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RE: Comments to the Senate Finance Committee Business & Infrastructure Working Groups (energy)

The American Petroleum Institute (API), on behalf of our members, appreciates the opportunity to provide some input to the working group process as the Senate Finance Committee begins to work through various tax policy issues. Given the size and scope of our industry in the US, changes to the tax code can impact the economics driving the jobs and outlook for our vibrant energy sector. Specifically, due to the capital intensive nature of our operations, the capability of recovering those costs is vitally important.

Of course, the goal of any well-structured tax system should be to raise revenue in a way that does the least amount of economic harm, while encouraging domestic investment and job creation, and allowing taxpayers to compete internationally for new opportunities. To achieve these goals, tax rules should be non-discriminatory among industries and should provide a level playing field for taxpayers engaged in similar activities.

Recently, concerns have grown about the current U.S. tax system, (i.e., that the rules limit U.S. competitiveness in an increasingly global economy), leading to calls for tax reform. Any tax reform should be based on sound, transparent policies, and tax rates should be lowered to support a tax structure that promotes investment and is competitive with other major trading partners.

We recognize that tax reform will be a substantial undertaking and will significantly impact how businesses look at the economics of their investments. We also highlight that any new tax rules addressing America's oil and natural gas industry could directly impact the amount of energy that is produced and supplied to the economy. Therefore, in order to help frame the debate on how to approach tax reform with respect to energy, we raise the following considerations.

Domestic Pro-growth/Pro-job Considerations

The U.S. oil and natural gas industry currently supports over 9.8 million jobs in the economy, over 2 million of which are supported by the refining and petrochemical segments. The industry as a whole accounts for 8 percent of the nation's Gross Domestic Product (GDP). One of the main reasons for this significant impact is the size and scope of the domestic capital investments which are necessary to produce and refine the energy demanded by U.S. consumers. For example, according to the U.S. Census Bureau, oil and natural gas extraction, refining and supporting activities accounted for over 13 percent of all new structure and equipment investment in 2010 – over $100 billion[1]. In addition, the top 50 exploration and production companies spent another $100 billion on acquiring access to various U.S. properties for future development.[2]

[1] 2010 Annual Capital Expenditures Survey, Table 4a, U.S. Census Bureau (released February 8, 2012). http://www.census.gov/econ/aces/xls/2010/full_report.html
[2] US oil and gas E&P benchmark study, 2010. http://www.ey.com/US/en/Industries/Oil---Gas/US-oil-and-gas-E-P-benchmark-study

Since oil and natural gas reserves are depleting resources, these substantial investments must be made on a recurring and continuous basis for the industry to maintain and continue to grow production and refining in the U.S., and to meet the economy's energy demands. Because investment needs to occur on a continuous basis, a stable and predictable stream of cash flow is critical to the economics supporting domestic projects. Given the risks inherent in the oil and gas business, and the level of the expenditures required, these costs must be recovered quickly in order for the industry to continue to reinvest in the next project or to hire new employees. The industry's oil and natural gas exploration and drilling investment analysis is very similar to the investments made by companies with a heavy concentration of research and development, where the technologies of tomorrow must be funded by the successes of today.

Therefore, any new pro-growth, pro-jobs tax regime must incorporate competitive and robust capital cost recovery provisions that take both risk and economic development goals into account. While a lower statutory rate will likely impact the after tax cash flow of all investments, we have found that in our industry there is not an exact "trade-off" between a lower corporate tax rate and the lengthening of cost recovery periods. We would note that, economy wide, a reduced tax rate can benefit existing investments (such as production from a factory already in place), but that lower rate may not provide for the continued after tax cash flow necessary to drive new investments and projected reinvestments. This is especially true if the capital cost recovery rules are significantly changed in the tax reform process.

Given the size of the oil and natural gas industry, we understand it will be impacted by any tax reform effort. But we believe it is imperative that any new tax system not specifically target any one industry over another for additional tax benefits, burdens, or costs. This targeted approach has been employed by the Administration budget proposals to repeal provisions such as IDC and LIFO for the oil and natural gas industry.[3] Using the tax code to pick winners and losers should be avoided. Specifically, within the energy sector we believe that any new tax system should not favor one form of energy at the expense of others or one type of taxpayer at the expense of others, particularly those engaged in the same activities. In a growing economy, all forms of energy production should be encouraged, but efforts to favor one form of energy over others should be avoided.

Additional Comments & Considerations

The industry recognizes the value of a lower corporate tax rate and supports movement in that direction. However, further base broadening measures used to support a lower tax rate could significantly impact the cash flow for domestic projects. As such, we are concerned that such measures could result in less domestic energy investment and ultimately undermine the goal of pro-growth tax reform. We would encourage the development of proposals that can achieve both of these objectives—lower rates and robust pro-growth capital cost recovery mechanisms.

Any new tax regime will be difficult for businesses to immediately adopt. Therefore, we support the development and implementation of fair and equitable transition rules. Establishing transition rules that provide adequate time for implementation and that take into account prior reliance on the current tax code as manifested in existing agreements, practices, and other requirements is essential for the success of any new tax system.

Infrastructure Funding

[3] More information on the impacts of these targeted tax proposals can be found on the API website at http://www.api.org/policy-and-issues/policy-items/taxes/api-budget-response.

An additional area being considered along with changes to the income tax regime is the funding for our nation's transportation infrastructure. The oil and natural gas industry certainly recognizes the primary role of highways in the U.S. transportation system and our economy. We also understand the need for a continuing federal investment in developing and preserving the nation's highways. The existing federal motor fuels tax applied on fuel products as they enter into the retail marketplace allows for a structured and efficient revenue collection system as well as defines a connection between the highway user and the infrastructure costs.

In considering highway funding mechanisms the industry applies five main principles. First, the imposition of a tax must allow for a high level of transparency between the consumer and the government service the tax is funding. This fosters the commitment by policy makers that the tax's structure, imposition or rate is justified by the level of services needed or expected. Second, the imposition and collection of the tax by the industry must be administrable and efficient. In addition, the tax should be similar to the various state motor fuel taxes to reduce compliance burdens and ensure the incident of taxation is at a point that greatly reduces fraud. Third, the tax must apply in a similar fashion regardless of whether the product is domestically produced or imported and does not apply to exported product. Therefore, it achieves a high level of trade parity. Fourth, the tax should serve as an equitable proxy for transportation usage and fairly apply to a broad spectrum of transportation fuels. Finally, amounts raised should be dedicated to bridge and highway infrastructure programs.

We would expect that any proposal for a new revenue/tax system would adhere to these principles and be structured to generate enough money to meet expected revenue needs. Of course, supplemental revenue raisers may be considered against these principles and used to address shortfalls, but they cannot be derived from permanent changes to industry income tax provisions.

Again, we thank you for the opportunity to comment as part of this process and welcome any questions that you may have. Should you wish to discuss these points further, please do not hesitate to contact me at 202-682-8455.

Sincerely,



Stephen Comstock