Energy taxation

Obama FY 2015 budget proposes eliminating various oil, gas and coal company preferences

On 4 March 2014, the Obama Administration released the Fiscal Year 2015 Budget of the United States Government. The 2015 budget calls for total outlays of US$3.9 trillion, revenues of US$3.337 trillion and a budget deficit for fiscal year 2015 of US$564 billion. The 2015 budget proposes to increase discretionary spending in fiscal year 2015 by US$56 billion above the spending baseline agreed to in the Balanced Budget Act of 2011. The new funding, which would be offset by US$28 billion in spending cuts to existing programs and US$28 billion in tax increases, would fund an Opportunity, Growth and Security Initiative, split evenly between nondefense and defense discretionary spending. As in prior years, the 2015 budget proposes the repeal of certain US federal income tax incentives currently available to certain oil and gas companies, as well as those in the mining industry. The 2015 budget would repeal over US$4 billion per year in tax incentives to oil, gas and other fossil fuel producers.

The Obama Administration contends that allowing preference items encourages more oil, gas and coal investment than would occur in a neutral system, resulting in market distortion that is detrimental to long-term energy security and inconsistent with the Obama Administration’s policy of supporting clean energy, decreasing reliance on oil and reducing carbon emissions. If ultimately enacted, the proposals would also be expected to help pay for increased funding for clean energy and research and development, among other items.

A portion of the 2015 budget’s overall expenditure would be offset by repealing (or otherwise eliminating) or modifying a number of US federal income tax incentives that now directly benefit certain oil and gas companies.
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Energy policy highlights
The 2015 budget provides US$27.9 billion in discretionary funds for the U.S. Department of Energy that will: (a) position the United States to compete as a world leader in clean energy and advanced manufacturing; (b) enhance US energy security; (c) cut carbon pollution and respond to and prepare for the threat of climate change; and (d) modernize the nuclear weapons stockpile and infrastructure. The 2015 budget echoes the President’s previously stated commitment to an “all-of-the-above” strategy for energy policy through, in part, investing in clean energy research and development; promoting energy efficiency in cars, homes and businesses; and encouraging responsible domestic energy production.

The 2015 budget also sets goals of making energy go further across the economy and continuing to invest in energy security, partly by:

• Cutting energy wasted by US homes and businesses with action aimed at doubling the economic output per unit of energy consumed in the United States by 2030 (relative to 2010 levels)

• Establishing an Energy Security Trust and enacting reforms to promote responsible oil and gas development on federal lands. In an effort to help fund efforts to reduce oil consumption by autos and trucks and to cut US reliance on foreign oil, the trust would be funded through royalty revenues from federal oil and gas development, but no new land areas are proposed for oil and gas leasing

• Making energy project permitting more robust. The 2015 budget increases funding for the Department of the Interior’s Bureau of Land Management programs by approximately 18% to improve the permitting process for oil and gas, renewable energy and infrastructure uses of federal lands, including the transition to an electronic streamlined system for oil and gas permits

Like last year’s budget, the 2015 budget does not propose to extend a number of expired or expiring energy tax extenders, certain of which relate to renewable or alternative energy provisions. Further, the 2015 budget proposes to exempt certain foreign pension funds from the application of the Foreign Investment in Real Property Tax Act.

Direct impact on the oil and gas industry

A portion of the 2015 budget’s overall expenditure would be offset by repealing (or otherwise eliminating) or modifying the following US federal income tax incentives that now directly benefit certain oil and gas companies:

• Expensing of intangible drilling and development costs

• Percentage depletion for oil and natural gas wells

• The domestic manufacturing deduction for oil and natural gas companies

• The exception to passive loss limitations for working interests in oil and natural gas properties

• The enhanced oil recovery credit

• The credit for oil and gas produced from marginal wells

• The deduction available for tertiary injectants

• Increase the geological and geophysical amortization period for independent producers to seven years

Additionally, the 2015 budget proposes increasing the Oil Spill Liability Trust Fund tax by one cent for the period from 2015 through 2016 and another one cent for periods after 31 December 2016 and also proposes certain other changes to the sources subject to the Oil Spill Liability Trust Fund tax.

Indirect impact on the oil and gas industry

The 2015 budget also includes the following provisions that, if enacted, may negatively impact the financial condition and results of operations of certain oil and gas companies:

• Reinstatement and expansion of the Superfund taxes

• Repeal of the last-in/first-out method of accounting for inventories

• Modification of the rules for dual-capacity taxpayers

• Certain other international tax reform measures
Impact on the coal industry

In addition to addressing certain US federal income tax incentives available to the oil and gas industry, the 2015 budget also includes a number of provisions directly aimed at the coal industry:

- Repeal expensing of exploration and development costs
- Repeal percentage depletion for hard mineral fossil fuels
- Repeal capital gains treatment for royalties
- Repeal the domestic manufacturing deduction for coal and other hard mineral fossil fuels

Reforms to federal oil and gas management

As in the prior year, the 2015 budget proposes to reform the management related to oil and gas development on federal lands and waters. Stating that recent studies have found that “taxpayers could earn a better return through policy changes and more rigorous oversight,” the 2015 budget includes various reforms to onshore and offshore federal oil and gas programs. The proposed changes fall into three categories:

1. Advancing royalty reforms
2. Encouraging diligent development of oil and gas leases
3. Improving revenue collection processes

Collectively, the proposed reforms of federal oil and gas management will generate approximately US$2.5 billion in net revenue over 10 years.

Implications

As noted, these proposals are almost identical to the Obama Administration’s proposals for the 2011, 2012, 2013 and 2014 budget years. If enacted, they would have a significant impact on oil and gas and mining companies. Taxpayers should pay close attention to the possible effects of the changes and estimate the incremental cost for planning. In light of the budget issue facing Congress, taxpayers should watch these provisions carefully and understand the potential impact on their tax provisions and related cash flow.
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