United States – Progress Report on Fossil Fuel Subsidies

Part 1: Identification and Analysis of Fossil Fuel Provisions

A. Production Fossil Fuel Subsidies

There are a number of tax preferences, described below, available in the United States to producers of fossil fuels. The preferences below are all permanent provisions in the tax code. The annual revenue costs estimated for each provision are taken from the Mid-Session Review of the Budget of the United States Government, Fiscal Year 2015, which is available here: http://www.whitehouse.gov/omb/budget/msr. Provision descriptions are derived from the General Explanation of the Administration's Revenue Proposal, sometimes referred to as the Treasury Green Book, which is available here: http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx

In total, the United States government has identified eleven Federal fossil fuel production tax provisions, as shown below. Combined, these provisions total USD 4.7 billion in annual revenue cost (nominal annual average figure based on the 10-year revenue estimate). The provisions are listed in order of greatest annual revenue cost to least.

Production Tax Provision	Fossil Fuel Targeted	Description	Analysis	Expiration	Annual Revenue Cost (million)[1]
Expensing of intangible drilling costs	Oil Natural Gas	Taxpayers may elect to currently deduct intangible drilling costs (IDCs) paid or incurred with respect to the development of an oil or natural gas property located in the United States. For an integrated oil company that has elected to expense IDCs, 30 percent of the IDCs on productive wells must be capitalized and amortized over a 60-month period.	The expensing, rather than capitalization, of IDCs provides a tax preference to the oil and natural gas industry. Requiring capitalization of IDCs would place the oil and natural gas industry on a cost recovery system similar to that employed by other industries and reduce economic distortions. This provision, like other oil and natural gas preferences the Administration proposes to repeal, distorts markets by encouraging more investment in the oil and natural gas industry than would occur under a neutral tax system. This market distortion is detrimental to long-term energy security and is also inconsistent with the Administration's policy of supporting a clean energy economy, reducing our reliance on oil, and cutting carbon pollution. Moreover, the tax subsidy for oil and natural gas must ultimately be financed with taxes that result in underinvestment in other, potentially more productive, areas of the economy.	None	$1,495

Production Tax Provision	**Fossil Fuel Targeted**	**Description**	**Analysis**	**Expiration**	**Annual Revenue Cost (million)[1]**
Percentage depletion for oil and natural gas wells	Oil Natural Gas	Depletion is available to any person having an economic interest in a producing oil and natural 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 other limitations. Percentage depletion for producing oil and natural gas property (15 percent rate) is available only to independent producers and royalty owners and is limited to average production of 1,000 barrels of oil per day or its natural gas equivalent. The percentage depletion deduction is further generally limited to the lesser of 65 percent of the taxable income before the depletion allowance or 100 percent of the taxable income from the property before the depletion allowance.	Percentage depletion effectively provides a lower rate of tax with respect to a favored source of income relative to cost depletion. Cost depletion computed by reference to the taxpayer's basis in the property would place oil and natural gas producers on a cost recovery system similar to that employed by other industries and reduce economic distortions. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None .	$1,343
Domestic manufacturing deduction for fossil fuels	Oil Natural Gas Coal Lignite Oil Shale	A deduction is allowed with respect to income attributable to domestic manufacturing and production activities. For taxable years beginning after 2009, the manufacturing deduction is generally equal to nine percent of the lesser of qualified production activities income for the taxable year or taxable income for the taxable year, limited to 50 percent of the W-2 wages of the taxpayer for the taxable year. The deduction for income from oil and natural gas production activities is computed at a six-percent rate. This deduction is widely available and not targeted at fossil fuel industries.	The manufacturing deduction, which is available to all taxpayers that generate qualified production activities income, effectively provides a lower rate of tax for income from certain activities, including the production of fossil fuels. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None	$1,250

Production Tax Provision	**Fossil Fuel Targeted**	**Description**	**Analysis**	**Expiration**	**Annual Revenue Cost (million)**[1]
Two year amortization period for geological & geophysical expenditures	Oil Natural Gas	Geological and geophysical expenditures incurred by independent producers in connection with domestic oil and natural gas exploration may be amortized over two years. For integrated oil companies, these costs must be amortized over seven years.	The accelerated amortization of geological and geophysical expenditures incurred by independent producers provides a tax preference to the oil and natural gas industry. Increasing the amortization period for geological and geophysical expenditures incurred by independent oil and natural gas producers from two years to seven years would provide a more accurate reflection of their income and more consistent tax treatment for all oil and natural gas producers. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None	$305
Percentage depletion for hard mineral fossil fuels	Coal Lignite Oil Shale	Percentage depletion is available for coal and lignite (10 percent rate) and oil shale (15 percent rate). The percentage depletion deduction is generally subject to the alternative minimum tax at a 20 percent rate to the extent it exceeds the adjusted basis of the property. The deduction may not exceed 50 percent of the net income from the mineral property in any year.	Percentage depletion, rather than cost depletion, effectively provides a lower rate of tax with respect to a favored source of income. Cost depletion computed by reference to the taxpayer's basis in the property would place these fossil fuel industries on a cost recovery system similar to that employed by other industries and reduce economic distortions. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None	$205
Expensing of exploration and development costs for hard mineral fuels	Coal Lignite Oil Shale	Mining companies may elect to deduct 70 percent of domestic exploration and development costs. The 30 percent of expenses that cannot be deducted must be capitalized and amortized over a 60-month period. Taxpayers may also elect to capitalize mine exploration and development expenses and amortize them over a 10-year period. If this election is made, the expenses will not be tax preference items under the alternative minimum tax.	The expensing of exploration and development costs relating to coal and other hard mineral fossil fuels provides a tax preference to the these fossil fuel industries. Capitalization of exploration and development costs relating to coal and other hard mineral fossil fuels would place taxpayers in that industry on a cost recovery system similar to that employed by other industries and reduce economic distortions. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None	$68

Production Tax Provision	**Fossil Fuel Targeted**	**Description**	**Analysis**	**Expiration**	**Annual Revenue Cost (million)[1]**
Capital gains treatment for royalties of coal	Coal Lignite	Royalties received on the disposition of coal generally qualify for treatment as long-term capital gain and the royalty owner does not qualify for percentage depletion with respect to the coal. This treatment does not apply unless the taxpayer has been the owner of the mineral in place for at least one year before it is mined. The treatment also does not apply to income realized as a co-adventurer, partner, or principal in the mining of the mineral or to certain related party transactions.	The capital gain treatment of coal and lignite royalties provides a tax preference to these fossil fuel industries. Treating royalties as ordinary income would place taxpayers in that industry on a cost recovery system similar to that employed by other industries and reduce economic distortions. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None	$53
Deduction for tertiary injectants	Oil	Taxpayers engaged in petroleum extraction activities may generally deduct qualified tertiary injectant expenses incurred while applying a tertiary recovery method to increase the recovery of crude oil.	The deduction, rather than capitalization, of tertiary injectants provides a tax preference to the oil and natural gas industries. Capitalization of tertiary injectants would place the oil and natural gas industry on a cost recovery system similar to that employed by other industries and reduces economic distortions. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None	$10
Exception to passive loss limitation for working interests in oil and natural gas properties	Oil Natural Gas	Under normal rules, passive losses that remain after being netted against passive income generally can only be carried forward to offset passive income in future years. The exception permits losses from working interests in oil and gas properties to offset active income. The exception is only available if the working interest is owned in a way that does not limit the taxpayer's liability.	The special tax treatment of working interests in oil and natural gas properties provides a tax preference to the oil and natural gas industries. Eliminating the working interest exception would subject oil and natural gas properties to the same limitations as other activities and reduce economic distortions. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None	$8

Production Tax Provision	Fossil Fuel Targeted	Description	Analysis	Expiration	Annual Revenue Cost (million)[1]
Enhanced oil recovery (EOR) credit	Oil	Provides a 15 percent credit for expenses associated with an EOR project in the United States. An EOR project is a project that involves the use of one or more tertiary recovery methods to significantly increase the amount of recoverable crude oil. The credit is phased out when the reference price of oil exceeds a statutory amount indexed to inflation.	The credit provides a tax preference to the oil and natural gas industries. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None Currently phased out due to high oil prices.	$0
Marginal wells credit	Oil Natural Gas	Production tax credit for marginal wells or wells that have an average daily production of not more than 25 barrels per day. The credit is phased out when the reference price of oil exceeds a statutory amount indexed to inflation.	The credit provides a tax preference to the oil and natural gas industries. See expensing of intangible drilling costs for further analysis of the effects of fossil fuel tax preferences.	None Currently phased out due to high oil and natural gas prices.	$0

[1] Nominal annual average figure based on the 10-year revenue estimate, Table S-8, Mid-Session Review, Budget of the U.S. Government, Fiscal Year 2015.

B. Consumption Fossil Fuel Subsidies

There is one consumption subsidy that is funded by the Federal government in the United States. It is targeted at low-income households, and benefits are typically dispersed as a lump sum credit on a household's utility bill. Because the program is a targeted transfer that helps low-income households obtain essential energy services and does not encourage wasteful consumption, this program is not proposed for phase-out. Further information about the program can be obtained at: www.acf.hhs.gov/programs/liheap and http://liheap.ncat.org/

Consumption Subsidy	Description	Analysis	Expiration	Annual Revenue Cost (million $)
Low Income Home Energy Assistance Program (LIHEAP)	A discretionary block grant awarded to States, territories, and tribes and tribal organizations to provide home heating and cooling[1] energy assistance to low-income households. Grantees may use a portion of their LIHEAP funds for low-cost residential weatherization services and for program administration. Federal guidelines limit eligibility to households with incomes up to 150% of poverty or 60% of State median income[2]. The program typically reaches a small share (less than 20%) of eligible households. In FY 2008, the average LIHEAP heating benefit (heating and winter crisis benefits combined) was $363, representing 43% of average home heating expenditures for LIHEAP households.[3]	LIHEAP assistance is targeted to vulnerable households (those with elderly, disabled or young children) and to the poorest (those with the highest energy burdens relative to their income). These households are targeted as they may face serious health and safety risks if they do not have adequate heating and cooling in their homes. In FY 2008, 32% of LIHEAP households had an elderly member, 32% included a disabled member, and 21% had a child under 5 years old.[3] The average energy burden among LIHEAP recipient households was 17%, compared to 14% among all low-income households.[4]	Authorization expired at the end of FY 2007. Congress continues to provide annual appropriations.	$3,400 for FY 2014

[1] Home heating and cooling accounts for about 42 percent of residential energy expenditures among low-income households. Source: LIHEAP Home Energy Notebook for Fiscal Year 2009, page ii.

[2] States have the flexibility to set lower income limits, define "income," and adopt other eligibility criteria within Federal guidelines (e.g. asset tests, living in non-subsidized housing, elderly, young child in household, utility disconnection notice).

[3] From LIHEAP Report to Congress for Fiscal Year 2008: Executive Summary, page vi. FY 2008 figures are from the most recent publically available report to Congress on LIHEAP.

[4] From LIHEAP Report to Congress for Fiscal Year 2008, page 20.

Part 2: Implementation Strategies and Timeframes for Phase-Out of Fossil Fuel Tax Provisions

A. Production Fossil Fuel Subsidies

For all of the production fossil fuel subsidies listed in Part 1, the Obama Administration's Fiscal Year 2015 Budget proposal would eliminate the preferential treatment of fossil fuels in the United States tax code. However, the President is unable to unilaterally alter the tax code. The United States Congress must pass enabling legislation for the proposals to become law.

Production Tax Provision	Strategy and Timeframe	Implementation
Expensing of intangible drilling costs	The Administration's Fiscal Year 2015 Budget proposal would repeal expensing of intangible drilling costs and 60-month amortization of capitalized intangible drilling costs. Intangible drilling costs would be capitalized as depreciable or depletable property, depending on the nature of the cost incurred, in accordance with the generally applicable rules. The proposal would be effective for costs paid or incurred after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Percentage depletion for oil and natural gas wells	The Administration's Fiscal Year 2015 Budget proposal would repeal percentage depletion with respect to oil and natural gas wells. Taxpayers would be permitted to claim cost depletion on their adjusted basis, if any, in oil and natural gas wells. The proposal would be effective for taxable years beginning after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Domestic manufacturing deduction for fossil fuels	The Administration's Fiscal Year 2015 Budget proposal would exclude from the definition of domestic production gross receipts all gross receipts derived from the sale, exchange or other disposition of oil, natural gas or a primary product thereof and of coal, other hard mineral fossil fuels, or a primary product thereof for taxable years beginning after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Two year amortization period for geological & geophysical expenditures	The Administration's Fiscal Year 2015 Budget proposal would increase the amortization period from two to seven years for geological and geophysical expenditures incurred by independent producers in connection with all oil and natural gas exploration in the United States. Seven year amortization would apply even if the property is abandoned and any remaining basis of the abandoned property would be recovered over the remainder of the seven year period. The proposal would be effective for amounts paid or incurred after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.

Production Tax Provision	Strategy and Timeframe	Implementation
Percentage depletion for hard mineral fossil fuels	The Administration's Fiscal Year 2015 Budget proposal would repeal percentage depletion with respect to coal and other hard mineral fossil fuels. The other hard mineral fossil fuels for which no percentage depletion would be allowed include lignite and oil shale to which a 15 percent depletion rate applies. Taxpayers would be permitted to claim cost depletion on their adjusted basis, if any, in coal and other hard mineral fossil fuel properties. The proposal would be effective for taxable years beginning after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Expensing of exploration and development costs for hard mineral fuels	The Administration's Fiscal Year 2015 Budget proposal would repeal expensing, 60-month amortization, and 10 year amortization of exploration and development costs relating to coal and other hard mineral fossil fuels. The costs would be capitalized as depreciable or depletable property, depending on the nature of the cost incurred, in accordance with the generally applicable rules. The other hard mineral fossil fuels for which expensing, 60 month amortization, and 10 year amortization would not be allowed include lignite and oil shale to which a 15 percent depletion rate applies. The proposal would be effective for costs paid or incurred after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Capital gains treatment for royalties of coal	The Administration's Fiscal Year 2015 Budget proposal would repeal capital gain treatment of coal and lignite royalties and would tax those royalties as ordinary income. The proposal would be effective for amounts realized in taxable years beginning after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Deduction for tertiary injectants	The Administration's Fiscal Year 2015 Budget proposal would repeal the deduction for qualified tertiary injectant expenses for amounts paid or incurred after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Exception to passive loss limitation for working interests in oil and natural gas properties	The Administration's Fiscal Year 2015 Budget proposal would repeal the exception from the passive loss rules for working interests in oil and natural gas properties for taxable years beginning after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.

Production Tax Provision	Strategy and Timeframe	Implementation
Enhanced oil recovery (EOR) credit	The Administration's Fiscal Year 2015 Budget proposal would repeal the investment tax credit for enhanced oil recovery projects beginning after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.
Marginal wells credit	The Administration's Fiscal Year 2015 Budget proposal would repeal the production tax credit for oil and natural gas from marginal wells for production in taxable years beginning after December 31, 2014.	The United States Congress must pass enabling legislation for this proposal to become law.

B. Consumption Fossil Fuel Subsidies

The United States does not currently have any consumption fossil fuel subsidies that it intends to eliminate.

Part 3: Current Status of Phase-Out Strategies

A. Production Fossil Fuel Subsidies

No actions have been implemented to date on any United States production fossil fuel subsidies. The Unites States Congress must pass enabling legislation for phase-out of these subsidies to begin.

B. Consumption Fossil Fuel Subsidies

The United States does not currently have any consumption fossil fuel subsidies that it intends to eliminate.