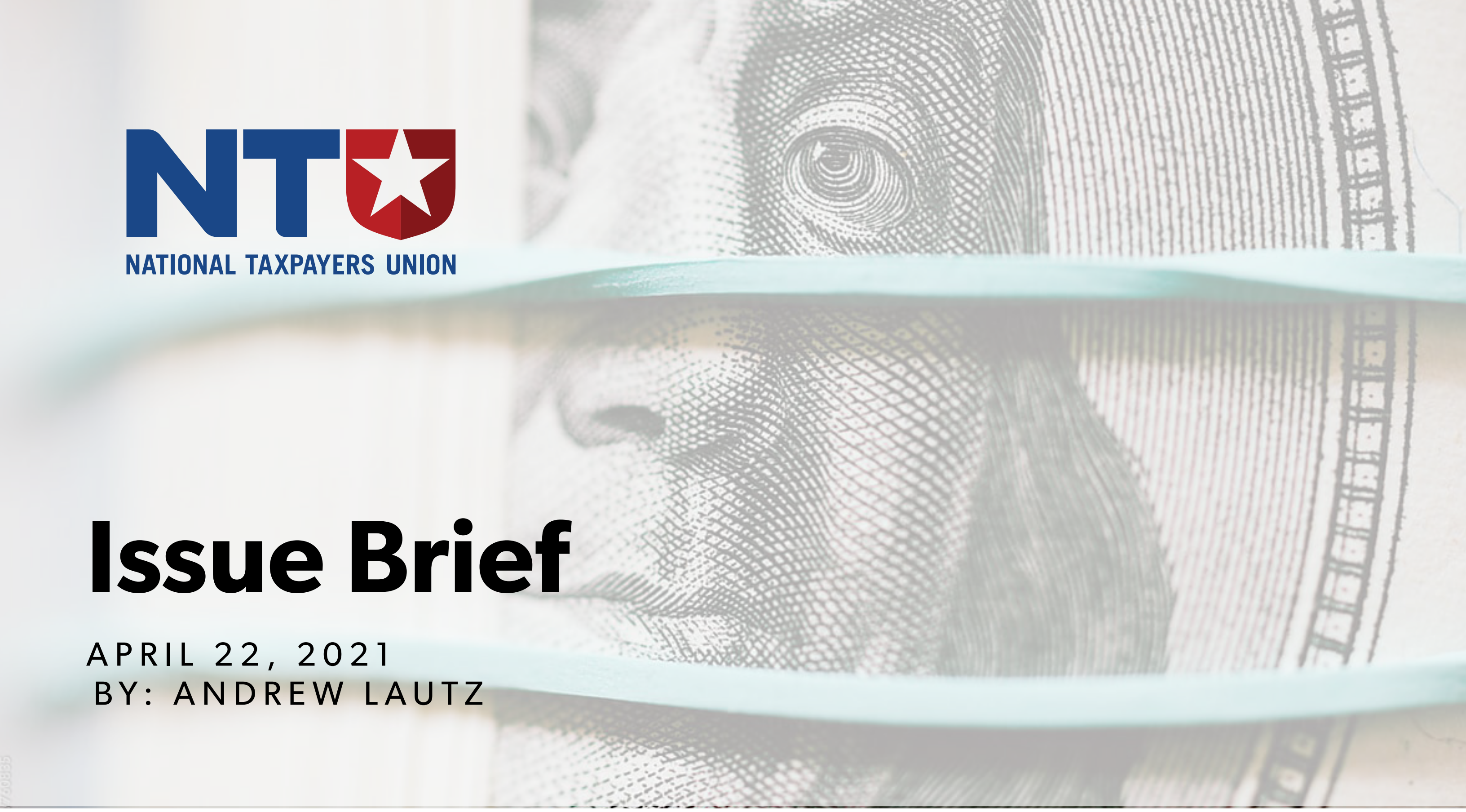

NATIONAL TAXPAYERS UNION

Issue Brief

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Sanders Bill Repealing Energy Tax Provisions Conflates "Loopholes" With Legitimate Cost Recovery

Sen. Bernie Sanders (I-VT), Rep. Ilhan Omar (D-MN), and a number of Senate and House Democrats recently introduced the "End Polluter Welfare Act," which would repeal or adjust dozens of provisions in the U.S. tax code that affect energy companies. Sanders and Omar are not short on alarming terms for these provisions, calling them "loopholes," "absurd corporate handouts," and "special interest giveaways." And while some tax expenditures no doubt add complexity and inefficiencies to the U.S. tax code, Sanders and Omar overreach by calling all the provisions they seek to modify or repeal "loopholes."

In fact, some provisions the lawmakers seek to repeal allow energy companies to access the same cost recovery opportunities afforded to U.S. companies in any other industry or sector. Other parts of the Sanders-Omar bill are punitive, seeking to put energy companies at a *disadvantage* relative to any other U.S. company, which could introduce further complexity or new inefficiencies to the U.S. tax code.

Key Facts:

The new "End Polluter Welfare Act" from Sen. Sanders and Rep. Omar conflates "loopholes" and "subsidies" with legitimate cost recovery provisions in the tax code.

Other measures of the bill are simply punitive, again challenging the notion that a tax code provision afforded to almost every industry or sector is a fossil fuel "carveout."

A better path forward to tackle climate change would be to leverage public-private partnerships in service of reducing carbon emissions.

A Summary of the "End Polluter Welfare Act"

The "End Polluter Welfare Act" is 56 pages and contains a whopping 39 sections, modifying or repealing dozens of provisions in the U.S. tax code. (A shorter, section-by-section summary can be found here.)

While reviewing each provision of the bill is beyond the scope of this publication, it's worth highlighting a few changes the Act would make:

- It would prohibit full and immediate expensing for any equipment "primarily used for fossil fuel activities" (Section 168(k) of the code) while also prohibiting fossil fuel activities from the qualified business income (QBI) deduction for pass-through businesses, the research and development (R&D) tax credit, and the Foreign-Derived Intangible Income (FDII) deduction for U.S. businesses that export goods and services abroad;
- It would alter the cost recovery terms for businesses engaged in a number of energy activities, including amortization for geological or geophysical expenses paid for the exploration for (or development of) oil or gas (from two years to seven years); natural gas pipeline depreciation (from treated as seven-year property to treated as 15-year property); percentage depletion for coal (at 10 percent currently, would be repealed) and oil shale (at 15 percent currently, would be repealed); and full and immediate expensing for qualified tertiary injectant expenses, mine or natural deposit development, mining exploration, and intangible drilling and development costs (which all move to seven-year amortization);
- The Act would add foreign oil and gas extraction income *back into* the definition of tested income for purposes of the Global Intangible Low-Taxed Income (GILTI) tax rate, effectively raising certain U.S. companies' foreign tax liability;
- It would also eliminate the ability for U.S. multinationals to offset their tax liability on foreign profits with amounts paid in royalties to foreign countries;
- It would terminate the Section 45Q tax credit for carbon oxide sequestration, along with Section 48A and Section 48B tax credits for advanced coal and gasification projects;
- It would prohibit U.S. contributions to the World Bank, or U.S. expenditures in the Advanced Research Projects Agency-Energy (ARPA-E), U.S. International Development Finance Corporation, and Export-Income Bank from going to fossil fuel projects;
- It would also prohibit the Departments of Transportation, Agriculture, and Energy from making certain grants, loans, and loan guarantees to fossil fuel projects.

These are just some of the provisions in the sprawling bill. One item worth pointing out, as Sen. Sanders and Rep. Omar wrote in their press release announcing the bill, is that the tax provisions targeted at fossil fuel energy companies collectively add up to about $15 billion per year. While $15 billion is an extraordinary amount in most contexts, it's worth putting that number in perspective: the federal government is projected to bring in around $3.5 trillion in revenue this fiscal year, meaning these energy provisions will total about four-tenths of one percent of total revenue collected by the government this year. Sanders and Omar project they can add $150 billion in revenue to federal coffers over the next 10 years by repealing these provisions; that's an increase of roughly *three-tenths* of one percent over current-law expectations.

It may be easy for Sanders and Omar to paint every single provision they want to repeal or modify as a "loophole" or "corporate handout." However, several of the provisions the lawmakers propose doing away with could punish small or independent energy businesses to the benefit of their larger competitors, and/or create distortions in the tax code that make it less efficient and more biased than it is under current law. In this regard, the costs of the "End Polluter Welfare Act" may outweigh the bill's (minimal) benefits.

Why Cost Recovery Is Not a "Loophole"

Several of the provisions mentioned above - including parts of Section 16 and 17, along with Sections 18, 19, 21, 29, 30, 31, and 32 (see the section-by-section here) - would impact energy companies' ability to more quickly recover various costs of doing business in their industries.

The Tax Foundation explains, in short, why cost recovery -- and, specifically, full and immediate cost recovery -- is such an important principle to many parts of the U.S. tax code:

> Cost recovery is the ability of businesses to recover (deduct) the costs of their investments. Although sometimes overlooked in discussions about corporate taxation, capital cost recovery plays an important role in defining a business's tax base and can impact investment decisions—with far-reaching economic consequences. When businesses are not allowed to fully deduct capital expenditures, they spend less on capital, which reduces worker productivity and wages.

And former NTU Foundation Vice President Nicole Kaeding wrote in 2019:

> Cost recovery is especially important in the energy sector, where production is exceedingly capital intensive. Firms, particularly in the oil and gas sector, spend inordinate sums of money to extract and produce energy. Allowing them to properly deduct their expenses ensures that the tax code is neutral to their investment decisions.
>
> ...The cost structures for energy companies are different than those of other sectors. For example, one provision, known as intangible drilling costs, allows energy companies to deduct their expenses incurred preparing a well for production. Other industries don't use wells. So while it seems like the oil and gas industry is receiving a special benefit, they aren't. They are being treated how other industries are; they are allowed to deduct their capital expenditures.

Worse, several of the provisions Sanders and Omar target for repeal or modification offer cost recovery for investments that *control* or *reduce* pollution, rather than contributing to pollution or carbon emissions. These include:

- Five-year amortization rules for pollution control facilities, which are designed "to abate or control water or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat," often from coal-fired facilities;
- The allowance of deductions for mining and solid waste reclamation and closing costs;
- The indiscriminate ban on certain activities being eligible for full and immediate expensing under Section 168(k).

An additional point must be made on the latter provision: Section 168(k) is not, as Sanders and Omar claim, a "loophole" for the energy industry. Instead, the lawmakers are proposing *banning* certain companies from accessing a provision of the tax code that is available to almost any other business at this time. Rather than being a "loophole" or "subsidy" or "giveaway" to energy companies, this proposal would rig the tax code *against* certain industries or sectors that are not in the favor of the lawmakers introducing the bill. That is a dangerous precedent that Congress should swiftly reject.

Certain Punitive Provisions Should Be Removed From the Act

As mentioned above, numerous parts of the Sanders/Omar legislation are less about closing "loopholes" or correcting inefficiencies in the tax code and more about punishing companies that the lawmakers introducing this bill do not like. This makes the tax code more biased, reducing efficiency in the code, and, ironically, may benefit large energy producers at the expense of smaller, independent companies.

Banning "fossil fuel activities" from full and immediate expensing (Section 168(k)), the QBI deduction, the R&D tax credit, and the FDII deduction does not correct a "loophole" in the tax code, as Congress did not *create* these provisions in the tax code with specific carve outs *for* the energy industry. Rather, Sanders and Omar would newly ban companies from accessing these legitimate provisions of the code, opening the door to lawmakers banning all sorts of specific companies or sectors from opportunities afforded them under current tax law.

Section 18, which forces independent energy producers to amortize their geological and geophysicial (G&G) costs over seven years rather than over two years, would actually remove a provision of the code that benefits smaller companies *at the expense* of their larger and better-financed peers. The nonpartisan Congressional Research Service (CRS) recently wrote (emphasis ours):

> To the extent that subsidizing geological and geophysical costs stimulate drilling of successful wells, they reduce dependence on imported oil in the short run, but contribute to a faster depletion of the nation's resources in the long run. Arguments have been made to justify the subsidy on grounds of unusual risks, national security, uniqueness of oil as a commodity, the industry's lack of access to capital, and *protection of small producers*.

There may be legitimate argument among policymakers over whether small, independent energy producers should receive more generous cost recovery opportunities than large producers. However, in choosing to merely equalize the cost recovery provisions of the code for large and small producers -- rather than, say, increasing the amortization periods for *both* large and small producers -- Sanders and Omar may harm small energy producers and inadvertently benefit large producers.

Another provision of the "End Polluter Welfare Act" would limit the ability of U.S. oil and gas companies to reduce their tax liability for foreign profits by the value of royalty payments made to foreign governments. Sanders and Omar argue this "more accurately [reflects] the payments as deductible expenses instead."

As NTU Foundation's Kaeding wrote, though:

> Oil and gas companies pay income taxes for their foreign production in the foreign jurisdiction, but often other countries also assess royalties on companies that extract resources. For example, Norway imposes a corporate income tax of 22 percent, with an additional tax rate of 56 percent on oil and gas extraction, bringing the total marginal tax rate to 78 percent. Dual capacity rules ensure that the company gets a foreign tax credit against the full 78 percent tax paid to Norway.
>
> Eliminating dual capacity rules would result in double taxation for a specific industry.

Many of these provisions will make the tax code more biased (in some cases toward larger energy producers) and less efficient -- and, as CRS warns, "[c]onventional economic theory suggests ... that tax *neutrality* is more likely to ensure that investment is allocated to its most productive use" (emphasis added).

Better Options for Tackling Climate Change

None of the critiques above are to suggest that Congress should ignore the need to tackle climate change and its deleterious impacts. However, there is certainly a better path forward than making the tax code more biased and complicated in the service of 'sticking it' to companies that are out of favor with a subset of lawmakers.

NTU has supported bipartisan legislation like the Growing Climate Solutions Act, "limited-government climate legislation that would make it easier for American farmers, ranchers and private landowners to share information and best practices, and to access private sector carbon markets should they choose to voluntarily adopt emissions-reducing agriculture and land management practices and technologies." To the extent additional legislation leverages public-private partnerships to reduce carbon emissions, Congress should thoughtfully consider such proposals.

Conclusion

Climate change is an urgent problem demanding bipartisan solutions from members of Congress and the Biden administration. That said, making the tax code more biased and less efficient is the wrong way to go, and lawmakers should reject the "End Polluter Welfare Act." Sen. Sanders and Rep. Omar may legitimately believe that every provision of current law they tackle in their legislation is a special "loophole" or "carveout" designed to benefit oil, gas, and coal companies, but that is simply not the case. Congress can and should continue its work to simplify the tax code, but should note while doing so that not every deduction, credit, or cost recovery provision is made equal.

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NATIONAL TAXPAYERS UNION

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