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ANNEX

G20 Initiative on Rationalizing and Phasing Out Inefficient Fossil Fuel Subsidies

Implementation Strategies & Timetables

UNITED STATES

Part 1A: Identification of Fossil Fuel Provisions

Tax Provision	Description	Expiration	Annual Revenue Cost (millions of $)*
Permanent Provisions			
Percentage depletion for oil and gas	• Depletion is available to any person having an economic interest in a producing oil and gas property. There are generally two types of depletion--cost and percentage depletion. Cost depletion is limited to the taxpayer's basis in the property, whereas percentage depletion is not limited by the basis, but is subject to limitations based on net income derived from the property and taxable income. • Percentage depletion for producing oil and gas property (15 percent rate) is available only to independent producers and royalty owners. For marginal properties, the taxable income limitation is suspended for taxable years ending before January 1, 2010.	None Suspension of taxable income limitation for marginal properties expired December 31, 2009.	$1,003
Expensing of intangible drilling costs	• Taxpayers may elect to currently deduct intangible drilling costs (IDCs) paid or incurred with respect to the development of an oil or gas property located in the United States. For an integrated oil company that has elected to expense IDCs, 30 percent of the IDCs on productive wells must be capitalized and amortized over a 60-month period.	None	$789
Geological & geophysical expenditures	• Geological and geophysical expenditures incurred by independent producers and smaller integrated oil companies in connection with domestic oil and gas exploration may be amortized over 2 years compared to 7 years for major integrated oil companies.	None	$111
Percentage depletion for hard mineral fossil fuels	• Percentage depletion is available for coal and lignite (10 percent rate) and oil shale (15 percent rate). The percentage depletion deduction is generally subject to the alternative minimum tax at a 20 percent rate to the extent it exceeds the adjusted basis of the property. • The deduction may not exceed 50 percent of the net income from the mineral property in any year (the "net-income limitation").	None	$106

* Nominal annual average figure based on the U.S. FY 2011 Budget 10-year revenue estimate.

Tax Provision	Description	Expiration	Annual Revenue Cost (millions of $)*
Royalty taxation of coal	• Royalties received on the disposition of coal generally qualify for treatment as long-term capital gain and the royalty owner does not qualify for percentage depletion with respect to the coal. This treatment does not apply unless the taxpayer has been the owner of the mineral in place for at least one year before it is mined. The treatment also does not apply to income realized as a co-adventurer, partner, or principal in the mining of the mineral or to certain related party transactions.	None	$75
Expensing of exploration and development costs for hard mineral fuels.	• Mining companies may elect to deduct 70 percent of domestic exploration and development costs. The 30 percent of expenses that cannot be deducted must be capitalized and amortized over a 60-month period. • Taxpayers may also elect to capitalize mine exploration and development expenses and amortize them over a 10-year period. If this election is made, the expenses will not be tax preference items under the alternative minimum tax.	None	$41
Passive loss exception for working interests in oil and gas properties	• The passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. A similar rule applies to credits. Suspended deductions and credits are carried forward and treated as deductions and credits from passive activities in the next year. • An exception is provided, however, for any working interest in an oil or gas property that the taxpayer holds directly or through an entity that does not limit the liability of the taxpayer with respect to the interest.	None	$18
Deduction for tertiary injectants	• Taxpayers engaged in petroleum extraction activities may generally deduct qualified tertiary injectant expenses incurred while applying a tertiary recovery method.	None	$7
Enhanced oil recovery (EOR) credit	• 15 percent credit for expenses associated with an EOR project • Currently phased out due to high oil prices • An EOR project is generally a project that involves the use of one or more tertiary recovery methods to increase the amount of recoverable domestic crude oil	None	$0
Marginal wells credit	• Production credit ($3-per-barrel of oil or $0.50-per-1,000-cubic-feet adjusted for inflation from 2004) for marginal wells or wells that have an average daily production of not more than 25 barrels	None	$0

Tax Provision	Description	Expiration	Annual Revenue Cost (millions of $)*
	per day • Currently phased out due to high oil prices		
Domestic manufacturing deduction for oil and gas.	• A deduction is allowed with respect to income attributable to domestic manufacturing and production activities. This deduction is widely available and not targeted at fossil fuel industries. The manufacturing deduction is equal to 6 percent of the lesser of qualified production activities, limited to 50-percent of the W-2 wages of the taxpayer. For taxable years beginning after 2009, the deduction is computed at a 9 percent rate, except that the deduction for income from oil and gas production activities is computed at a 6 percent rate.	None	$1,731
Domestic manufacturing deduction for coal and other hard mineral fossil fuels	• A deduction is allowed with respect to income attributable to domestic manufacturing and production activities. This deduction is widely available and not targeted at fossil fuel industries. The manufacturing deduction is equal to 6 percent of the lesser of qualified production activities, limited to 50-percent of the W-2 wages of the taxpayer. For taxable years beginning after 2009, the deduction is computed at a 9 percent rate.	None	$6

Part 1A (cont.): Identification of Fossil Fuel Subsidies

Consumption Subsidy	Description	Expiration	Annual Cost
Low Income Home Energy Assistance Program (LIHEAP)	• A discretionary block grant awarded to States, territories, and tribes and tribal organizations to provide home heating and cooling[9] energy assistance to low-income households. • Grantees may use a portion of their LIHEAP funds for low-cost residential weatherization services and for program administration. • Federal guidelines limit eligibility to households with incomes up to 150% of poverty or 60% of State median income[10]. • The program typically reaches a small share (less than 20%) of eligible households and offsets a portion of participants' home heating and cooling expenses. • In FY 2006, the typical LIHEAP household had income at 80% of poverty and received a heating assistance or crisis benefit of $385 representing 42% of their total home heating expenditures[11].	Authorization expired at the end of FY 2007. Congress continues to provide annual appropriations.	$5,100 million for FY2010[12]

[9] Home heating and cooling accounts for about 43 percent of residential energy expenditures among low-income households. Refrigeration, water heating and other appliances account for the remainder. Source: LIHEAP Home Energy Notebook for Fiscal Year 2007, page ii.

[10] The FY 2009 and FY 2010 LIHEAP appropriations language extended eligibility to households with income up to 75% of State median income. States also have the flexibility to set lower income limits, define "income," and adopt other eligibility criteria within Federal guidelines (e.g. asset tests, living in non-subsidized housing, elderly, young child in household, utility disconnection notice, etc.).

[11] From LIHEAP Report to Congress for Fiscal Year 2006: Executive Summary.

[12] This includes $4.51 billion in base grants and $590 million in contingency funding which is released at the discretion of the Administration to provide additional assistance to States affected by energy-related emergencies.

Part 1B: Analysis of Fossil Fuel Provisions

Tax Provision	Analysis
Permanent Provisions	
Percentage depletion for oil and gas	Percentage depletion effectively provides a lower rate of tax with respect to a favored source of income. Cost depletion computed by reference to the taxpayer's basis in the property would place oil and gas producers on a cost recovery system similar to that employed by other industries and reduce economic distortions. The lower rate of tax provided by percentage depletion, like other oil and gas preferences the Administration proposes to repeal, distorts markets by encouraging more investment in the oil and gas industry than would occur under a neutral system. To the extent the lower tax rate encourages overproduction of oil and gas, it is detrimental to long-term energy security and is also inconsistent with the Administration's policy of reducing carbon emissions and encouraging the use of renewable energy sources. Moreover, the tax subsidy for oil and gas must ultimately be financed with taxes that result in underinvestment in other, potentially more productive, areas of the economy.
Expensing of intangible drilling costs (IDCs)	The expensing of IDCs provides a tax preference to the oil and gas industry. Capitalization of IDCs would place the oil and gas industry on a cost recovery system similar to that employed by other industries and reduces economic distortions. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Geological & geophysical expenditures	The accelerated amortization of geological and geophysical expenditures incurred by independent producers provides a tax preference to the oil and gas industry. Increasing the amortization period for geological and geophysical expenditures incurred by independent oil and gas producers from two years to seven years would provide a more accurate reflection of their income and more consistent tax treatment for all oil and gas producers. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Percentage depletion for hard mineral fossil fuels	Percentage depletion effectively provides a lower rate of tax with respect to a favored source of income. Cost depletion computed by reference to the taxpayer's basis in the property would place these fossil fuel industries on a cost recovery system similar to that employed by other industries and reduce economic distortions. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Royalty taxation of coal	The capital gain treatment of coal and lignite royalties provides a tax preference to these fossil fuel industries. Treating royalties as ordinary income would place taxpayers in that industry on a cost recovery system similar to that employed by other industries and reduce economic distortions. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Expensing of exploration and development costs for hard mineral fuels.	The expensing of exploration and development costs relating to coal and other hard mineral fossil fuels provides a tax preference to the these fossil fuel industries Capitalization of exploration and development costs relating to coal and other hard mineral fossil fuels would place taxpayers in that industry on a cost recovery system similar to that employed by other industries and reduce economic distortions. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Passive loss exception for working interests in oil and gas properties	The special tax treatment of working interests in oil and gas properties provides a tax preference to the oil and gas industries. Eliminating the working interest exception would subject oil and gas properties to the same limitations as other activities and reduce economic distortions. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.

Tax Provision	Analysis
Deduction for tertiary injectants	The deduction for tertiary injectants provides a tax preference to the oil and gas industries. Capitalization of tertiary injectants would place the oil and gas industry on a cost recovery system similar to that employed by other industries and reduces economic distortions. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Enhanced oil recovery (EOR) credit	The credit provides a tax preference to the oil and gas industries. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Marginal wells credit	The credit provides a tax preference to the oil and gas industries. See percentage depletion for oil and gas for further analysis of the effects of fossil fuel tax preferences.
Domestic manufacturing deduction for oil and gas.	The manufacturing deduction, which is widely available, effectively provides a lower rate of tax for income from certain activities, including the production of fossil fuels. This lower rate of tax encourages more investment in fossil fuel production than would otherwise occur. The manufacturing deduction must ultimately be financed with taxes that result in underinvestment in other potentially productive areas of the economy.
Domestic manufacturing deduction for coal and other hard mineral fossil fuels	The manufacturing deduction, which is widely available, effectively provides a lower rate of tax for income from certain activities, including the production of coal and other hard mineral fossil fuels. See domestic manufacturing deduction for oil and gas for further analysis.

Part 1B (cont.): Analysis of Fossil Fuel Subsidies

Consumer Subsidy	Analysis
Low Income Home Energy Assistance Program (LIHEAP)	LIHEAP assistance is targeted to vulnerable households (those with elderly, disabled or young children) and to the poorest (those with the highest energy burdens relative to their income). These households are targeted as they may face serious health and safety risks if they do not have adequate heating and cooling in their homes. Health risks can include death from hypothermia or hyperthermia and increased susceptibility to strokes and heart attacks. Safety risks may include the use of makeshift or faulty heating and cooling sources that can lead to indoor fires, sickness, or asphyxiation.[13] In FY 2006, 31% of LIHEAP households had an elderly member, 30% included a disabled member, and 21% had a child under 5 years old.[14] Likewise, in FY 2007, the average energy burden among LIHEAP recipient households was 16%, compared to 13% among all low-income households and 7% among households of all income levels.[15]

[13] From LIHEAP Report to Congress for Fiscal Year 2006: Appendix E, page 86.

[14] From LIHEAP Report to Congress for Fiscal Year 2006: Executive Summary.

[15] FY 2006 and FY 2007 figures are from the most recent publically available reports on LIHEAP.

Part 2: Draft National Implementation Plan for Phase-Out of Fossil Fuel Provisions

Tax Provision	Strategy and Timetable	Implementation
Percentage depletion for oil and gas	The Administration's Fiscal Year 2011 Budget proposal would not allow percentage depletion with respect to oil and gas wells. Taxpayers would be permitted to claim cost depletion on their adjusted basis, if any, in oil and gas wells. The proposal would be effective for taxable years beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Expensing of intangible drilling costs	The Administration's Fiscal Year 2011 Budget proposal would not allow expensing of intangible drilling costs and 60-month amortization of capitalized intangible drilling costs would not be allowed. Intangible drilling costs would be capitalized as depreciable or depletable property, depending on the nature of the cost incurred, in accordance with the generally applicable rules. The proposal would be effective for costs paid or incurred after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Geological & geophysical expenditures	The Administration's Fiscal Year 2011 Budget proposal would increase the amortization period from two to seven years for geological and geophysical expenditures incurred by independent producers in connection with all oil and gas exploration in the United States. The proposal would be effective for amounts paid or incurred after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Percentage depletion for hard mineral fossil fuels	The Administration's Fiscal Year 2011 Budget proposal would not allow percentage depletion with respect to coal and other hard mineral fossil fuels. Taxpayers would be permitted to claim cost depletion on their adjusted basis, if any, in coal and other hard mineral fossil fuel properties. The proposal would be effective for taxable years beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Royalty taxation of coal	The Administration's Fiscal Year 2011 Budget proposal would repeal capital gain treatment of coal and lignite royalties and the royalties would be taxed as ordinary income. The proposal would be effective for amounts realized in taxable years beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Expensing of exploration and development costs for hard mineral fuels.	The Administration's Fiscal Year 2011 Budget proposal would not allow expensing and 60-month amortization of exploration and development costs relating to coal and other hard mineral fossil fuels. The costs would be capitalized as depreciable or depletable property, depending on the nature of the cost incurred, in accordance with the generally applicable rules. The proposal would be effective for costs paid or incurred after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Passive loss exception for working interests in oil and gas properties	The Administration's Fiscal Year 2011 Budget proposal would repeal the exception from the passive loss rules for working interests in oil and gas properties. Deductions attributable to passive activities in oil and gas properties, to the extent that they exceed income from passive activities, generally could not be deducted against other income. The proposal would be effective for taxable years beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Deduction for tertiary injectants	The Administration's Fiscal Year 2011 Budget proposal would not allow the deduction for qualified tertiary injectant expenses. These costs would be capitalized as depreciable or depletable property, depending on the nature of the cost incurred, in accordance with the generally applicable rules. The proposal would be effective for amounts paid or incurred after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.

Tax Provision	Strategy and Timetable	Implementation
Enhanced oil recovery (EOR) credit	The Administration's Fiscal Year 2011 Budget proposal would repeal the investment tax credit for enhanced oil recovery projects beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Marginal wells credit	The Administration's Fiscal Year 2011 Budget proposal would repeal the production tax credit for oil and gas from marginal wells in taxable years beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Domestic manufacturing deduction for oil and gas.	The Administration's Fiscal Year 2011 Budget proposal would exclude from the definition of domestic production gross receipts all gross receipts derived from the sale, exchange or other disposition of oil, natural gas or a primary product thereof for taxable years beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.
Domestic manufacturing deduction for coal and other hard mineral fossil fuels	The Administration's Fiscal Year 2011 Budget proposal would exclude from the definition of domestic production gross receipts all gross receipts derived from the sale, exchange or other disposition of coal, other hard mineral fossil fuels, or a primary product thereof for taxable years beginning after December 31, 2010.	The U.S. Congress must pass enabling legislation for this proposal to become law.