FEDERAL TAX INCENTIVES FOR COAL, OIL AND GAS, AND WIND

This memorandum provides information on the availability of federal tax incentives for coal, oil and gas, and wind resources.

COAL INCENTIVES

Federal tax incentives pertaining to coal include:

- **Percentage depletion for hard mineral fossil fuels** - Pursuant to Sections 611 through 613A and 291 of the Internal Revenue Code, percentage depletion is available for coal and lignite at a rate of 10 percent of gross income from the property. The deduction is limited to 50 percent of taxable income from the property. For corporations, the percentage depletion for coal and lignite is reduced by an amount equal to 20 percent of the percentage depletion that exceeds the adjusted basis of the property.
- **Expensing of exploration and development costs for hard mineral fuels** - Pursuant to Sections 617(a) and 291 of the Internal Revenue Code, a mining company may elect to deduct 70 percent of the cost of domestic exploration and development. The remaining 30 percent of expenses must be capitalized and amortized over a 5-year period. Pursuant to Section 59(e) of the Internal Revenue Code, a taxpayer also may elect to capitalize mine exploration and development expenses and amortize those expenses over a 10-year period.
- **Capital gains treatment of coal royalties** - Pursuant to Section 631(c) of the Internal Revenue Code, a taxpayer that owned minerals in place for at least 1 year before the minerals were mined may treat the royalties from the mined coal as long-term capital gains rather than ordinary income.
- **Advanced coal project credits** - Pursuant to Section 48A of the Internal Revenue Code, tax credits equal to 30 percent of qualified investments are allocated to projects that use integrated gasification combined cycle or other advanced coal-based electricity generation technologies to capture and sequester 65 percent of carbon dioxide emissions.
- **Gasification credit** - Pursuant to Section 48B of the Internal Revenue Code, tax credits equal to 30 percent of qualified investments are allocated to gasification projects that capture and sequester at least 74 percent of carbon dioxide emissions.
- **Carbon dioxide sequestration credit** - Pursuant to Section 45Q of the Internal Revenue Code, a credit is available for the sequestration of carbon dioxide captured from industrial sources. The credit is equal to $10 per metric ton, adjusted for inflation, for carbon dioxide used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project. The credit is equal to $20 per metric ton, adjusted for inflation, for carbon dioxide permanently sequestered without first being used as a tertiary injectant. The credit is disallowed at the end of the calendar year in which 75 million metric tons of qualified carbon dioxide is certified as having been injected or sequestered.

OIL AND GAS INCENTIVES

Federal tax incentives pertaining to oil and gas include:

- **Expensing of intangible drilling costs** - Pursuant to Sections 263(c) and 291 of the Internal Revenue Code, a nonintegrated oil company may elect to expense, rather than capitalize, intangible drilling costs paid or incurred in the development of oil or natural gas property. An integrated oil company may deduct only 70 percent of intangible drilling costs. The remaining 30 percent of expenses must be capitalized and amortized over a 5-year period.
- **Cost and percentage depletion for oil and natural gas wells** - Pursuant to Sections 611 through 613A and 291 of the Internal Revenue Code, taxpayers with an economic interest in a producing mine or oil and gas property may elect to use cost depletion or percentage depletion. Cost depletion is limited to the taxpayer's basis in the property. Percentage depletion is subject to limitations based on the net income derived from the property and taxable income. Percentage depletion is available only to independent producers and royalty owners. Integrated oil and gas companies must use cost depletion.
- **2-year amortization period for geological and geophysical expenditures** - Pursuant to Section 167(h) of the Internal Revenue Code, independent producers of oil and natural gas may amortize geological and geophysical expenditures over a 2-year period.
- **Deduction for tertiary injectants** - Pursuant to Section 193 of the Internal Revenue Code, a taxpayer engaged in petroleum extraction activities may deduct, rather than capitalize, qualified tertiary injectant expenses incurred in recovering oil.

- **Exception to passive loss limitation for working interests in oil and natural gas properties** - Pursuant to Section 469 of the Internal Revenue Code, a taxpayer that owns a working interest in a manner that does not limit the taxpayer's liability may offset active income with losses from the working interest in the oil and gas property.
- **Enhanced oil recovery credit** - Pursuant to Section 43 of the Internal Revenue Code, a taxpayer is allowed a 15 percent credit for expenses associated with an enhanced oil recovery project using one or more tertiary recovery methods. The credit phases out if the crude oil reference price in the prior taxable year exceeds $28 per barrel, indexed for inflation, by at least $6.
- **Marginal well credit** - Pursuant to Section 45I of the Internal Revenue Code, a $3 credit per barrel, adjusted for inflation, applies to production of crude oil from a marginal well. A 50 cent credit per thousand cubic feet, adjusted for inflation, applies to production of natural gas from a marginal well. Marginal wells are defined as wells with an average daily production of no more than 25 barrels per day.
- **Carbon dioxide sequestration credit** - Pursuant to Section 45Q of the Internal Revenue Code, a credit is available for the sequestration of carbon dioxide captured from an industrial source. The credit is equal to $10 per metric ton, adjusted for inflation, for carbon dioxide used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project. The credit is equal to $20 per metric ton, adjusted for inflation, for carbon dioxide permanently sequestered without first being used as a tertiary injectant. The credit is disallowed at the end of the calendar year in which 75 million metric tons of qualified carbon dioxide is certified as having been injected or sequestered.
- **Deduction for income attributable to domestic production of oil and gas** - Pursuant to Section 199 of the Internal Revenue Code, an oil and gas producer can deduct 6 percent of its income attributable to the domestic production of oil and gas.

WIND INCENTIVES

Federal tax incentives pertaining to wind include:

- **Production tax credit** - Pursuant to Sections 45 of the Internal Revenue Code, the owner of a qualified renewable energy facility may receive an inflation adjusted tax credit for each kilowatt-hour of electricity generated by the facility and sold to an unrelated third party. A taxpayer may claim the credit over a 10-year period beginning with the date the facility is placed in service. Wind-powered facilities must commence construction before January 1, 2020, to qualify for the credit. The credit is equal to 2.3 cents per kilowatt-hour for electricity produced from a wind-power facility on which construction commenced before January 1, 2017. Wind-powered facilities that commenced construction after 2016 are eligible to receive a reduced credit equal to 80 percent of the credit for facilities that commenced construction in 2017, 60 percent of the credit for facilities that commenced construction in 2018, and 40 percent of the credit for facilities that commenced construction in 2019.
- **Energy investment tax credit** - Wind-powered facilities that would otherwise qualify for the production tax credit, and which are constructed before January 1, 2020, may make an irrevocable election to claim an investment tax credit, pursuant to Section 48(a)(5) of the Internal Revenue Code, in lieu of the production tax credit. The one-time credit is equal to a percentage of the total investment in the facility, which is determined based on the year construction commenced on the facility. The credit is equal to 30 percent of the amount invested in facilities that commenced construction in 2016, 24 percent of the amount invested in facilities that commenced construction in 2017, 18 percent of the amount invested in facilities that commenced construction in 2018, and 12 percent of the amount invested in facilities that commenced construction in 2019.