

Plowback Incentive

Fundamentally, the question facing the nation is how to marshal the capital to develop its domestic resources. The 1999 NPC *Natural Gas* study estimates that an additional \$10 billion over and above the current expenditure level will need to be invested annually in domestic production over the next fifteen years to meet the expected demand. To date this target has not been met; capital expenditures are essentially flat. At issue is how to obtain capital for domestic development. Independent producers are risk takers who will invest capital if it is available to find and produce more oil and natural gas. To encourage additional investment a method needs to be created to “plow back” as much of the revenue from oil and natural gas sales as possible to develop new production. Structuring the federal tax code to allow greater revenues to be retained by energy producers who reinvest those revenues into new exploration and production can enhance domestic investment.

Proposal Alternatives

- 1) *A special deduction from gross income from the well would be allowed for an amount equivalent to 50% of the costs incurred in the drilling and development of domestic oil and natural gas wells after December 31, 2001. These costs would include all Intangible Drilling Costs, Geological & Geophysical costs, equipment and related costs. In the event of a dry well, the costs would be allowed to offset qualifying gross income from other productive wells with any excess carried forward to offset future qualifying income of the taxpayer. Qualifying income is gross income from an oil or gas well which was completed or re-completed by incurring additional qualifying costs after December 31, 2001. The deduction is from gross income and would not reduce the costs or deductions generated by the expenditures themselves. Deductions in excess of gross income from a well could be carried forward or carried back to offset qualifying income from that well. If a well were plugged and abandoned prior to complete utilization of the deduction, the balance would be treated similarly to dry hole costs.*
- 2) *A 10% tax credit, based on the total drilling and development costs for wells drilled after 2001. These costs would include all Intangible Drilling Costs, Geological & Geophysical costs, equipment and related costs. The credit would apply against both the regular tax and the Alternative Minimum Tax. It could be carried back and carried forward. In order to obtain the credit, the taxpayer must be able to demonstrate that he has expended a like amount on similar development activity within 12 months following the end of the tax year to which the credit applies.*

Reason for Change

The challenge is to create a mechanism to direct the capital to domestic production. One such approach would be to create a “plowback” incentive that would apply to expenditures for domestic oil and natural gas exploration and production. This type of proposal would encourage capital formation and development of domestic wells provided it was immediately beneficial. It would address the compelling need to improve natural gas supply as well as reduce the growing dependency on foreign oil. It must, in fact, apply to both oil and natural gas because they are

inherently intertwined – often found together. Moreover, because of their inherent link, a healthy domestic natural gas exploration and production industry cannot exist without a healthy comparable oil industry.

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