America's Oil & Gas Producers

Marginal Well Tax Credit

In 2004, Congress enacted an IPAA advocated Marginal Well Production Tax Credit amendment to the Internal Revenue code that established a tax credit for existing marginal wells.

> ***Preserving marginal wells is central to our energy security. Neither government nor the industry can set the global market price of crude oil. Therefore, the nation's internal cost structure must be relied upon for preserving marginal well contributions.***
>
> **National Petroleum Council**
> ***Marginal Wells* Study 1994**

Marginal oil wells are those with average production of not more than 15 barrels per day, those producing heavy oil, or those wells producing not less than 95 percent water with average production of not more than 25 barrels per day of oil. Marginal gas wells are those producing not more than 90 Mcf a day.

The provision allows a $3 a barrel tax credit for the first 3 barrels of daily production from an existing marginal oil well and a $0.50 per Mcf tax credit for the first 18 Mcf of daily natural gas production from a marginal well.

The tax credit is in and out in equal increments as prices for oil and natural gas fall and rise. Prices triggering the tax credit are based on the annual average wellhead price for all domestic crude oil and the annual average wellhead price per 1,000 cubic feet for all domestic natural gas. The credit for the current taxable year is based on the average price from the previous year. The phase in/out prices are as follows:

OIL – phase in/out between $15 and $18

GAS – phase in/out between $1.67 and $2.00

For producers without taxable income for the current tax year, the amendment provides a 5-year carryback provision allowing producers to claim the credit on taxes paid in those years.

A principal recommendation of the National Petroleum Council's *Marginal Wells* report was the creation of a countercyclical marginal well tax credit.[1] The Dept. of Energy has evaluated the benefits of a tax credit and believes that it could prevent the loss of 140,000 barrels per day of production if fully employed during times of low oil prices like those of 1998 and 1999. This countercyclical credit established a safety net of support for these critical wells.

Eighty-five percent of all American oil wells are marginal wells, but they provide 20 percent of American oil production. Seventy-four percent of all American natural gas wells are marginal wells, providing 12 percent of American natural gas production.

The Obama Administration proposes to repeal the marginal well tax credit. Removal of this important safety net for American production should be opposed.

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[1] It also recommended expanding the Enhanced Oil Recovery tax credit, an inactive well recovery tax credit, and expensing of capital expenditures associated with marginal wells.

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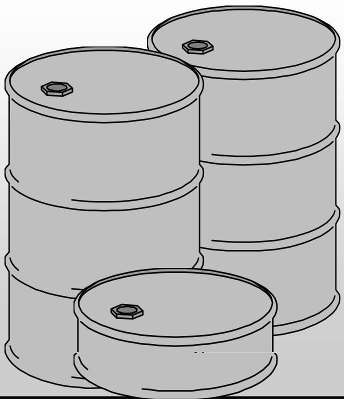
Marginal Oil Well Facts

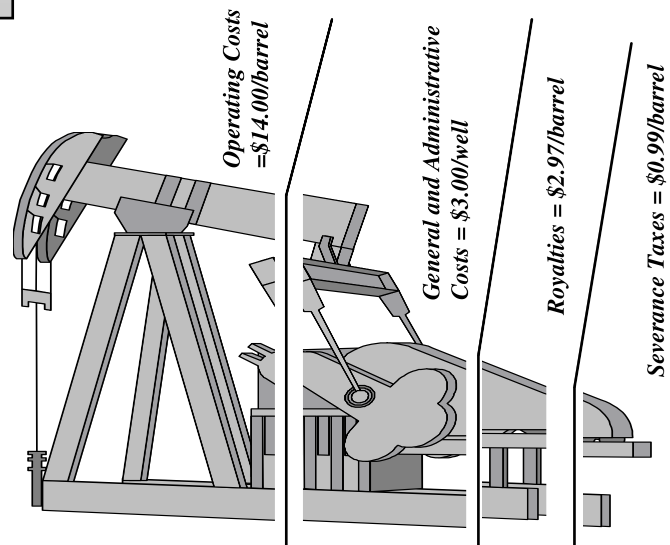


The average marginal well produces 2.2 barrels of crude oil per day

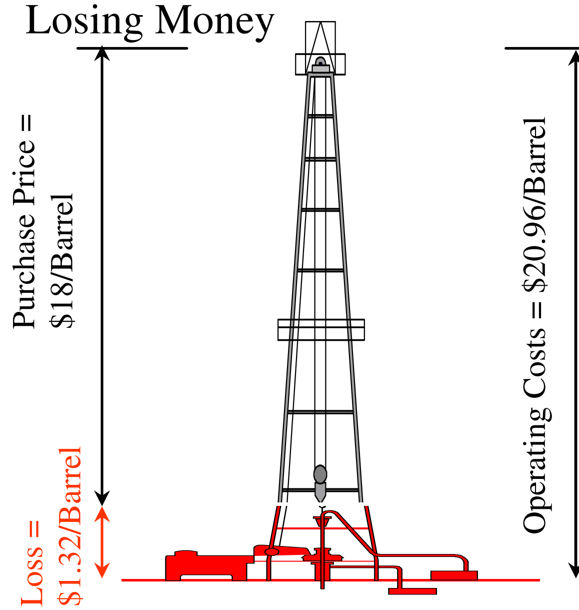
Altogether America's marginal oil wells produce crude oil equivalent to 50 percent of the amount imported from Saudi Arabia.

The Operating Costs of A Marginal Oil Well

When oil sells for $18 a barrel, the average marginal well costs $20.96 per barrel to operate.



Losing Money



At an $18/Barrel purchase price, the average marginal well loses $1.32/Barrel or $2.91 per day. Annually, the loss per well would be $1062. For a typical operator of 100 wells, annual losses would exceed $100,000