



Illinois Oil & Gas Association
P.O. Box 788
Mt. Vernon, Illinois 62864

1. Contact Information

Name: Edward Cross

Title: Chief Executive Officer

Organization: Illinois Oil & Gas Association

Mailing Address: P.O. Box 788, Mt. Vernon, Illinois 62864

Email: crosse1981@gmail.com

Telephone Number: 785-220-3534

2(a) Description of Current Tax Expenditure

Title of Tax Expenditure: Excess of percentage over cost depletion, fuels (oil and gas)

Estimated Cost (2020-2024): \$2.3 billion

Internal Revenue Code Section: Secs. 613 and 613A

Description of Current Law:

Depletion is available to any person having an economic interest in a producing oil and gas property. There are generally two types of depletion – cost and percentage depletion. Cost depletion is limited to the taxpayer's basis in the property, whereas percentage depletion is not limited by the basis but is subject to limitations on net income derived from the property and taxable income.

Percentage depletion for producing oil and gas property (15 percent rate) is available only to independent producers and royalty owners. Special rules apply to oil and gas production from marginal wells (generally, wells for which the average daily production is less than 15 barrels of oil or barrel-of-oil equivalents or that produce only heavy oil). In no event may the rate of percentage depletion exceed 25% for any taxable year.

Also, perhaps most notably, percentage depletion is limited the first 1,000 barrels of oil (or equivalent) of daily production, so many larger independents receive this tax treatment for only a small percentage of their production.

2(b) Description of Current Tax Expenditure

Title of Tax Expenditure: Expensing of exploration and development costs, fuels (oil and gas)

Estimated Cost (2020-2024): \$6.2 billion

Internal Revenue Code Section: Sec. 263(c)

Description of Current Law:

Federal law provides special rules for the treatment of intangible drilling and development costs (IDCs). Under these rules, an operator or working interest owner who pays or incurs IDCs in the development of an oil or gas property in the United States may elect either to expense or capitalize those costs. If an election to expense IDCs is made, the taxpayer deducts the amount of the IDCs as an expense in the taxable year the cost is paid or incurred. IDCs include all expenditures made by an operator for wages, fuel, repairs, hauling supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and gas. The election to deduct IDCs applies only to those IDCs associated with domestic properties.

Reason to Keep Percentage Depletion and IDCs in the Tax Code:

Continued domestic exploration requires significant amounts of capital. In today's exploration/production industry, most capital for drilling is generated by independent producers internally. However, even in instances when outside investors are involved, these two tax provisions (percentage depletion and IDCs) are essential in attracting capital sufficient to maintain the pace and volume of drilling activity necessary to sustain current or increasing demand. Without these two tax provisions, neither large nor small domestic independents would generate the capital necessary for continuing to grow drilling and production activity. Estimates are that the repeal of IDCs and percentage depletion would decrease domestic drilling by at least 30 percent.

3. How does this Tax Expenditure Grow the Economy?

Domestic oil and natural gas drilling and production activities are major positive economic drivers. U.S. independent oil and natural gas producers are primarily responsible for current domestic energy production, with its attendant economic, employment and national security benefits. More than 18,000 independent producers drill about 90% of US oil and natural gas wells, account for 80% of U.S. oil production, 90% of U.S. natural gas production, and account for 90% of capital and operating expenditures.

Independents point to two primary factors that drive the domestic oil and natural gas industry:

- 1) Advancements in the science and technology of drilling and completing oil and gas wells and,
- 2) Availability of capital sufficient to finance the enterprise.

As mentioned earlier, without these two tax provisions (percentage depletion and IDCs), neither large nor small domestic independents would generate the capital necessary for continuing to grow drilling and production activity.

A recent study conducted by the Wood Mackenzie consulting firm found that if intangible drilling costs could no longer be expensed, an average of 225,000 jobs per year would be lost, of which an estimated 65,000 would be jobs in the oil and gas industry. The same study concluded that investment through the drilling and development of oil and gas resources would decline by \$407 billion over the period 2017 to 2026.

4. How does this Tax Expenditure Make the Tax Code Fairer?

Percentage Depletion

Percentage depletion provides capital to keep current marginal wells producing and capital to be reinvested in new oil and gas ventures in the United States. In addition, percentage depletion acts as a hedge that cushions small royalty owners against the time of ultimate recovery of all commercial oil and gas production. According to the National Association of Royalty Owners, the typical royalty owner in the U.S. is over 60 years of age, widowed, and receives less than \$500 in monthly royalties.

Intangible Drilling Costs

It takes several years and millions of dollars to drill the exploration and production wells that eventually extract oil/natural gas and generate revenue. Even in shale plays, there is no guarantee that a company will produce oil/gas when it drills exploration wells. Today's domestic E&P industry deals with both exploration risk (dry holes) and especially economic risk (completed, producing wells may never produce sufficient hydrocarbon value to return the initial investment costs). Allowing a current tax deduction for IDCs helps to alleviate the tremendous costs and risks involved in exploration, completion and production.

5. How do these Tax Provisions Help Other Important Federal Policy Objectives?

The idea of North American energy independence – a pipe dream as recently as the turn of the 21st Century - is no longer just a concept, but a tangible, achievable reality. America is no longer as reliant on unstable and/or unfriendly regimes for oil supply. The reality of decreasing reliance on certain OPEC nations for a majority of our crude oil supplies provides new options for the U.S. in foreign affairs and military planning and decision-making.

In addition, the availability and long-term reliability of reasonably priced energy (particularly domestically-produced oil and natural gas) will continue to play a critical role in the resurrection of the U.S. manufacturing sector.

The upstream oil and natural gas industry in the U.S. supports 3.6 million U.S. jobs and adds nearly \$563 billion (about 2% of U.S. GDP) to the U.S. economy. In 2024, the upstream oil and natural gas industry paid \$149 billion in federal and state taxes. The entire U.S. oil and natural gas industry (both upstream and downstream sectors) supports 10.8 million jobs and contributes 7.6% of total U.S. GDP.

In 2024, independents - companies who are not fully integrated across the supply chain - produced 80% of U.S. oil and 90% of U.S. natural gas. Independent operators produce 85% of U.S. oil, 90% of U.S. natural gas, operate 95% of U.S. wells, drill 90% of new wells, and account for 90% of capital and operating expenditures.

6. Should this Tax Expenditure be Repealed or Reformed, and if so how?

No. Current law provisions for percentage depletion and expensing of intangible drilling costs should be retained, so that domestic, independent oil and gas producers and royalty owners are allowed to continue to deduct their ordinary business expenses, just as do other U.S. businesses and industries.

7. How does this Tax Expenditure benefit Americans?

After many decades of productive stewardship, oil and natural gas resources continue to play an important part in the livelihoods of all Americans. The small businesses that make up the American independent oil and gas industry puts millions of people across America to work each day and pumps hundreds of billions of dollars into the national and state economies each year; money that helps support families, fund schools, and build roads.

Mineral leases and royalty payments provide additional income to American residents. According to the National Association of Royalty Owners, U.S. royalty owners received nearly \$55 billion last year.