INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

November 19, 2012

The Honorable Harry Reid
Majority Leader
United States Senate
Washington, DC

The Honorable John Boehner
Speaker
United States House of Representatives
Washington, DC

The Honorable Mitch McConnell
Minority Leader
United States Senate
Washington, DC

The Honorable Nancy Pelosi
Minority Leader
United States House of Representatives
Washington, DC

The development of America's abundant oil and natural gas reserves has generated millions of dollars in state, local and federal revenues while creating tens of thousands of good jobs and bolstering America's national and economic security. Federal tax policy can enhance or impede – or devastate – the success of this development. Changing tax policy in the chaos of negotiations during a lame duck session of Congress presents a risk to American energy development that must not occur.

Much of the argument for changing tax policy for American oil and natural gas producers comes from a common misperception that the nation's oil and natural gas producers receive taxpayer subsidies. This is flatly wrong. Businesses, across sectors of the economy, are taxed on their earnings after the costs of doing business are deducted. Most businesses—like the oil and natural gas industry—deduct various operating expenses. Subsidies however take the form of direct payments from the government.

In fact, IPAA member companies receive many of the same federal tax deductions provided to a broad range of other industries, ranging from Starbucks to Apple and almost every American manufacturer.

In the most basic terms, these provisions – which are not handouts – aim to encourage the further reinvestment in American energy development and, of course, continued job creation and more revenues. As history has shown, America's economic health and energy security are uniquely connected. These common sense and historic tax provisions seek to ensure the continued safe development of our job-creating, revenue-generating American energy resources.

Since the beginning of the US tax code, America's independent oil and natural gas producers have been able to deduct various drilling-related costs. These "intangible drilling costs" typically represent 65 to 80 percent of the capital expenditure budget of independent producers. The Obama Administration has proposed the termination of this tax deduction. Eliminating the tax deduction for drilling costs at current tax rates will cut independents' capital budgets by 25 percent. This will hurt independent producers – companies that develop 95 percent of America's oil and natural gas – and constrain, rather than expand, access to American energy supplies, costing American jobs, and limiting energy-related revenues.

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA ▪ 1201 15TH STREET, NW ▪ SUITE 300 ▪ WASHINGTON, DC 20005
202-857-4722 ▪ FAX 202-857-4799 ▪ WWW.IPAA.ORG

Another targeted provision in the Administration's budget request would terminate the use of the percentage depletion deduction for oil and natural gas. All mineral resources are permitted to use percentage depletion as a way to reflect the decreasing value of the resource as it is produced. Originally added to the tax code in 1926, the oil and natural gas percentage depletion allowance only applies to America's smaller independent producers—the average employs 12 people—and royalty owners. Loss of this deduction puts America's "marginal" wells at risk – wells that produce 20 percent of US oil and about 13 percent of US natural gas.

America's independent oil and natural gas producers have historically reinvested as much as 150 percent of their American cash flow back into American production to create jobs and energy supplies here at home. In 2010 alone, independent producers were estimated to have paid over $69 billion in federal and state taxes, while employing more than 500,000 workers in the exploration and production. These workers earn wages more than 50 percent higher than the average of all American manufacturing jobs. With unemployment near 8 percent, the nation has arguably never needed this industry's resilience as much as it does right now.

Recently, the International Energy Agency estimated that the US could become the world's largest oil producer and the world's largest natural gas producer within a decade. The implications of such success can affect both the American economy and its foreign policy. Yet, a workable, common sense tax structure is critical to continue this much-needed development of American energy. Any changes need to be carefully considered and thoroughly evaluated. Consequently, modifying the federal tax code during the waning days of the 112th Congress could put all of this future in jeopardy. We ask that energy policy tax decisions should be removed from any negotiations on the debate over the "fiscal cliff".

Sincerely,

Virginia B. Lazenby

Virginia Lazenby
Chair
Independent Petroleum Association of America

Barry Russell

Barry Russell
President and CEO
Independent Petroleum Association of America