

## Manufacturers' Deduction

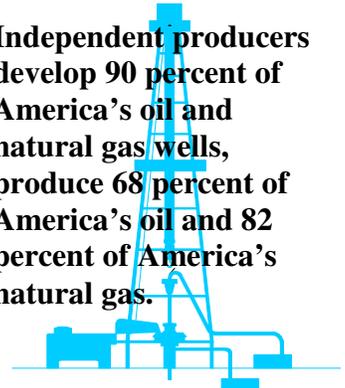
The American JOBS Creation Act of 2004 (JOBS Act) initiated a new tax deduction related to production in the United States. The deduction began as a 3 percent deduction against income derived from American production. For the oil and natural gas industry, legislation in the 110<sup>th</sup> Congress capped the deduction at 6 percent and it is always limited to amount equal to 50 percent of a company's wages.

While the JOBS Act began as a bill to modify the Extraterritorial Income Exclusion (ETI) tax rules declared illegal by the World Trade Organization, it was ultimately designed—as its name implies—to create new U.S. jobs. For this reason, the deduction is tied to wages. Similarly, the deduction only applies to American production.

For independent producers, this provision (Section 199) means additional capital for investment in the United States. Independent producers derive their capital “from the well head” – that is, their capital comes from selling the oil and natural gas they produce. Moreover, they have a history of reinvestment of their cash flow into new production. A 2005 study concluded that the top 50 independent producers reinvested 150 percent of their US cash flow back into American projects. Consequently, dollars that are taken for taxes are dollars not invested in new American production. Section 199 presents a clear opportunity to direct more money into US production at a time when a national policy to improve energy security is widely supported.

The Obama Administration has proposed to end the manufacturers' deduction for the oil and natural gas industry. Congress should reject this legislation. At a time when Congress is developing energy proposals designed to reduce America's dependency on foreign energy sources, it makes no sense to strike a provision that applies only when a producer invests in the United States. Instead, Congress should be looking for more ways to encourage American oil and natural gas production.

**Independent producers develop 90 percent of America's oil and natural gas wells, produce 68 percent of America's oil and 82 percent of America's natural gas.**



April 2009