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IHS Report: Removal of the percentage depletion tax provision has unintended consequences for U.S. economy, small energy producers and royalty owners

National Stripper Well Association Chairman Mike Cantrell said removing the percentage depletion deduction from the tax code would have unintended consequences for the nation's economy by harming domestic energy small businesses and royalty owners.

OKLAHOMA CITY – Eliminating the percentage depletion tax provision for U.S. oil and gas producers would cut into economic growth, cost jobs and labor income, and cost the federal government a net $2.5 billion in tax revenue by 2025, and another $1.1 billion in royalty revenue from oil and gas produced on federal land, according to an economic impact assessment released today by the National Stripper Well Association (NSWA). The assessment was produced for NSWA by IHS, a leading global source of critical information and insight.

Percentage depletion is a tax provision used by oil and natural gas producers that allows them to recoup some of the costs involved in exploring for and developing fossil fuel sources.

Over the next decade (2015-2025), the economic impact of eliminating the percentage depletion deduction from the tax code would cost the United States economy $184.5 billion in gross value-added, an average of 178,000 jobs per year and $115 billion in earned labor income, the report said.

"At tax time, we could always count on getting a little bit back from percentage depletion," said National Stripper Well Association Chairman Mike Cantrell, who is a longtime marginal well operator. "That's what we would use to drill wells and rework existing wells to increase production. Some years, it was the only investment capital we had."

Cantrell said that the more than 770,000 marginal oil and natural gas wells currently in production in the United States represent nearly 80 percent of the total wells, and are responsible for "19.6 percent of the total of all oil and natural gas produced domestically."

Although they are not the only ones who use the tax provision, small independent producers who operate marginally-economic wells would be disproportionately affected by elimination of the percentage depletion deduction.

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In addition, the report found that by the end of the forecast period, the number of producing wells would decrease by 4.2 percent, and new wells drilled would decrease by 23.5 percent. Daily oil production would decrease by nearly four percent and daily gas production by two percent. The production cutback would result in more than 37,000 wells not drilled and 644 million barrels of oil, and 2.8 tcf of natural gas, not produced.

Cantrell said the "unintended consequences" of any change in tax policy that eliminates the percentage depletion allowance for oil and gas producers will be costly for the American economy. And the consequences get worse over time as investment in new wells, which would otherwise have been drilled under the current policy, are not made.

"Stripper well producers are the 'family farmers' of the oil and natural gas industry, and are collectively responsible for a significant part of the energy independence we see today in the U.S. Keeping the existing number of wells online doesn't just benefit us, it benefits all Americans," he said.

Small operators are concentrated in mature, largely conventional, oil- and gas-producing areas and consequently, more than 75 percent of the loss of producing wells, and two-thirds of the loss of new wells can be attributed to these areas. Almost every state is affected, IHS found, whether fossil fuel production exists in the state or not, although Texas is predicted to absorb more than half the drilling losses and about 45 percent of the production losses.

Private royalty owners who lease mineral rights for production and who have gotten a share of the revenue from the production of the wells in return can also claim the percentage depletion deduction.

The report noted that eliminating the percentage depletion deduction affects royalty owners in two ways. First, because it lowers the incentive it means that leasing mineral rights or lending investment capital for new wells seen as riskier investments will likely be forgone; and, secondly marginal wells will produce less or go offline, diminishing the amount of production revenue and lowering royalty owners' earnings.

Overall, private royalty owners are expected to earn $34.3 million less over the decade-long forecast period.

"Eliminating the percentage depletion tax deduction lowers the productive capacity, not only of the oil and gas industry, but the entire American economy as a whole," Cantrell said. "Our livelihood as the small business sector of the energy industry, and that of nearly 10 million royalty owners nationwide, is based upon our ability to save percentage depletion."

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ABOUT NSWA: The National Stripper Well Association was founded in 1934 as the only national association representing the interests of the nation's smallest and most economically vulnerable wells before Congress, the Administration and the Federal bureaucracies. It is the belief of NSWA that producers, owners and operators of marginally-producing wells have a unique set of needs and concerns regarding federal legislation and regulation. NSWA's sole responsibility is advocacy on behalf of these small producers.