which taxes are simpler, flatter, more visible, and lower than they are today. The government's power to control one's life derives from its power to tax. We believe that power should be minimized.

ATR was founded in 1985 by Grover Norquist at the request of President Reagan.

The flagship project of Americans for Tax Reform is the Taxpayer Protection Pledge, a written promise by legislators and candidates for office that commits them to oppose any effort to increase income taxes on individuals and businesses. Since ATR first sponsored the Pledge in 1986, hundreds of U.S. Representatives, more than fifty U.S. Senators and every successful Republican Presidential candidate have all signed the Pledge. In the 111th Congress, 172 U.S. Representatives and 34 U.S. Senators have taken the Pledge never to raise income taxes.

Americans for Tax Reform began promoting the Taxpayer Protection Pledge on the state-level in the early 1990s.

ATR works with state taxpayer coalitions in all 50 states to ask candidates for state legislature and constitutional office to sign the State Taxpayer Protection Pledge, which reads: "I _____ pledge to the taxpayers of the __________ district, of the state of __________, and to all the people of this state, that I will oppose and vote against any and all efforts to increase taxes."

Additionally, Americans for Tax Reform works with state-based center-right groups to help replicate ATR's national Wednesday Meeting in the states. Currently, there are over 50 meetings in 46 states. These meetings bring together a broad cross section of the center-right community- taxpayer groups, social conservative groups, business groups, legislators, etc., to promote limited government ideals.

Realizing that Americans not only need to be protected from higher taxes, but from higher spending; Americans for Tax Reform created the Center for Fiscal Accountability (CFA) in 2008. CFA focuses on all central issues related to fiscal responsibility and accountability, especially spending restraint and the promotion of a more transparent and accountable government on the local, state, and federal level through easily searchable online spending and contract databases.

Americans for Tax Reform and Americans for Tax Reform Foundation also sponsor the annual calculation of Cost of Government Day (COGD), the day on which Americans stop working to pay the costs of taxation, deficit spending, and regulations by federal and state governments.

ATR is a nonprofit, 501(c)(4) lobbying organization. Contributions to Americans for Tax Reform are not tax deductible. The Americans for Tax Reform Foundation is a 501(c)(3) research and educational organization. All contributions to the Americans for Tax Reform Foundation are tax deductible to the extent provided for in federal law.