



January 17, 2014

The Honorable Max Baucus
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

tax_reform@finance.senate.gov

Re: Comments on Staff Discussion Draft on Cost Recovery

Dear Chairman Baucus:

The below-listed organizations appreciate the opportunity to comment on the Staff Discussion Draft on Cost Recovery and Accounting released on November 21, 2013. We will focus our comments on the Discussion Draft's proposed repeal of percentage depletion.

Section __25 of the Discussion Draft would terminate the percentage depletion deduction for mines, wells, and natural deposits (IRC §613) and oil and gas wells (IRC §613A) placed in service after December 31, 2014. We believe this proposed change is unwarranted and that, if enacted, it would significantly harm the competitiveness of American natural resources industries. U.S. mineral, coal, natural stone, aggregates, and independent oil and gas producers, play an integral role in fostering continued American economic prosperity and energy security. The percentage depletion deduction is vitally important to these U.S. natural resources operations and should be retained.

Current Tax Law on Percentage Depletion:

Under longstanding law, taxpayers producing from mines, wells, and other natural deposits are allowed to claim as a deduction for depletion a percentage of the gross income from these properties. This percentage deduction rate varies depending on the type of product produced. For example, and subject to various tax law

limitations, the percentage depletion deduction is 5 percent for sand and gravel, 10 percent for coal, and 15 percent for gold, silver, copper, iron ore, and certain oil and natural gas production.

The percentage depletion deduction is an essential component of American mineral, coal and other natural resources production operations and manufacturing operations and must be retained. The percentage depletion tax deduction recognizes the unique nature of resources investments, which require significant financial commitments to long-term projects to deliver a competitive product at a low margin.

Congress created percentage depletion because it recognized that the limitations of cost depletion resulted in premature loss of important mineral resources. With percentage depletion, Congress intended to ensure that these essential national assets would be fully developed and produced.

The percentage depletion deduction provides an effective way to account for the diminution of reserves within mines, wells, and other natural deposits, encouraging domestic production by providing a tax incentive to improve the cash flow for production operations. The quantity and quality of reserves for any particular property may be uncertain and most natural resources projects require a large amount of investment and long lead time to produce a product with unknown revenue streams. Percentage depletion was enacted so that the natural resources industries could account for the uncertainty in reserves and future revenues when investing in and developing and operating production projects in the United States. Maintaining a strong natural resources production sector and limiting our dependence on foreign production is critical to the growth of the U.S. economy.

Mineral Resources

Even with the percentage depletion tax deduction, the U.S. tax burden on mining and other American resources operations puts them at a significant competitive disadvantage.

U.S. Mining:

Mining producers provide 42% of the nation's electricity through affordable coal power and an additional 19% through uranium powered nuclear plants – totaling 61% of our nation's electricity supply. Hardrock mining provides essential minerals for commercial use as cost-effective inputs for farms, national defense systems, and high technology such as cell phones, hybrid cars and minerals for the manufacturing base. Ores and metals are used in the production of capital goods for manufacturing and construction. Essential electronic, telecommunications and medical processes depend on metals. Non-metallic minerals are used in agriculture as fertilizers, in medicine as pharmaceuticals and in construction and other industrial processes.

The mining industry has a combined direct and indirect employment of almost 2 million jobs in all 50 states. U.S. mining's total direct and indirect economic contribution to GDP was over \$225 billion in 2010 -- generating over \$50 billion in tax payments to federal, state and local governments. The value added to GDP by major industries that consume processed mineral materials was \$2.4 trillion in 2012. Mining exports added \$24 billion in positive contributions to America's balance of trade.

U.S. Aggregates Producers

Two billion metric tons of construction aggregates (crushed stone, sand and gravel) were produced in 2012 at a value of approximately \$17 billion, contributing \$40 billion to the GDP of the United States. The aggregates industry workforce is made up of about 110,500 men and women. Every \$1 million in aggregate sales creates 19.5 jobs, and every dollar of industry output returns \$1.58 to the economy. Nearly two-thirds of the non-fuel minerals mined each year in the U.S. are aggregates. There are more than 10,000 construction aggregate operations nationwide, including in virtually every congressional district. Construction aggregates are used primarily in asphalt and concrete. Ninety-four percent of asphalt pavement is aggregate; 80 percent of concrete

is aggregate, whether pavement ("horizontal construction") or buildings, dams, sewage treatment plants and the like ("vertical construction"). About 10 tons of aggregates per person are used annually in America. Every mile of interstate contains 38,000 tons of aggregates; about 400 tons of aggregates are used in construction of the average home. Crushed stone, sand and gravel products go into the manufacture of glass, paper, paint, pharmaceuticals, cosmetics, chewing gum, household cleansers and many other consumer goods, and are essential for the safety, security and high quality of life of all Americans.

Industrial Minerals

According to the United States Geological Survey (USGS), the total estimated value of U.S. production of industrial minerals, or non-fuel minerals, in 2012 was \$41.6 billion, and the industry employed over 100,000 men and women. Industrial minerals are a vital part of our everyday lives. These minerals, such as limestone, silica, soda ash, talc, kaolin, and calcium carbonate, are used extensively in various manufacturing processes. In an average working day you likely will come into contact with at least 100 items that have been manufactured from industrial minerals. Glass, paint, ceramic tiles and plates, wood flooring, drinking water, wines/beers, salt, sugar, detergents, cement and concrete and even cat litter are all manufactured using industrial minerals.

Natural Stone

Dimension stone is natural stone or rock that has been selected and fabricated to specific sizes or shapes. According to the USGS, approximately 1.7 million tons of dimension stone, valued at \$340 million, was sold or used by U.S. producers in 2012, and the industry employed approximately 3,000 people. Dimension stone was produced by 141 companies, operating 219 quarries, in 36 States. Dimension stone is used for numerous purposes including making countertops, tiles, stone monuments, building exteriors, roofing slate, street curbs, and flagstones.

Agriculture Nutrients

There are three primary nutrients, nitrogen (N), phosphorous (P) and potassium (K), which are essential for healthy plant growth and high quality food crop yields. Of these three essential nutrients, phosphorous and potassium are natural resources which are mined from the Earth.

Phosphate is a nonrenewable resource, and mined phosphate rock is the only known source of phosphate suitable for processing into phosphatic plant nutrients suitable for large scale crop yields necessary for domestic food security. Phosphorous, used for crop nutrition, is essential for plant photosynthesis and comes only from shallow-rock deposits around the globe, which are of limited extent within the United States. Without a reliable domestic supply of phosphate rock to process into plant nutrients, the security and economic stability of the U.S. food supply is at risk.

Potassium (NA), or potash, is also a natural resource necessary for the production of food crops. Potash is produced in only eleven countries worldwide. Two of those countries, China and Brazil, utilize all the potash they produce and import significant quantities. In fact, more than 100 countries are dependent on imported potash and must secure their supply from the 9 countries that have potash to export. The United States, the largest importer of potash, typically relies on imports for 85-90 percent of its potash supply. Therefore, any existing or new domestic sources should be utilized to help reduce our dependence on imports. The latest forecasts regarding potash show that worldwide demand will increase at an annual rate of 3 percent through 2017.

Currently, fertilizer use is responsible for approximately 50 percent of the world's food production. By 2050, the world must produce 70 percent more food to meet the needs of a growing population. In fact, 77 percent of the increase must come from higher yields, with 14 percent coming from increased cropping intensity and 9

percent coming from bringing more land into production. Without a reliable supply of essential nutrients like phosphorus and potash, it will simply be impossible to meet this demand for food.

Independent Oil and Gas Producers and Royalty Owners

Percentage depletion is a small and marginal oil and natural gas producer¹ and royalty owner issue because of the limitations placed on the deduction, for oil and natural gas, by current tax law.² Marginal wells are unique to the United States; other countries shut down these small operations. The percentage depletion deduction is essential to keeping marginal wells in operation. A change in existing law to deny percentage depletion could make many wells unprofitable on an after-tax basis and result in early abandonment (i.e. resources becoming shut in). Once shut down, marginal wells cannot be re-opened. A significant decline in marginal well production in the United States could increase the country's dependence on imported energy, exacerbate the problem of the trade deficit, and again make the United States vulnerable to concerted political or market action by foreign producers. Currently the U.S. marginal oil and natural gas base is significant. Approximately 80 percent of oil wells in the U.S. are marginal wells that produce 20 percent of U.S. oil, and 67 percent of natural gas wells produce 12 percent of U.S. natural gas. America's royalty owners are farmers, ranchers and families that benefit from their ownership of mineral assets and use these royalties to supplement retirement income and their farm and ranch incomes.

Question Posed by Staff:

In the Summary of the Staff Discussion Draft, the staff requested comments regarding whether small producers should continue to be eligible for percentage depletion (limited to cost basis) and, if so, how small producer eligibility should be determined and to what extent, if any, depletion rates should vary among resources. We appreciate that staff appear to have recognized that repeal of percentage depletion would have an adverse impact on affected taxpayers. However, we believe percentage depletion should be retained for all currently eligible taxpayers and that it should not be limited to small producers, however defined. Repeal of percentage depletion would have a significant adverse impact on future exploration and development for mines wells, natural deposits, and oil and gas wells regardless of the size of the producer. Also, we would note that the suggestion of continued percentage depletion eligibility, but limited to cost basis, is not in essence retention of percentage depletion; it is more in the nature of cost depletion with somewhat different timing for the claiming of the depletion deductions.

Summary:

We believe strongly that the Finance Committee should not impose what would amount to a massive tax increase on future U.S. mining, natural stone, aggregates or independent oil and gas operations by eliminating the percentage depletion deduction. While you have indicated that you intend to also reduce tax rates, rate reductions of the limited magnitude that have been discussed publically would not significantly ameliorate the tax increase resulting from percentage depletion repeal. This tax increase would raise the cost of doing business for U.S. producers and would threaten millions of U.S. jobs. Moreover, because mineral prices are established in world commodity markets, U.S. producers cannot easily pass on higher tax costs in the form of

¹ Marginal production is defined as crude oil and natural gas production from a stripper well property producing 15 barrels/day (90 mcf/d) or less or from production of heavy oil.

² Current tax law limits the use of percentage depletion of oil and gas in several ways. First, the percentage depletion allowance may only be taken by independent producers and royalty owners and not by integrated oil companies. Second, depletion may only be claimed up to specific daily American production levels of 1,000 barrels of oil or 6,000 mcf of natural gas. Third, the deduction is limited to 65% of net taxable income. Fourth, the net income limitation requires percentage depletion to be calculated on a property-by-property basis. It prohibits percentage depletion to the extent it exceeds the net income from a particular property. These limitations apply both for regular and alternative minimum tax purposes.

higher prices. A likely result of eliminating the percentage depletion deduction would be reduced American employment, increased electricity prices, and increased reliance on foreign producers for the materials used throughout our economy.

We very much appreciate the opportunity to provide our views on this crucial issue for natural resources industry members.

Sincerely,

American Exploration & Mining Association
American Iron and Steel Institute
Building Stone Institute
National Council of Coal Lessors
Independent Petroleum Association of America
Indiana Limestone Institute
Industrial Minerals Association – North America
Iron Ore Lessors Association, Inc.
National Building Granite Quarries Association, Inc.
National Industrial Sand Association
National Lime Association
National Mining Association
National Stone, Sand & Gravel Association
Portland Cement Association
The Fertilizer Institute