MARCH 2019

RAINEY CENTER POCKET GUIDE

Federal Tax Incentives and Benefits for Oil, Gas, Coal, and Nuclear Energy

BY SARAH HUNT

Introduction

This pocket guide is a quick reference tool that identifies significant federal tax incentives, subsidies, and benefits for energy production and generation. The guide identifies, describes, and organizes federal energy incentives and benefits by source type: Coal, Oil and Gas, and Nuclear. Included at the end are additional scholarly and government sources helpful to those researching federal fossil energy tax policies.

This pocket guide is not intended to be a complete listing of federal program benefits that energy producers may receive, i.e. the guide does not cover indirect subsidies such as the Low-Income Heating Assistance Program, administrative fees or contributions to remediation or transportation programs, etc.

About the Rainey Center

The Rainey Center is a post-partisan, 501(c)3 public policy research and leadership development organization led by and for women, minorities, and political mavericks, named after Rep. Joseph Rainey, a former slave who was the first African-American to serve in the United States House of Representatives.

TABLE OF CONTENTS

COAL
TAX PROVISIONS

Energy Research Credit (26 USC 41): Flat rate credit of 20% for payments to energy research consortia—includes both fossil and renewable energy.

Indian Coal Production Tax Credit (26 USC 45): Production tax credit for coal produced from coal reserves owned by an Indian tribe, or were held in trust by the U.S. for the benefit of an Indian tribe. Expired, but some lawmakers would like to make it permanent.

Mine Rescue Team Training Credit (26 USC 45N): Equal to the lesser of 20% of the amount paid or incurred by the taxpayer for mine rescue team training or $10,000.Expired, but some lawmakers would like to see it extended.

Advanced Coal Credits (26 USC 48A, 48B): Tax credits for the construction of advanced coal and coal gasification plants. All the credits have been fully allocated, but Congress could allocate additional credit.

Amortization of pollution control facilities (26 USC 169): Allows qualified coal generation facilities to write off costs of equipment or facilities that abate or control water, atmospheric pollution, or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat.

Election to Expense Advanced Mine Safety Equipment (26 USC 179E): Taxpayer may elect to treat 50% of the cost of qualified mine safety equipment as an expense, which is not chargeable to capital account subject to an investment limitation. This incentive is expired, but would be extended 1 year under Chairman Brady's bill.

Mining and Solid Waste Costs (26 USC 468): Tax deduction for mining and waste site reclamation and closure.

Mining Exploration Deduction (26 USC 617): Allows coal mining companies to deduct certain exploration and development costs.

Percentage Depletion (26 USC 291 and 613): Allows coal companies to deduct 10% of their sales revenue to reflect the declining value of their investment—regardless of the investment's actual value.

Capital Gains Treatment of Coal Royalties (26 USC 631): Allows coal companies to treat income from coal mines as a capital gain, taxed at 15% maximum, instead of regular income taxed at a higher rate.

Master Limited Partnerships (MLP) (26 USC 851, 7704): Partnership or LLC with interests that are traded in over the counter markets like stock
in a corporation. MLP's are taxed as partnerships—eliminating the corporate income tax for these entities. 90% of an MLP's income must come from qualified sources, which includes natural resource activity such as coal, oil and natural gas extraction (but not renewable energy activity).

Credit for Carbon Dioxide Sequestration (26 USC 45Q): Credit was expanded and increased in the Bipartisan Budget Act of 2018 (see chart below).

	Pre-Budget Act Qualified Sequestration	**Post Bi-Partisan Budget Act of 2018 Qualified Sequestration**
EOR, Other Industrial Utilization	$10/ton +inflation	12/83 ton to $35/ton plus inflation (linear increase thru 2026; inflation adjustment thereafter)
	75-million-ton limit	
Sequestration	$20/ton + inflation	$22.66/ton to $50/ton plus inflation (linear increase thru 2026; inflation adjustment thereafter)
	75-million-ton limit	Credit applies for 12 years beginning on date equipment placed in service

NON-TAX PROVISIONS

The Powder River Basin is not currently designated as a "coal-producing region." Such a designation would give the federal government additional authority to receive a fair return on leases. The Ending Polluter Welfare Act (sec. 28) proposed instituting such a change. The 16 mines in the Powder River Basin produces 45% of the nation's coal.

DOE Loan Guarantees for Advanced Coal Projects (42 USC 16513).

DOE Fossil Energy Research and Development Program: The Office of Fossil Energy manages this program, which includes the CCS Demonstration Programs, CCS and Power Systems Program, and Natural Gas Technologies R&D program.

Title 17 DOE Loan Guarantee Program: Provides loan guarantees to finance advanced energy projects, including fossil fuel energy projects.

OIL AND NATURAL GAS

TAX PROVISIONS

Alternative fuel credit for natural gas (26 USC 30): Natural gas refueling property qualifies.

Marginal wells production credit 5-year carryback (26 USC 39): Allows 5-year carryback for marginal wells production credit.

Energy Research Credit (26 USC 41): Flat rate credit of 20% for payments to energy research consortia—includes both fossil and renewable energy.

Enhanced oil recovery (26 USC 43): 15% income tax credit for advanced oil recovery investments.

Low sulfur diesel fuel production credit (26 USC 45(H)): Allows for a 5 cents a gallon tax credit for qualified small business refiners to produce fuel that is in compliance with EPA designated 'Highway Diesel Fuel Sulfur Control Requirements'.

Marginal wells credit (26 USC 45(I)): tax credit for production at marginal or inefficient wells.

Oil and Gas Arbitrage Bonds Exemption (26 USC 148(b)(4)): The Energy Policy Act of 2005 carved out an exception allowing the issuing of debt in order to acquire higher yield debt in the case of investments in natural gas supply contracts.

Geophysical Amortization (26 USC 167(h): Tax provision created in 2005 to allow certain oil and gas corporations to amortize incidental drilling costs in 2 years. The "Ending Polluter Welfare Act" recommended extending this period to seven years.

Special depreciation for Alaska Natural Gas Pipeline (26 USC 168(e)(3)): Allows 7-year depreciation of Alaska natural gas pipelines compared to the standard 15-year depreciation. The 'Ending Polluter Welfare Act' proposed returning to the standard 15-year deprecation.

> **Natural Gas Distribution Lines:** The Energy Policy Act of 2005 shortened the Modified Accelerated Cost Recovery System recovery period for all natural gas distribution lines from 20 years to 15 years.

Refinery Upgrade Deduction (26 USC 179(c)): Option to expense 50% of costs to upgrade a refinery.

Tertiary Injectant Deduction (26 USC 193): Allows deduction of advanced oil recovery investments.

Environmental remediation expense deduction (26 USC 198): Deduction for certain environmental clean-up costs.

Qualified Business Income Passthrough Deduction (26 USC 199(A)): Oil and gas investments held as publicly traded partnerships or as another "passthrough" entity can deduct 20% of business income or the greater of 50 percent of Form W-2 wages from the qualified trade or business. Additional deduction options and restrictions apply to this deduction.

Intangible Drilling Costs (IDCs) (26 USC 263(c) and 291): Expensing of costs associated with exploration and development immediately, rather than waiting for those activities to generate income. The IDC deduction allows independent oil and gas producers to deduct these costs immediately, rather than over the useable life of the well, which can be 20+ years. Integrated oil and gas producers capitalize 30% of their IDCs and recover them over a 60-month period.

Percentage Depletion (26 USC 291 and 611-613(A)): Allows oil and gas companies to deduct 15% of their sales revenues to reflect the declining value of their investment.

Special rule for oil and gas wells (26 USC 461(i)(2)): Accelerates deductions for oil and gas corporations.

Passive Loss Exemption (26 USC 469(c)(3)): Allows oil and gas company owners and investors to use losses from fossil fuel investments to shelter other income from taxation.

Tar Sands Oil and Other Liquid Fossil Fuels Exempt from Oil Spill Trust Fund Taxes (26 USC 4612(a)): "In the context of the per-barrel OSLTF tax provision, a 1980 House committee report stated that "the term crude oil does not include synthetic petroleum, e.g., shale oil, liquids from coal, tar sands, or biomass, or refined oil.'"

Deduction of Oil Spill Costs (Part IX, Subchapter B Chapter 1 IRC): BP was able to use these provisions to deduct billions of dollars in costs related to the Deep-Water Horizon incident.

LIFO Accounting for Fossil Fuel Companies (26 USC 472, 473): Allows oil and gas companies to minimize the value of their inventories for tax purposes.

Master Limited Partnerships (MLP) (26 USC 851 and 7704): A MLP is a partnership, or LLC with interests that are traded in over the counter market, like stock in a corporation. MLP's are taxed as partnerships—eliminating the corporate income tax for these entities. 90% of an MLP's income must come from qualified sources, which includes natural resource activity such as coal, oil and natural gas extraction (but not renewable energy activity).

Dual Taxpayer Deduction (26 USC 901): Allows oil and gas companies that operate overseas to classify royalty payments to foreign governments as taxes. This reduces their tax liability because foreign taxes, unlike royalty payments, are tax deductible.

Reduced tax for diesel-water fuel emulsion (i.e. diesel fuel blended with

water) (26 USC 4081(a)(2)(D), 4081(c), and 6427(m)): Reduces diesel fuel tax rate for diesel-water fuel emulsion to reflect the reduced BTU content per gallon resulting from the water.

NON-TAX PROVISIONS

Royalty Relief, including for deep gas, and deep water production of oil and gas (43 USC 1337, 42 USC 15904 and 15905) – DOI can provide discretionary royalty relief. These provisions also provide relief for deep water drilling.

Royalty-exempt Beneficial Use of Fuels (43 CFR 3178.4) -- Onshore and offshore oil and gas companies may use hydrocarbons for "beneficial purposes" on the lease without paying Federal royalties. These purposes include use as fuel for drilling rig engines, enhanced recovery, and for lifting, heating, or compressing oil and natural gas.

Ultra-deep water research program (42 USC 16371) – Public-private partnership to increase offshore oil & gas production.

33 USC 2704 caps oil spill liability at $75 million, and $350 million for tar sands pipeline clean up.

DOE Fossil Energy Research and Development Program: The Office of Fossil Energy manages this program, which includes the CCS Demonstration Programs, CCS and Power Systems Program, and Natural Gas Technologies R&D program.

Title 17 DOE Loan Guarantee Program: Provides loan guarantees to finance advanced energy projects, including fossil fuel energy projects.

Exemption of oil and gas products and waste from liability under the Superfund.

Exemption of hydraulic fracturing from regulation under the Safe Drinking Water Act.

NUCLEAR ENERGY

TAX AND NON-TAX PROVISIONS

Production Tax Credit (26 USC 45J): PTC of 1.8 cents per kilowatt hour for new nuclear plants placed in service before December 31, 2020 for the first 8 years of operation. Limited to the first 6,000 megawatts of new nuclear generating capacity. Credit is transferable to project partners.

Price Anderson Act: Artificially limits the amount of primary insurance that nuclear operator must carry, and places a cap, or ceiling, on the total amount of liability each nuclear power plant licensee faced in the event of an accident.

Title 17 DOE Loan Guarantee Program: Provides federal loan guarantees to finance advanced energy projects, including nuclear energy projects.

Conclusion

In addition to electricity and personal transportation costs, the U.S. taxpayer pays for reliable fossil energy through a variety of programs and subsidies in the amount of billions of dollars a year. Regardless of fuel type, these resources are intended to help energy producers, suppliers, and generators maintain competitive operations and employment of thousands of workers throughout the country.

As Congress continues to debate the purpose and priorities of energy related programs, the Rainey Center and its scholars stand ready to be a resource to help ensure policy makers have the facts they need to make critical decisions about America's energy future.

ADDITIONAL RESOURCES

U.S. Department of Energy, Office of the Chief Financial Officer, Fiscal Year 2019 Budget Justification (February 12, 2018)
https://www.energy.gov/cfo/downloads/fy-2019-budget-justification

Clark, Corrie E. "Renewable Energy R&D Funding History: A Comparison with Funding for Nuclear Energy, Fossil Energy, Energy Efficiency, and Electric Systems R&D". Congressional Research Service (June 18, 2018)
https://fas.org/sgp/crs/misc/RS22858.pdf

Dinan, Terry. "Testimony before the Subcommittee on Energy, Committee on Energy and Commerce: Federal Support for Developing, Producing, and Using Fuels and Energy Technologies". U.S. Congressional Budget Office (March 29, 2017)
https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52521-energytestimony.pdf

Sherlock, Molly F., Stupak, Jeffrey M. "Energy Tax Incentives: Measuring Value Across Differ-

ent Types of Energy Resources". Congressional Research Service (March 19, 2015)
https://fas.org/sgp/crs/misc/R41953.pdf

US Energy Information Administration "Direct Federal Financial Interventions and Subsidies in Energy in Fiscal Year 2016". (April 2018)
https://www.eia.gov/analysis/requests/subsidy/pdf/subsidy.pdf
https://www.eia.gov/analysis/requests/subsidy/ (website)

Griffiths, Benjamin W., Gülen, Gürcan, Dyer, James S., Spence, David, and King, Carey W. "The Full Cost of Electricity (FCe-): Federal Financial Support for Electricity Generation Technologies". University of Texas at Austin (March 2017)
http://energy.utexas.edu/the-full-cost-of-electricity-fce/

"Fiscal Year 2019 President's Budget of the U.S Government" – See Tax Expenditures. U.S. Office of Management and Budget.
https://www.whitehouse.gov/wp-content/uploads/2018/02/spec-fy2019.pdf

Metcalf, Gilbert E. "The Impact of Removing Tax

Preferences for U.S. Oil and Gas Production”. Council on Foreign Relations (August, 2016) https://www.cfr.org/sites/default/files/pdf/2016/07/Discussion_Paper_Metcalf_Tax_Preferences_OR.pdf
Porter, Eduardo. “Do Oil Companies Really Need $4 Billion Per Year of Taxpayers’ Money?”. New York Times (August 5, 2016) https://www.nytimes.com/2016/08/06/upshot/do-oil-companies-really-need-4-billion-per-year-of-taxpayers-money.html

Elliot, Carrie Brandon. “News Analysis: The TCJA’s Effects on Oil and Gas Investments” Tax Notes. (July 25, 2018) https://www.taxnotes.com/tax-reform/news-analysis-tcjas-effects-oil-and-gas-investments

THE RAINEY CENTER

Imagine a friendship between a conservative woman working in energy policy and an African American, progressive man working in national security policy. We bonded over a shared experience: Routinely not seeing any other women or people of color in rooms of policy decisions-makers. Our aspiration to see more diversity in public policy inspired us to build a policy leadership community to grow and amplify the voices of women, minorities, and mavericks in public policy, and together we launched the Rainey Centerin early 2018.

The American people are rich in their diversity. We aim to build a policymaking class that is as diverse as the America herself. The best public policy is made when many voices and experiences are at the table. More voices will yield both more creative solutions and policies designed by members of communities they impact. We also believe that inclusive governance is necessary for sustainable politics and the legitimacy of our democratic institutions.

Sarah Hunt,
Co-Founder and CEO

Bishop Garrison,
Co-Founder and President

The Rainey Center is a post-partisan, 501(c)3 public policy research and leadership development organization led by and for women, minorities, and political mavericks, named after Rep. Joseph Rainey, a former slave who was the first African-American to serve in the United States House of Representatives.

Joseph Rainey Center for Public Policy
80 M Street SE
Washington, DC 20003

info@raineycenter.org
raineycenter.org