Oil & Gas Alert

Update on tax legislation

March 2016

The Obama Administration's FY 2017 budget proposes eliminating various oil, gas and coal company preferences.

On 9 February 2016, the Obama Administration released the Fiscal Year 2017 Budget of the U.S. Government (the 2017 budget). The budget calls for total outlays of US$4.147 trillion, revenues of US$3.644 trillion and a budget deficit for fiscal year 2017 of US$503 billion. As in prior years, the 2017 budget provides for the proposed repeal of certain US federal income tax incentives currently available to certain oil and gas and mining companies.

Direct impact on the oil and gas industry

A portion of the 2017 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:

- Repeal expensing of intangible drilling and development costs
- Repeal percentage depletion for oil and natural gas wells
- Repeal the domestic manufacturing deduction for oil and natural gas companies
- Increase the geological and geophysical amortization period for independent producers to seven years
- Repeal partnership treatment for fossil fuel master limited partnerships and treat them as C corporations (after 31 December 2021)
- Repeal the exception to passive loss limitations for working interests in oil and natural gas properties
- Repeal the enhanced oil recovery credit
- Repeal the credit for oil and gas produced from marginal wells
- Repeal the deduction available for tertiary injectants

Additionally, the 2017 budget proposes increasing the Oil Spill Liability Trust Fund tax by 2 cents to 10 cents per barrel for periods after 31 December 2016, and proposes updating the law to include other sources of crude. This proposal also prohibits drawback of the oil spill tax.

Indirect impact on the oil and gas industry

The 2017 budget also includes the following provisions that, if enacted or eliminated, 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 2017 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

Proposed new $10.25 per barrel fee on oil

The 2017 budget proposes a new US$10.25 per barrel fee on oil, which is projected to raise US$319 billion over 10 years. The fee would be imposed on domestically produced crude oil and imported crude oil and petroleum products. The fee would be phased in ratably over the next five years beginning on 1 October 2016 (and adjusted for inflation from 2016). This fee would not be imposed on exported crude oil and petroleum products, and domestically sold home heating oil would be exempted temporarily. Revenue from this fee would be used to fund the proposed 21st century clean infrastructure package to upgrade the transportation system, reduce carbon emissions and invest in cleaner transportation technologies. In addition, 15% of the revenues from the fee would be used to provide assistance to low-income families to cope with increased energy costs.

Implications

As noted, with the exception of the new US$10.25 per barrel fee on oil, these proposals are almost identical to the Obama Administration's proposal for the 2011–2016 budget years. If enacted, they would have a significant impact on oil and gas and fossil fuel mining companies. Taxpayers should pay close attention to the possible effects of the changes and estimate the incremental cost for planning. Taxpayers also should watch these provisions carefully and have an understanding of the potential impact on their tax provisions and related cash flow.

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