

Timeline History of Natural Gas and Oil Tax Provisions

Intangible Drilling and Development Costs (IDC) – IDC tax treatment is designed to attract capital to the high risk business of natural gas and oil production. IDC generally include any cost incurred that has no salvage value and is necessary for the drilling of wells or the preparation of wells for the production of natural gas or oil.

- 1913 – IDC considered deductible in the year incurred
- 1976 – IDC considered as a tax preference item and subjected to minimum tax
- 1986 – Integrated companies required to capitalize 30% of IDC over 60 month period; “excess” IDC considered as a tax preference item under the AMT
- 1992 – Independent Producers and Royalty Owners (IPRO) may eliminate all or part of IDC as a tax preference item

Percentage Depletion – All natural resources minerals are eligible for a percentage depletion income tax deduction. Percentage depletion for natural gas and oil has been in the tax code since 1926. Unlike percentage depletion for all other resources, natural gas and oil percentage depletion is highly limited.

- 1913 – Cost depletion allowed but did not reflect drilling risks
- 1918 – “Discovery Value” depletion created but was too complicated to value
- 1926 – Percentage depletion created to encourage drilling; set at 27.5% for natural gas and oil; limited to 50% of net income of property
- 1969 – Percentage depletion reduced to 22%
- 1975 – Percentage depletion repealed for natural gas and oil except for IPRO; limited to first 1000 B/D and capped at 65% of net taxable income; set at 15% and made not transferrable if the property were transferred
- 1986 – “Excess” percentage depletion treated as a tax preference item under the AMT
- 1990 – Percentage depletion allowed to be transferrable; percentage depletion allowed to increase above 15% for marginal wells as prices fall (maximum 25% at a \$10/B reference price; property net income limitation increased to 100%)
- 1991 – Excess percentage depletion no longer treated as a tax preference item under the AMT
- 1997 – Percentage depletion property net income limitation suspended for marginal wells through 1999
- 1999 – Percentage depletion property net income limitation suspended for marginal wells through 2001
- 2002 – Percentage depletion property net income limitation suspended for marginal wells through 2003
- 2004 – Percentage depletion property net income limitation suspended for marginal wells through 2005
- 2006 – Percentage depletion property net income limitation suspended for marginal wells through 2007
- 2008 – Percentage depletion property net income limitation suspended for marginal wells during 2009
- 2010 – Percentage depletion property net income limitation suspended for marginal wells during 2011

Geological and Geophysical (G&G) Expenditures – G&G costs are associated with developing new American natural gas and oil resources.

- 1913 – G&G expenditures considered deductible in the year incurred
- 1942 – IRS instructions begin drawing distinctions on G&G expenditures between those related to those related to the acquisition/retention of properties (treated as capital expenditures) and those that did not (treated as deductible)
- 1946 – Tax Court ruling supports IRS
- 1950 – IRS issues ruling that G&G related to property acquisition/retention are capital expenditures; G&G that does not lead to property acquisition/retention are deductible
- 1983 – IRS ruling provides more detailed guidance
- 2005 – Congress amends tax code to set G&G amortization for all cases at 24 months
- 2006 – Congress modifies G&G amortization for largest integrated oil companies to 5 years
- 2007 – Congress modifies G&G amortization for largest integrated oil companies to 7 years

Enhanced Oil Recovery (EOR) Tax Credit – The EOR credit is designed to encourage oil production using costly technologies that are required after a well passes through its initial phase of production.

- 1990 – Congress creates EOR tax credit of 15 % of EOR costs; credit has a phase out as oil prices increase; tertiary recovery technologies available for the credit defined by regulation (includes CO₂ injection)

Marginal Well Tax Credit – This countercyclical tax credit was recommended by the National Petroleum Council in 1994 to create a safety net for marginal wells during periods of low prices.

- 1994 – National Petroleum Council *Marginal Wells* report recommends creating a countercyclical tax credit as a safety net to support marginal wells during periods of low commodity prices
- 2004 – Congress creates countercyclical marginal wells tax credit

Passive Loss Exclusion for Working Interests – Congress provided this distinction to encourage investment in American natural gas and oil production

- 1986 – Congress creates division of investment income/expense into two baskets – active and passive. The Act exempted working interests in natural gas and oil from being part of the passive income basket and, if a loss resulted, it was deemed to be an active loss that could be used to offset active income as long as the investor's liabilities were not limited.

Manufacturers' Tax Deduction – Congress enacted this provision to encourage the development of American jobs.

- 2004 – Congress creates the Section 199 tax deduction for American manufacturing; deduction begins at 3 % growing to 6 % and stops at 9 %; deduction limited to 50 % of U.S. W2 payroll
- 2008 – Congress limits the Section 199 tax deduction of the oil and natural gas industry to 6 % (capped at 50 % of W2 payroll)