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Tax Breaks for Fossil Fuels

This is the third in a series of articles on the preferential treatment of fossil fuels. We have not been able to control for spewing CO2 into the air, as we can for other air pollutants. The EPA is presently testing this hypothesis. We have also not been able to charge for CO2 disposal by a cap and trade agreement (U.S. Rep. Markey tried). Secondly, we have allowed unsafe, environmentally destructive and very inefficient fossil fuel production to occur, as soon as these methods become economically viable. The recent evolution of hydraulic fracturing is an example. This article examines the outright advantages the fossil fuel industry has been given. Can we at least level the playing field?

Master Limited Partnerships (MLPs) are given special tax advantages (since 1986) as a way of fostering the development of energy infrastructure in this country. The general partner is the company that forms the MPL, and is thus able to maintain control with a relatively small equity stake. As long as the firms have at least 90% of their assets engaged in the extraction or transportation of energy they are not taxed at the corporate level. Instead the earnings and tax deductions are passed directly to the investor. The unit holder pays taxes on the partnership's earnings at his/her personal income tax rate. This is similar to a family owned business, but on a much larger scale. Additionally the cash distributions that the MLP pays to the investor are not all treated as taxable personal income. Often, the majority of the payment is treated as tax-free return of capital.

The U.S. energy market is expanding rapidly, in part due to the shale oil boom, and MLPs have increased 8-fold in the last decade (50 to 420 with a value of $30 billion to the present $105 billion). Recently Dominion is spinning off its oil and pipeline business as an MLP. Closing this loophole would be a good start, before new pipelines are built. This is one of many tax breaks that encourage fossil fuel production, at the expense of renewable energy companies.

On a larger scale, according to Professor Joseph Aldy (Harvard University, see Harvard Magazine, July-August 2014), the U.S. is wasting more than $4 billion a year by giving oil and gas companies tax breaks that do not benefit consumers or the economy. Some of these tax breaks date back nearly a century, when oil drilling was a very risky business. Since then the market and drilling methods have changed greatly. Aldy argues that eliminating these tax breaks could slash the national debt by $41 billion over the next decade, without materially increasing retail fuel process, reducing employment, or weakening our national energy security.

These tax breaks do not have a significant effect on production, but they do distort investment decisions. They enrich oil companies that would have drilled anyway. These taxes are indiscriminant and target neither new nor pollution-reducing technologies.

Aldy would eliminate 12 specific tax provisions; but three of these provisions would eliminate 89% of these tax breaks ($3.6 billion/year). These three provisions are the expensing of intangible drilling costs, the domestic manufacturing deduction for oil and gas, and the depreciation allowance for oil and gas wells.

At the 2009 G-20 Summit Meeting world leaders recognized that the world was subsidizing fossil fuel production to about $500 million/year and called for the practice to end. If fossil fuel production subsidies were eliminated global, usage would gradually decrease. Aldy estimates that global CO_2 emissions would fall about 7% by 2020, and about 10% by 2050.

If the President could get rid of the energy production subsidies, he could then deliver on what he committed to in 2009. It would also decrease our national debt, and would have the potential to change the behavior in other countries that also subsidize fossil fuel production.

Write our local congressional senators and representatives! CO_2 is a noxious gas; it is a greenhouse gas that increases global warming. The fossil fuel lobby can be beaten with public support for energy efficiency and renewable energy.

Article by Climate Advisory Committee member David L. Williams