Intangible Drilling Costs (IDCs): a critical deduction for maintaining high-paying American jobs, environmental leadership, and energy security

IDCs are not a credit nor a subsidy

Unlike tax credits, IDCs do not reduce the total taxes paid over the lifetime. Similar to the research and development (R&D) deductions, ***IDCs simply allow oil and natural gas companies to recover their intangible costs more quickly, freeing funds up to reinvest in development, resulting in more jobs.*** The IDC tax deduction has been included in the U.S. income tax code since its inception to recognize the high risks involved in drilling exploratory and developmental wells and to encourage investment in the capital-intensive production of domestic oil and natural gas. [1]

What are Intangible Drilling Costs?

When an operator drills a well, approximately 15 percent of the costs are tangible (pipe, controls, etc.) and 85 percent of the costs are intangible (IDCs). The largest share of IDCs often consists of the labor costs, which typically consists of a crew of roustabouts, roughnecks, floor hands, lead tong operators, motormen, derrickmen, assistant drillers, and the driller. Onshore labor costs typically include three crews to allow for safe and continuous operations.

What is the current tax policy on IDCs?

Independent producers can fully deduct IDCs in the year incurred, while large major integrated companies (companies that perform upstream, midstream, and downstream activities from exploration and production to refining and distribution) must capitalize 30 percent of IDCs and recover those costs over a five-year period.[2] IDCs allow operators to immediately deduct expenses, which is similar to other tax mechanisms to encourage investment, such as the deduction for R&D expenses allowed for other industries. Additionally, most manufacturing assets are eligible for bonus depreciation, which also allows for an immediate tax deduction.

What would happen if the current tax policy on IDCs is changed?

Drilling expenditures, mainly the jobs provided by exploration and development activities, account for billions of U.S. investment dollars each year, which allows ongoing environmentally protective and safe production of domestic oil and natural gas. **The short-term consequences of changing the policy would be an immediate and sharp reduction in U.S. production, and hamper the industry's ability to further invest in emissions detection and capture technologies. Additionally, Americans would face higher energy prices, likely leading to lower economic growth."**

IDCs are critical to our country's overall economic recovery from the COVID-19 pandemic

The domestic oil and gas industry played a significant role in the nation's economic recovery after the 2008 recession. Modifying the deduction for IDCs would greatly hamper the oil and natural gas industry's ability to play a similar role in the nation's post-COVID-19 recovery.

The biggest burden of eliminating IDCs would be felt by domestic independent oil and natural gas producers who account for 83 percent of the nation's oil production, and 90 percent of natural gas and natural gas liquids production. This industry supported nearly five million good paying jobs in 2018[3].

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[1] https://www.api.org/news-policy-and-issues/blog/2014/09/18/intangible-costs-real-benefits
[2] https://crsreports.congress.gov/product/pdf/IF/IF11528
[3] https://www.ipaa.org/wp-content/uploads/2019/05/IPAA-Economic-Contribution-Final-Report.pdf

Historically, ***the elimination or curtailment of the current expensing of these ordinary and necessary business expenses would result in an approximate 25 percent reduction in the number of wells drilled in the U.S. in year one***—making the U.S. reliant on foreign countries (that generally have less environmentally sound practices) to meet its energy needs. Furthermore, current expensing allows for continued investment in technologies that capture or reduce greenhouse gas emissions, recycle water, and otherwise provide for environmentally responsible and safe energy production.

How does Oil and Gas Exploration and Development Support Communities?

Oil and natural gas producers benefit American families and communities through direct and indirect job creation, significant contributions to federal, state, and local budgets, as well as through significant contributions to landowners. Eliminating the deduction for IDCs would greatly reduce the industry's ability to invest in states where the industry serves as a major economic driver.

- **New Mexico**: In 2020, oil and gas contributed nearly $3 billion to the state's general fund which accounted for nearly 40 percent of their general fund revenues. Additionally, tens of thousands of New Mexicans are employed because of oil and natural gas production.[4]
- **West Virginia**: The oil and natural gas industry supports more than 71,000 jobs and the estimated wages associated with these jobs are more than $3.5 billion. The industry has paid nearly $3 billion in state severance tax and property tax since 2008.[5]
- **Pennsylvania**: The natural gas industry supports and sustains over 300,000 jobs. Pennsylvania's severance tax, the Impact Fee, has generated over $2 billion since 2012, which has been distributed to support local government budgets and statewide environmental and conservation programs, while Pennsylvania landowners and state government benefit from over $1.1 billion annually in royalty payments.
- **Texas**: In FY 2020, the Texas oil and natural gas industry paid $13.9 billion in state and local taxes and state royalties. The industry provides over 400,000 jobs with an average salary of nearly $130,000.[6]

SUMMARY: Changes to Current IDC Tax Policy Would be Detrimental to America

The immediate deduction of IDCs simply allows oil and natural gas companies to recover their costs consistent with the economic reality of their underlying expenses, freeing up funds to reinvest in new projects that create jobs. Changes to the current tax policy would be detrimental not only to independent oil and gas producers, but to the U.S. economy, resulting in:

1) reduced nationwide investments,
2) reduced high paying jobs,
3) decreased revenue to the federal government and states, and
4) increased dependence on foreign countries to meet our energy needs.

About the American Exploration and Production Council:
AXPC is a national trade association representing the largest independent oil and natural gas exploration and production companies in the United States. We lead the world in the cleanest and safest onshore production of oil and gas, while supporting millions of Americans in high-paying jobs and investing a wealth of resources in our communities. Learn more at https://www.axpc.org/

[4] https://www.nmoga.org/benefits
[5] https://www.gowv.com/resources/gas-facts
[6] https://docs.txoga.org/files/2487-txoga_quickfacts_jan2021.pdf