

Senate Finance Committee – “Reforming America’s Outdated Energy Tax Code”
The Honorable Don Nickles, U.S. Senate 1981-2004
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Chairman Wyden, Ranking member Hatch, and members of the committee, thank you very much for inviting me to speak to you today about energy tax policy. When I look back at my twenty-four years of Senate service, I enjoyed working on this committee more than just about anything else, and in particular working with many of you on tax policy. It is an honor and a privilege to be invited back to work with you on those issues again.

Mr. Chairman, the opinions I give today are solely my own, but I believe it is important to disclose that I and my company The Nickles Group are proud to represent some of the finest energy companies in the world, including ExxonMobil, Exelon, Anadarko Petroleum, National Oilwell Varco, Koch Industries and ITC Holdings. I am also a member of the corporate boards of Valero Energy and the Washington Mutual Investors Mutual Fund.

Chairman Wyden, I sat in this witness chair just a little over two years ago when your predecessor Senator Max Baucus invited me to the committee to talk about tax reform and energy tax policy. I praised Senator Baucus and House Chairman Dave Camp at that hearing for all the work they were doing to prepare for tax reform, and I was excited about the potential for getting the job done. Here we are two years later, and while comprehensive tax reform has not yet been achieved, leaders like Chairman Camp did make significant progress. But as we all know, there is a lot of more work to be done. I know that the leaders of this committee are among the smartest and hardest workers in the Senate, and so I encourage you to continue your work and finish the job.

My primary message at that hearing two years ago was that, if you do tax reform correctly, there would be no reason to hold another “energy” tax hearing,

because a reformed tax code should treat energy companies and the products they produce just like everybody else. No subsidies, and no penalties. If the tax code you devise encourages investment, lowers the corporate rate, and embraces a simplified territorial system, U.S. energy companies will flourish along with all other companies.

There remains a great deal of work to achieve that reformed tax code. In the meantime, a large number of tax provisions primarily affecting businesses have expired and await Congressional action. I agree with Chairman Camp that a few of those provisions – particularly those which encourage investment like bonus depreciation and small business expensing – should be made permanent. Others, such as the wind production tax credit (wind PTC) should remain expired.

Fellow Oklahoman Will Rogers said, “All government programs have three things in common: a beginning, a muddle and no ending.” Perhaps the best example of this is the wind PTC.

The wind PTC is an overly-generous subsidy supporting a mature industry which has expanded ten-fold in the last decade and now accounts for over 60,000 megawatts of installed generation capacity. It is an industry that also benefits from a renewable portfolio standard mandate in 29 states and the District of Columbia, and which will further benefit from President Obama’s aggressive regulatory agenda on existing and new power plants. The wind PTC’s 2.3-cent-per-kilowatt subsidy is 30-to-50 percent of the average wholesale cost of electricity in most regions of the country. And as my friend Congressman Mike Pompeo (R-KS) recently pointed out, the wind PTC has been around long enough – twenty-three years – that it is old enough to drink.

In fact, Mr. Chairman, the wind PTC is so generous that in parts of the country where electricity is bought and sold in wholesale markets, wind developers will actually pay the market to take their power because they cannot otherwise collect the subsidy. This ridiculous situation is killing base-load coal and nuclear power in those regions because they cannot afford to give their product away.

Subsidies like the wind PTC are inherently political, but I wonder how many members of this committee know that a few weeks ago the IRS issued regulations that dramatically expanded which windmills qualify for the credit? When Congress last renewed the credit, they changed the effective date to say that anyone who started construction of their wind project by the end of 2013 could qualify for the ten-year subsidy. Originally, the IRS generously interpreted “beginning construction” to be met if the developer spent a mere 5 percent of the total project costs – hardly a high bar. However, apparently even that was not generous enough for the President’s friends in the wind industry, so in August the IRS lowered the threshold to 3 percent (IRS Notice 2014-46). I would encourage this committee to ask the IRS which wind projects and which companies benefited from this regulatory generosity, as well as where those companies are domiciled.

My former colleagues, the wind PTC has been around for twenty-three years, and projects that qualified under the President’s new regulations will continue receiving the credit until 2024! Please save the American taxpayer \$13 billion and let the wind PTC remain expired.

As I previously mentioned, a properly reformed tax code also should not penalize energy companies or their products. That is a message which has clearly been lost on this President, who has year after year asked Congress to increase taxes on domestic oil and gas companies because he does not like their products. I originally ran for the Senate because I wanted to reverse President Carter’s energy policies that were hostile to domestic energy production, picked winners and losers, and stifled competition. Today I see our current President seeking to repeat many of the energy and tax policy mistakes of the Carter era.

We are experiencing a major renaissance in the domestic oil and gas industry, Mr. Chairman. The International Energy Agency predicts that the U.S. will be the world’s number one producer of oil by 2015. In 2013 we reduced our imports of oil by 15 percent and of natural gas by 32 percent. Our exports of refined

products have increased 60 percent since 2010 and we are now the world's largest combined producer of oil and natural gas.

When the President first proposed his energy tax increases in 2009, the domestic oil and gas industry was investing \$232 billion. Last year the industry invested \$322 billion, a 40 percent increase. This industry is the shining light in our otherwise lackluster economy, but if the President's proposals had been enacted that amazing growth would have been threatened.

The President's punitive proposals include denying oil and gas companies the Section 199 manufacturing deduction that all other manufacturers receive. In fact oil and gas companies already receive a smaller benefit than all other manufacturers, but the President believes even that should be taken away. He would also dramatically increase the cost of exploring and drilling by increasing the recovery period intangible drilling costs. IDC's are the ordinary and necessary business expenses of this industry, Mr. Chairman, and they should remain immediately deductible. And the President would also like to penalize U.S.-based oil and gas companies and disadvantage them relative to their foreign competitors by denying them a credit for taxes paid to foreign governments. Known as the "dual capacity" provision, this proposal would cause U.S. companies to be double-taxed and would be disadvantage them as they compete to win access to oil and gas production projects all over the world.

Mr. Chairman, I appreciate all the work this committee and the House committee have done over the last two years to prepare for tax reform. Chairman Camp in particular did us all a big favor by putting a complete, detailed plan on the table for everyone to read, model, and evaluate. I certainly do not agree with every aspect of Chairman Camp's plan, but I admire his courage and the tremendous amount of work he and his staff put into the effort. With regard to energy taxes, I think Chairman Camp got more right than wrong. He would end targeted renewable subsidies like the wind PTC, and preserve important cost recovery mechanisms like expensing of intangible drilling costs. He repeals the Section 199 manufacturing deduction for everyone – not just oil and gas – because they all

benefit from a lower corporate rate. And his territorial international tax system would not double-tax U.S. oil and gas companies.

Unfortunately, the energy tax reform and cost recovery discussion drafts released by Chairman Baucus before he left the Senate I fear head largely in the wrong direction. Those discussion drafts would require intangible drilling costs and other company's R&D expenses to be amortized over 60 months. Companies need to be able to expense these costs in the year incurred. Senator Baucus' discussion drafts also took the wind PTC and put it on steroids, creating a never-ending subsidy for renewable electricity based on carbon content. I would encourage the committee to reject this unnecessary and expensive proposal.

Mr. Chairman and members of the committee, we all know that our uncompetitive tax code is badly in need of repair. The Tax Foundation just this week published a new metric which measures the degree to which the 34 OECD countries' tax systems promote competitiveness. At the top of the list was Estonia, with a 21 percent corporate rate and no double taxation of dividend income. The U.S. ranked a miserable 32 out of 34, just barely edging out France and Portugal for the least competitive tax system. Further skewing the tax code to promote renewables at the expense of traditional energy resources will do nothing to make us more competitive.

Thank you again for the opportunity to testify today, Mr. Chairman. I look forward to discussing these issues further.