

**Milbank**

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# Client Alert

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## OIL AND GAS INDUSTRY TARGETED IN RECENTLY RELEASED REVENUE PROPOSALS

On Monday, May 11, 2009, the Treasury Department released the so-called “Green Book” containing general explanations of President Obama’s revenue proposals for the upcoming fiscal year. A number of the President’s revenue proposals target the oil and gas industry. The following summarizes the most significant of those proposals:

### **Levy Excise Tax on Certain Offshore Oil and Gas Production**

Under current law, no Federal tax is imposed on the production of oil and gas on the Outer Continental Shelf. The Administration plans to work with Congress to develop a proposal to impose an excise tax on certain oil and gas produced offshore.

### **Repeal Expensing of Intangible Drilling Costs (“IDCs”)**

Taxpayers who pay or incur IDCs in the development of an oil or gas property located in the United States may elect either to expense or capitalize those costs. Taxpayers who elect to expense IDCs may deduct the amount of the IDC as an expense in the taxable year the cost is paid or incurred or may instead elect to capitalize and amortize a portion of their IDCs over 60 months. The President’s proposal would repeal the current law that allows taxpayers to elect to expense or amortize over 60 months IDCs. Taxpayers would be required to capitalize IDCs as depreciable or depletable property, depending on the nature of the cost incurred. The proposal would be effective for costs paid or incurred after December 31, 2010.

### **Repeal Passive Loss Exception for Working Interests in Oil and Gas Properties**

Passive loss rules limit the ability of certain non-corporate taxpayers to claim deductions and credits from passive trade or business activities. Under current law, an exception from the passive loss rules is provided for deductions and credits attributable to a working interest in an oil or gas property that the taxpayer holds directly or through certain entities. The President’s proposal would repeal the exception from the passive loss rules for working interests in oil and gas properties for taxable years beginning after December 31, 2010.

If you have any questions about this client alert, please visit our website at [www.milbank.com](http://www.milbank.com) or contact one of the attorneys listed below:

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### Repeal Percentage Depletion

Taxpayers recover their cost of natural resources through depletion deductions. A taxpayer may be able to calculate its depletion deductions based on the cost depletion method or the percentage depletion method. Under the cost depletion method, a taxpayer's basis recovery for a taxable year is proportional to the exhaustion of the property during that year. In contrast, under the percentage depletion method the amount of the taxpayer's deduction ranges from 15 to 25 percent of the taxpayer's gross income from the property. Current law allows qualifying taxpayers to deduct the larger of the amount determined using the percentage depletion method or the cost depletion method. The President's proposal would eliminate the ability to use percentage depletion for oil and gas wells, effective for taxable years beginning after December 31, 2010.

### Repeal Domestic Manufacturing Deduction for Oil and Gas Production

Current law provides a deduction (the "manufacturing deduction") for domestic production activities that is generally equal to 6% of the income from the sale of oil or natural gas produced in the United States. The President's proposal would modify the deduction so that it is not applicable to income from the sale, exchange or other disposition of oil, natural gas or a primary product thereof in taxable years beginning after December 31, 2010.

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