

# ENERGY TAX ISSUES

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## HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

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JULY 18, 2000  
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# ENERGY TAX ISSUES

TUESDAY, JULY 18, 2000

U.S. SENATE,  
SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT,  
COMMITTEE ON FINANCE,  
Washington, DC.

The hearing was convened, pursuant to notice, at 2:45 p.m., Hon. Orrin G. Hatch (chairman of the subcommittee) presiding.  
Also present: Senator Robb.

## OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH, CHAIRMAN, SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT

Senator HATCH. We are happy to call the subcommittee to order. Today, the Senate Finance Subcommittee on Taxation and IRS Oversight will examine legislation before the committee that addresses our growing dependency on foreign oil for transportation fuels.

I would like to thank Chairman Roth for recognizing the importance of this issue, and for his cooperation in scheduling this hearing.

Our dependency on foreign oil is clearly one of the most pressing economic and national security issues we face at this time. Many in attendance today will recall the energy crisis under President Jimmy Carter in 1978.

The oil embargo by Arab nations at that time brought us skyrocketing gas prices and long lines in our local gas stations. Central to the crisis was our Nation's dependency on foreign sources for 35 percent of our oil.

What is striking, though, is since the 1970's, our dependency on foreign oil has increased sharply, from 35 percent to a whopping 56 percent. Every day, Americans spend \$300 million on imported oil. This makes up a full third of our entire trade deficit. Is it any wonder the decisions made by oil-producing nations across the globe have such a profound impact on our farmers, our truck drivers, and our economy as a whole?

Our second panel today will focus on tax proposals before the Finance Committee that would go a long way toward helping us to address our Nation's dependency on foreign oil supplies by increasing our domestic oil and gas production.

Our first panel will discuss legislation to provide tax incentives to increase the use of alternative fuels in the United States. Because alternative fuels are produced and distributed domestically, increasing their use will contribute to lowering our dependency on

foreign oil. They also have the added environmental benefit of being clean-burning.

Promoting alternative fuels is an important issue to me. I played a principal role, together with Senators Rockefeller and Jeffords, in developing both alternative fuels bills that are before the Finance Committee.

I would like to point out that, in his last State of the Union address, President Clinton proposed legislation to increase alternative fuel use, but 6 months earlier Senator Rockefeller and I had already introduced S. 1003, the Alternative Fuels Promotion Act.

Since the President's speech, Senator Rockefeller and I have joined with Senator Jeffords on a revised bill, S. 2591, the Alternative Fuels Tax Incentives Act. We were joined in this effort by Senators Bryan and Robb.

While our Nation has made important technological strides toward the use of alternative fuels, these are the three principal market barriers remaining to their widespread use: one, the incremental cost of alternative fuel vehicles; two, the cost of alternative fuel; and three, the lack of alternative refueling stations in our Nation. To be effective, legislation will need to overcome all three of these particular barriers.

Senator Grams was to be our first witness, but he is not here, so we will interrupt when he comes.

So what I would like to do is introduce the first panel. We may have Senator Baucus as well, or other members of the committee who may want to make some comments.

We will now hear from our first panel to discuss tax incentives to increase the use of alternative fuels in our Nation.

I would like to welcome Hon. Jeff Groscost, Speaker of the Arizona House of Representatives. You can take your seats here at the table. Speaker Groscost, if we have to, we will fit in Senator Grams as soon as he gets here. Speaker Groscost was instrumental in enacting Arizona's Alternative Fuel Tax Credit provisions, which I am told are the strongest in the Nation.

Also participating on the panel are Mr. Richard Kolodziej, president of the Natural Gas Vehicle Coalition; Mr. William Ball, director of Strategic Planning for General Motors Advanced Technology Vehicles, representing the Electric Vehicle Association of the Americas; Ms. Michelle Robinson, senior transportation advocate of the Union of Concerned Scientists. We are happy to have you here. And Ms. Beverly Miller, director of Salt Lake Clean Cities Coalition. We are very happy to have you here, Beverly.

Ms. Miller is somewhat of a celebrity in my home State of Utah. Out of the 80 Clean Cities Coalitions in the United States, Beverly Miller was chosen the Coordinator of the Year. So, we are very proud of you for that and what you have accomplished in our State of Utah.

So I want to welcome each of you. We will begin with you, Mr. Kolodziej.

**STATEMENT OF RICHARD KOLODZIEJ, PRESIDENT, NATURAL GAS VEHICLE COALITION, WASHINGTON, DC**

Mr. KOLODZIEJ. Thank you, Mr. Chairman.

The Natural Gas Vehicle Coalition appreciates the opportunity to be here today to discuss S. 2591, the Alternative Fuels Tax Incentives Act. My name is Rich Kolodziej, and I am president of the coalition.

Our more than 180 companies represent natural gas companies, automobile manufacturers, the other equipment manufacturers and service providers, as well as environmental groups and government organizations.

Mr. Chairman, it is vitally important that we increase the use of non-petroleum alternative motor fuels. Now is the time to take action. Today there are more alternative fuel vehicle models in operation and available than ever before, domestic natural gas is readily available, and State and local governments across the country are adopting legislative incentives.

However, despite all this, consumers continue to be hesitant to buy these vehicles because of the additional cost involved and the lack of a fueling station infrastructure, the points that you have on your chart.

Congress can help by providing incentives that are going to reduce those incremental costs and spur alternative fuel infrastructure development.

Fortunately, both of these would be addressed by the prompt enactment of the Alternative Fuels Tax Incentives Act that was introduced earlier in the year, as you mentioned, with your leadership and the leadership of your fellow Finance Committee members, Senators Jeffords, Bryan, Robb, and Rockefeller. I believe just that point alone clearly demonstrates that these are not, and should not be, partisan issues.

While we have made progress, much has to be done at the national level still if we are to significantly reduce our dependence on foreign oil, improve our air quality, and develop a sustainable natural gas vehicle market.

Developing a sustainable natural gas vehicle market is important to this country because NGVs help address at least two important national policy objectives simultaneously.

First, NGVs help reduce our dependence on foreign oil. The U.S. imports significant more petroleum today, as you mentioned, than we did in 1992 when the Energy Policy Act was passed. The recent oil curtailments by OPEC members demonstrates the serious consequences of even a small disruption in world oil supply.

By the time this year is over, U.S. consumers are expected to spend almost \$56 billion more on motor fuels than they did last year because of OPEC's actions. This is roughly 20 times as much revenue in one year as might be lost to the Treasury over the seven years of the Jeffords-Hatch bill.

The only way to break free of our reliance on petroleum fuels is to increase the use of non-petroleum fuels, non-petroleum alternative fuels. Efforts to increase fuel efficiency, while laudable and important, will not improve energy security. A vehicle that gets 60 miles a gallon, or even 80 miles a gallon, still is 100 percent dependent on oil.

The second way America benefits from the increased use of NGVs is the environment. Compared to comparable gasoline vehicles, NGVs produce far less carbon monoxide, volatile organic com-

pounds, and nitrogen oxides. They even produce 20 percent less greenhouse gases.

For example, the Honda Civic GX, which is produced in Ohio, has the cleanest internal combustion engine in production today. A gasoline vehicle certified to the minimum current Federal standards emits 194 times more pollution than the Honda Civic GX.

To further put this in perspective in terms of the cleanliness of NGVs, consider that a three-mile trip to the grocery store and back in the average pick-up truck emits more smog-forming hydrocarbons than driving a natural gas Ford F-250 pick-up truck 750 miles.

Meanwhile, in the heavy-duty area, heavy-duty natural gas vehicles produce far less NO<sub>x</sub> and up to 90 percent less particulate matter than comparable diesel vehicles. In fact, heavy-duty natural gas vehicles already meet the particulate levels called for in the recently proposed EPA emission standards, and those standards won't even go into effect until 2007.

Natural gas vehicles also produce significantly less air-toxic emissions. Today there are almost 90,000 NGVs on the road, and they displace more than 90 million gallons of gasoline a year.

The U.S. produces the best and the cleanest NGVs in the world. The U.S. engine and automobile manufacturers should be commended for their impressive array of light-duty natural gas vehicles, as well as heavy-duty vehicles, including transit and school buses, street sweepers, and refuse haulers and tractor trailers.

But, Mr. Chairman, we are not there yet. Demand for alternative fuel vehicles must increase further if manufacturers are to benefit from the economies of scale that will come from mass production.

I will give you just one example. Ford Motor Company manufactured over 100,000 Crown Victoria sedans last year. One hundred thousand. Of that total, only about 1,000 were dedicated natural gas Crown Victorias. If production of natural gas models can reach critical mass, if we can get to that critical mass, the cost of NGVs will come down dramatically. That is why your bill needs Congressional action this year.

With these tax incentives in place, the natural gas industry projects that by 2010, there could be more than 1.6 million NGVs on U.S. roads, and that would displace 4 and 1/3 billion gallons of gasoline. This is almost 4.5 times the amount of gasoline consumed in Utah in 1998.

Mr. Chairman, before I conclude my remarks I would like to thank you and Senator Robb for your leadership in introducing S. 2591. Our entire industry is committed to working with you in providing our most enthusiastic support.

That concludes my oral presentation.

Senator HATCH. Thank you, Mr. Kolodziej.

[The prepared statement of Mr. Kolodziej appears in the appendix.]

Senator HATCH. Mr. Speaker, we are happy to have you with us. We will turn to you at this time, Speaker Groscost.

**STATEMENT OF HON. JEFF GROSCOST, SPEAKER OF THE  
ARIZONA HOUSE OF REPRESENTATIVES, PHOENIX, AZ**

Mr. GROSCOST. Thank you, Senator Hatch and members of the committee. I appreciate the opportunity to be here. I appreciate the leadership that you folks are showing in moving forward with this initiative. I wanted to talk a little bit about what has happened in Arizona.

I've got to admit that what happened in Arizona was after driving up the freeway in Utah and seeing signs that said "Natural Gas—62 cents a gallon" and wondering exactly what the heck it was that was underneath that \$1.32 a gallon in St. George that only cost 62 cents a gallon. As you drive on up the freeway, you see the same sign in Cedar City, in Fillmore, in Provo, Utah, and actually all the way up to the Canadian border in what used to be the mountain fuel service area.

As we started investigating it, we found out there was an alternative that, at the time, which was 1993 when we were being kicked upside the head by the EPA for non-attainment in the Phoenix metro region, that it was a component that we could use to help us solve our clean air problem, or rather our problem with dirty air.

As we further investigated, this was not a Star Wars technology, but rather a technology that was off the shelf and was absolutely something that we thought that we could incorporate into our constituents' lifestyles.

As we have moved forward, we have worked on three specific areas in our legislation or three things that we have tried to incorporate. The first, is fuel neutrality. In other words, any alternative fuel which, in fact, can clean the air, we give a fairly impressive array of credits and grants for.

The second, is those incentives are based on the fact that we think that we can move more people with incentives rather than mandates, something that I would suggest, if you look at California with its mandate for 10 percent of its fleet to be electric by the year 2003, then look at Arizona, where we have put in fairly heavy incentives. You will see that, not per capita but in actual numbers, we actually have more electric vehicles than California does.

The third thing, would be we base it on the actual reduction of pollution. In other words, we use the good, old-fashioned free enterprise system to try and motivate people by giving them a bigger reward when, in fact, they reach a better standard. We give them a larger reward on what they can get back by way of grants or tax credits.

Those specific grants and tax credits in Arizona mirror a lot of the things that you have in your bill. I can tell you, one new component that you have in your bill that we absolutely are going to go back next year and try and incorporate into our program, is the tax credit you have for fuel usage.

For us, that is especially important because we have allowed bi-fueled vehicles into our program, only because in Arizona, much like Utah, you have a long driving distance between destinations. Without a bi-fuel, it severely limits the use of a vehicle or the applicability for the customer.

So by utilizing the tax credit that you have on actual fuel usage, we think that we can overcome the problem of people tending to use gasoline instead of natural gas and the bi-fuels.

Although, I have got to tell you, when gasoline is over \$1.50 a gallon and natural gas, if they fuel at home with a fuel maker, is only 42 cents a gallon, it is not too hard to get people to drive on the natural gas.

In Arizona, our first incentive is when you buy the vehicle. If it is either an OEM or if it is converted before you take delivery, there is no sales tax on the vehicle. On a \$30,000 truck, that is about, in Arizona, a \$2,800 savings.

The second, is if it is either an OEM or if it is converted before you take delivery of the vehicle from the dealer, we will pay—your vehicle license tax on a \$30,000 vehicle in Arizona is about \$600. It is one of our more onerous taxes. If it is an alternative fuel vehicle, we give a permanent, one-time registration and the plate only costs \$70 as opposed to that \$600 per year.

The third incentive, is we will pay the cost of the conversion or the incremental cost on an OEM. For instance, on the Honda Civic that was just talked about, we will pay the difference between the natural gas Civic and the cost of a Civic that runs on gasoline.

Then the fourth incentive, and probably the largest incentive, is one that we have put in place that I think demonstrates that we really do want to make a difference in our air quality. That is based on the pollution reduction.

If, under EPA's Memorandum 1A the platform can be certified to be at least a low-emitting vehicle, an LEV, we will give 30 percent in tax credit against the entire cost of the vehicle. So in other words, \$9,000 on that \$30,000 truck.

If it can reach ULV, ULEV, or ILEV, ultra-low or inherently low-emitting vehicle status, we will give 40 percent tax credit against the cost of the vehicle. If they can reach SULEV or ZEV, we will give 50 percent tax credit against the cost of the vehicle.

I can tell you that we actually have up-fitters in Arizona which are meeting ILEV and ULEV on vehicles that did not even have LEV standards associated with them, such as Suburbans. Everybody just assumed they were so polluting there was no reason to even establish a LEV standard.

We have a four-month waiting list on Suburbans at a dealership near my home where, literally, they are four months behind, about 800 vehicles, in being able to convert those in time to get them into the public's hands.

It has made a difference in Arizona. Now we are in our fifth year without a single violation of any of the hydrocarbons, CO, knocks. We are in our fourth year without a single violation of the ozone standard. We are ready to be upgraded back to moderate from serious. As late as 1995, we had 11 violations of ozone. It has made a huge difference.

The biggest thing that I would like to see added to your legislation, which I think would do exactly what our legislation has done in Arizona, and that is remove the barriers to people trying natural gas for the first time, realizing it is a domestic product, something that, if you have driven through an oil field, you see them burning off the natural gas to get to the petroleum. It is much more plenti-

ful than the petroleum, it is less expensive, as well as being cleaner.

The one thing I would like to see added, is we now see a specter of the IRS beginning to count what are very generous credits, rebates, and tax credits as normal income for tax purposes.

I guess I have got a problem with the State of Arizona putting large incentives out there to move people, only to see those incentives being eaten up in their Federal taxes. That would be the one thing that I would love to see added.

Other than that, with or without that, I would be extremely supportive of the legislation and would like to thank the committee for taking it forward.

Senator HATCH. Thank you so much, Speaker.

[The prepared statement of Speaker Groskost appears in the appendix.]

Senator HATCH. Mr. Ball, I wonder if I could ask you to relinquish your seat. Then Senator Grams, we are going to take your testimony next.

Rod, we are happy to have you here. We look forward to your testimony right now. Then we will go to Mr. Ball.

#### STATEMENT OF HON. ROD GRAMS, A U.S. SENATOR FROM MINNESOTA

Senator GRAMS. Thank you, Mr. Chairman. Thanks for accommodating me. I appreciate Mr. Ball giving up his seat. So, thank you very much.

But I want to thank you, Mr. Chairman, for holding this hearing today on our Nation's growing reliance on foreign oil and our need to find ways in which we can reduce that reliance.

Mr. Chairman, for many, including the farmers, the truckers, businesses, and families of our Nation, the rising price of gasoline is quickly becoming a crisis. I look at the situation we are now facing with high fuel prices and I have a hard time understanding why it is such a surprise to so many people in Washington.

Now, it is important to remember that energy supply and price concerns are nothing new. We have had decades to respond to the threat of supply disruptions and to decrease our reliance upon foreign oil.

The DOE was created by President Jimmy Carter in response to the energy crisis in the early 1970's, and at that time, Mr. Chairman, we were reliant on foreign oil to meet only 35 percent of our needs. Today, despite hundreds of billions of taxpayer money wasted, we are almost 60 percent reliant on foreign oil.

In fact, since 1992, U.S. oil production has been reduced by 17 percent, but our consumption of oil has increased by 14 percent. In 1990, U.S. jobs in oil and gas exploration and production were roughly 405,000. Today, those jobs have been reduced to approximately 290,000. That is a 27 percent decline.

In 1990, the United States was home to 657 working oil rigs. Today, there are only 153 scattered across the Nation. That is a decrease of 77 percent.

Now, those numbers, I believe, represent overwhelming proof that our Nation's domestic energy policies are the underlying crisis and the cause of the high fuel costs. That is one of the reasons why

I have joined many of my colleagues in the Senate in urging an immediate response to our reliance on foreign oil that considers both short and long term remedies.

Our Nation, first, must find a way to encourage increased domestic oil and gas exploration and production, and I am pleased that your committee is looking at tax incentives that could help.

Our Nation has its own reserves of crude oil and natural gas, but current regulations and administration policies have significantly impacted our ability to access those reserves.

I am also a strong advocate of turning even more of our attention to the development of domestically produced renewable sources of energy. I have long been an advocate of the renewable energy programs because I know they are good for our economy and they are good for the environment.

They can also lessen our reliance on foreign oil, which prompts me to urge your consideration today of my ethanol tax bill.

Mr. Chairman, Minnesota is now home to over a dozen operating ethanol plants with a capacity of over 200 million gallons annually. These plants mean new jobs, good wages, good benefits for people living in rural areas where these plants are built.

According to a report by the Minnesota legislative auditor, these plants and the resulting economic activity are expected to create as many as 5,000 new high-wage jobs. In addition to its positive economic impact, ethanol production allows our Nation to move away from our dependence on foreign energy sources.

The U.S. Department of Agriculture estimates that for every gallon of ethanol produced domestically, we displace seven gallons of imported oil. Ethanol plays a role in increasing our National energy security by providing a stable, home-grown, renewable energy supply; ethanol is estimated to reduce our demand for foreign oil by as much as 98,000 barrels per day.

So today, Mr. Chairman, I am introducing legislation that will allow small, farmer-owned cooperatives to access the full benefits of the small ethanol producer tax credit.

Mr. Chairman, current law provides for an income tax credit of 10 cents per gallon for up to 15 million gallons of annual ethanol production by a small ethanol producer.

A small ethanol producer is one defined as having a production capacity of less than 30 million gallons per year. The credit was enacted as part of the Omnibus Reconciliation Act of 1990 and it was championed by our former colleague, Senator Bob Dole.

Unfortunately, the credit was enacted at a time when the growth and the shape of the ethanol industry was still difficult to predict. This has led to an unfortunate situation in Minnesota, Iowa, and in other areas where farmer-owned cooperatives have been unable to access the credit due to the way in which the original legislation was drafted.

Now, Mr. Chairman, the original legislation certainly envisioned these small, farmer-owned cooperative as being eligible for the tax credit, but the intricacies of the Tax Code have made it impossible for them to do so. My proposal would simply provide a technical correction to ensure that farmer-owned cooperatives are included in the definition of who can benefit from the small ethanol producer tax credit.



My bill also expands the definition to include facilities with less than 60 million gallons of annual capacity rather than 30 million gallons under current law.

I want to again stress that this proposal is consistent with the original intent of the 1990 law that created the small ethanol producer tax credit. Farmer-owned cooperatives were never intended to be excluded from receiving the benefits of the tax credit if they produced less than 30 million gallons.

It was just hard to envision the role and the growth of the cooperatives when we passed the law back in 1990. Now, cooperatives are not huge corporate ventures, but they are an association of small farmers.

So, in closing, Mr. Chairman, I believe that reducing our Nation's reliance on foreign oil will require a multi-faceted approach that leaves no stone unturned in our quest for increased domestic energy production.

I believe that ethanol must play a very strong role in reducing our reliance on foreign oil, and the legislation that I am introducing will help us achieve that very, I believe, vitally important goal.

So I want to thank you again, Mr. Chairman, for taking time for my testimony, and I appreciate the accommodation. Thank you.

Senator HATCH. Well, thank you, Senator. We appreciate that testimony. I hope you will put me down as a co-sponsor of your bill.

Senator GRAMS. Thank you.

Senator HATCH. I think we have to develop every alternative fuel we can.

Senator GRAMS. Thank you.

Senator HATCH. We are very honored to have you here today.

Senator GRAMS. And like I said, I think the intent of the law never was to exclude these cooperatives, and we just need a technical correction to make sure that they can do it, and would encourage the protection.

Senator HATCH. Well, thank you, Senator.

Senator GRAMS. Thank you very much.

Senator HATCH. We appreciate you being here.

Senator GRAMS. Thank you.

Senator HATCH. Mr. Ball, we will take your testimony at this time.

**STATEMENT OF WILLIAM L. BALL, DIRECTOR, STRATEGIC PLANNING, GENERAL MOTORS ADVANCED TECHNOLOGY VEHICLES, REPRESENTING THE ELECTRIC VEHICLE ASSOCIATION OF THE AMERICAS, DETROIT, MI**

Mr. BALL. As a native Minnesotan, it is a pleasure to have yielded to the Senator.

Senator HATCH. Well, you were very gracious to do so, and we appreciate it.

Mr. BALL. Mr. Chairman, my name is Bill Ball. I am the director of Strategic Planning for General Motors Advanced Technology Vehicles Group. I am appearing today on behalf of the Electric Vehicle Association of the Americas.

Currently, I am the automotive co-chair for this national, non-profit association of electric utilities, auto manufacturers, and sup-

pliers, state and local governments, and others who have joined together to support the greater use of electric drive technologies.

A principal activity of our organization is to encourage the adoption of government policies that will facilitate the development and use of electric modes of transportation. We appreciate this opportunity to testify.

EVAA believes that targeted tax incentives, put in place immediately and remaining available until markets and infrastructure develop, are the most effective means by which government can partner with industry and consumers to build a long-term sustainable market for electric drive and other alternative fuel technologies.

With over 100 years of technical development, current automotive transportation offers choices that are efficient, reliable, consumer-friendly, and affordable, with a convenient and nationwide refueling infrastructure. All of these attributes have yet to be proven for electrics and other modes of alternatively fueled personal transportation.

However, transportation, fueled by electricity is a potential contributor to achieving energy diversity and more efficient use of energy resources. Electricity is inexpensive, stable, and generated from a variety of domestic fuels.

For each 1 percent of our rolling stock that is replaced with electricity fueled vehicles, we can reduce our motor vehicle petroleum use by a commensurate one percent.

The Energy Policy Act of 1992 recognized this by including modest, targeted tax credits for battery, fuel cell, and certain hybrid electric vehicles. However, these tax credits are scheduled to begin phasing out in 2002 and expire in 2004. This timing will not provide the necessary incentives to support the introduction of these technologies.

While every major automobile manufacturer now has offered battery electric vehicles for sale and/or lease on a limited basis, these products entered the market later than anticipated, and subsequently, the market has not developed as quickly as envisioned.

In 1996, General Motors was the first auto manufacturer to introduce a modern, ground-up electric vehicle, the EV1, to certain regional U.S. markets. Since that time, the industry has delivered approximately 3,200 light-duty electric vehicles and 200 electric buses.

In addition to current electric vehicles, several automobile manufacturers, including Ford, Toyota, and Nissan, already have, or will soon, demonstrate and/or introduce small, two-passenger all electric vehicles into the U.S. market.

These vehicles, often referred to as "city cars" have the potential to change our current perspectives on personal mobility. Much like we have added technologies such as microwaves and cell phones to supplement and enhance food preparation and communications, supplementing the traditional family car with a generation of specialized mobility options may prove exceedingly attractive to consumers.

Another new member of the electric drive family that is premiering to high marks from environmental groups and consumers alike, is the hybrid electric vehicle. Last year, Honda began

selling its hybrid, the Insight, in the U.S. market and has promised to make available other platforms.

Toyota introduced its hybrid electric product, the Prius, this month to the U.S. market, having already sold over 30,000 units in the Japanese market. All of the other major auto manufacturers have committed to sell hybrid-electric vehicles in the U.S. within the next 3 to 4 years.

Hybrid-electric vehicles can provide excellent fuel efficiency, and can have excellent environmental performance in addition to being an important step toward promoting the development of electric drive, battery technologies, and controls.

The "youngest" member of the electric drive family, the fuel cell electric vehicle, which can harness the chemical energy of hydrogen and oxygen to generate electricity, has the potential to change the way we think about energy.

Fuel cells are more efficient than other technologies that rely on direct combustion and they produce zero, or near-zero emissions. All of the major auto manufacturers are investing heavily to develop this technology and each has committed to attempt to commercialize fuel cells by the end of this decade.

The challenges to these electric modes of transportation, whether battery, hybrid, or fuel cell, remain the cost of the current generation of technologies used in the vehicles, the limited availability of charging infrastructure, and the resulting continuing lack of consumer experience with the technology.

Mr. Chairman, the legislation that you and Senator Jeffords and others have introduced, the Alternative Fuels Tax Incentives Act, provides incentives that are critical to ensuring that those electric drive technologies that use alternative fuels have a chance to become part of the 21st century transportation mix.

EVAA endorses the legislation and applauds you for your proposal. By extending and enhancing current tax incentives for electric vehicles, S. 2591 assures that the necessary level of government support remains in place.

We urge you and the subcommittee to work with your colleagues in the House who have proposed similar legislation to ensure that the legislation is enacted as quickly as possible.

Thank you again for this opportunity to testify, Mr. Chairman.

Senator HATCH. Thank you, Mr. Ball. We appreciate having you here.

[The prepared statement of Mr. Ball appears in the appendix.]

Senator HATCH. Ms. Robinson, we will turn to you.

**STATEMENT OF MICHELLE ROBINSON, SENIOR TRANSPORTATION ADVOCATE, UNION OF CONCERNED SCIENTISTS, WASHINGTON, DC**

Ms. ROBINSON. Good afternoon. My name is Michelle Robinson and I am the senior transportation advocate for the Union of Concerned Scientists.

Thank you for the opportunity to speak on behalf of our 80,000 scientist and citizen members across the country about the critical role for alternative fuels and advanced vehicle technologies in our transportation system.

UCS has done a great deal of analysis in this area, so I am pleased to share some of what we have learned with you today.

There are three compelling reasons, we believe, to move more alternative fuels and advanced technology into our transportation system: clean air, a more stable climate, and energy independence.

As you are well aware, cars and trucks are responsible for a large share of our air pollution problem. One in two Americans breathe unhealthy air today, with motor vehicles contributing over 50 percent to urban air pollution.

It is true that, due to tighter standards and technical innovation, emissions from conventional cars and trucks have been reduced substantially over the past 30 years. However, the number of vehicles on the road and the miles that they travel have increased exponentially, offsetting the pollution reductions from individual vehicles.

Smog-forming pollutants and soot from gasoline and diesel-powered vehicles pose a serious health threat. As the local air quality today reminds us, we are no strangers here in Washington to orange and red alert pollution days.

Urban ozone and fine soot particles irritate the respiratory system and have been linked to increased hospital admissions for respiratory problems such as asthma. A recent study found that, in areas with high levels of fine particulate pollution, the risk of early death was 26 percent higher than in less polluted areas.

In addition, fine particles and diesel exhaust are considered a growing toxic threat to human health. Diesel exhaust contains over 40 chemicals that are listed by California and the United States. EPA as toxic air contaminants, probable human carcinogens, known human carcinogens, and reproductive toxicants. In fact, over 70 percent of the cancer risk in the Los Angeles area is attributed now to diesel particles.

But this is not just an urban problem. An article titled "Smokies Becoming Peaks of Pollution" in today's Washington Post points this out. Average daily exposure to harmful ozone can be two times higher at mountain peaks than at ground level in cities like DC or Atlanta.

This is increasingly obscuring the vistas and affecting the tissues of trees, much as those that affect human lungs, at the Nation's most visited national park, and unfortunately at Shenandoah National Park nearby.

In terms of the gases that are contributing to global warming, the transportation sector accounts for one-third of U.S. carbon emissions and is the fastest-growing sector in terms of carbon contribution.

There has never been a more important time in our transportation history to invest in cleaner vehicles and fuels. The recent oil price fluctuations are an expensive reminder of the economic risks of relying on foreign oil sources for over half of our petroleum supply. We currently send over \$180,000 per minute overseas to buy foreign oil, driving our trade deficit to record levels.

Clearly, there is no silver bullet to address the multiple health and environmental challenges created by our transportation system. There is a role for government, industry, and the consumer in reducing motor vehicle pollution.

We at UCS will continue to work to ensure that industry makes cleaner, more efficient conventional cars and trucks available in today's vehicle market, but introduction of alternative fuels and advanced vehicle technologies is critical for environmental and health protection in the long term.

Greater Federal investment in the success of these technologies is something Congress can do right now to help solve all three of the challenges posed by reliance on oil for mobility.

Vehicles that use alternative fuels and advanced technologies such as natural gas, electricity, hybrid technology, and fuel cells, as have already been mentioned, are inherently cleaner than today's gasoline cars and diesel trucks and buses.

To use buses as an example, the immediate environmental benefits from currently available alternative fuel buses can be considerable. The reduced emissions of precursors to smog and soot make replacing a new diesel bus with a natural gas bus equivalent to taking 20 to 30 cars off the road.

Battery electric power is an excellent match for smaller buses and shuttle services, with successful programs now in place in Chattanooga, TN and Santa Barbara, CA. The shuttle buses running in these cities are over 90 percent cleaner in terms of key pollutants and their diesel counterparts.

Ultimately, fuel cell buses, now being demonstrated in some U.S. and Canadian cities, will, when powered by alternative fuels, offer zero or near-zero emissions of regulated pollutants.

In this era of e-commerce, delivery trucks are another example of fleets that are perfect candidates for alternative fuels. Cleaner, efficient natural gas and electric models are now on the market, but cost remains a hurdle.

Fortunately, a growing number of States such as Arizona and Connecticut have been providing tax credits, but it is now time for the Federal Government to follow suit and you are taking leadership in that regard.

All of us sit behind belching garbage haulers and send our children off to school in aging, gross-emitting school buses. Tax policy that will bring down the initial costs of vehicle technologies, cleaner burning fuels, and appropriate infrastructure will make an enormous difference in the quality of life for your constituents.

Our work with state government transit authorities, school districts, business and community leaders across the country convinced us that there is strong interest in finding new technological solutions to existing air quality and public health problems.

We encourage you to demonstrate your support for the consumer and environmental protection promised by alternative fuels and vehicles by moving legislation such as the Alternative Fuels Tax Incentives Act, which you are the lead sponsor on, Mr. Chairman.

UCS supports your bill, I wanted to say, because it embodies two key concepts. First, it targets technologies that meet multiple environmental goals. Policies that reward technologies that make progress on one front only, for example, fuel efficiency, while losing ground on another, air quality, are ultimately inefficient and counter productive. So, we are pleased that your bill targets multiple goals.

Second, it addresses both vehicles and fuels. The environmental performance of motor vehicles is inextricably linked to the type of fuel it uses.

So we look forward to working with you and others in the Finance Committee, and others on this panel, to advance meaningful tax incentive legislation in the coming months.

Thank you for your leadership and your time today.

Senator HATCH. Well, thank you. We appreciate it.

[The prepared statement of Ms. Robinson appears in the appendix.]

Senator HATCH. Ms. Miller, we are happy to have you here. We know you have come a long distance to testify and you have a reputation that really is important in this country, and certainly in our home State of Utah. So, we are happy to listen to you now.

**STATEMENT OF BEVERLY MILLER, DIRECTOR, SALT LAKE CLEAN CITIES COALITION, SALT LAKE CITY, UT**

Ms. MILLER. Thank you very much. Well, it is definitely an honor to have been invited.

Mr. Chairman, I am Beverly Miller, director of the Salt Lake Clean Cities Coalition located in Salt Lake City, Utah. It was delightful to me to hear that Utah was an inspiration to Arizona, because Arizona right now is inspiring everybody. So, congratulations to you, Mr. Speaker.

Mr. GROSCOST. I think I sat in your office in the old courthouse when we started that.

Ms. MILLER. Really? All right.

Well, my grass roots organization serves a metropolitan area of 1.7 million people along the Wasatch Mountains. It is my honor to present testimony on behalf of the proposed Alternative Fuels Tax Incentives Act, Senate bill 2591.

Salt Lake Clean Cities, along with its 80 peers across the country, other clean cities, strives to place more alternative fuel vehicles, or AFVs as we call them, on our community highways.

Utah has approximately 3,600, running primarily on natural gas and propane. We are also charged to help develop a self-sustaining infrastructure to refuel these vehicles.

We enjoy the fourth largest natural gas refueling infrastructure in the country after California, Texas, and Georgia. The infrastructure includes private on-site stations, public stations, and much of that is networked together by a common credit card.

We are very proud of our efforts and our successes, but 3,600 are not a lot of vehicles, nor is that number quickly growing. There are people within my organization whose job it is to market AFVs, such as local auto dealers and alternative fuel sales people. Many of the 55 volunteer stakeholder groups enthusiastically talk up AFVs. We have been steadily at it for five and a half-years, yet the numbers still have not come.

It is our opinion the numbers have not come for several reasons. People dislike change. In the early days of AFVs, some had a bad experience and they do not forget this forever. People listen to and believe rumors.

When it comes to buying a vehicle, people like options and they want those vehicles to be as good as, or better than, what they are

used to. They want refueling to be drop-dead easy. There is also a cost factor. As the sign points out, AFVs cost more and so do refueling sites.

Fortunately, in Utah our natural gas fuel is very low, very inexpensive, and it has probably been the single most important factor in the State that we have had control over to make a difference.

The Clean Cities program was created to provide education, information, assistance, and training to help change people's attitudes about alternative fuel vehicles, and we work very hard at that job.

We also offer small financial incentives to buy down the cost of the vehicles, and though helpful, the incentives have not been sufficient enough to make a difference, apparently.

Recently, the National Conference of State Legislatures located in Denver, CO conducted a study to see what incentives would help move the industry ahead. The results showed that incentives must be: (1) big enough; (2) easy to use; (3) focused on infrastructure; and (4) focused on fuel use.

Senator Hatch's proposed Alternative Fuels Tax Incentives Act appears to meet those requirements, and with the proposed AFV credit, even goes beyond. I might sort of second Senator Grams' comments about ethanol as a fuel. It is a clean fuel as far as we are concerned.

We are fuel neutral. We work for whatever clean fuel we can get into our State. If we have help with ethanol, that would be very much appreciated.

The recent increase in the cost of gasoline and diesel has actually made a difference for us by causing people to at least be interested in AFVs, because locally, natural gas is half the price of gasoline. We have encouraged our AFV fleet managers to talk about what they save, sometimes tens of thousands of dollars on fuel and maintenance.

We have seen some buying activity as a consequence, but we still remain sort of a speck on the wall when it comes to transportation fuel at percentage of use. We are like 3 percent in the country. Three percent of transportation fuels are alternative fuels. We need assistance, and I see the assistance coming from the Federal Government, which could once again take a leadership position.

Senate bill 2591 would complement the action Congress took in 1992 when it passed the Energy Policy Act. It is important to note that, nationwide, the largest AFV fleets today tend to be the three fleets that Congress mandated in 1992.

The Energy Policy Act directed the Federal Government, all the States, and all alternative fuel provider fleets to begin buying AFVs. Obviously, that directive has been successful because the mandated fleets have AFVs in far greater numbers than non-mandated fleets.

Strong language, action, leadership for the Federal Government have greatly helped us get to where we are today, so it could help us again. But we are not asking for mandates. This request is for incentives.

Another reason to support Senator Hatch's bill is tied to the fact that the Federal Government is investing heavily in building and rebuilding the Nation's roads, such as Salt Lake City's freeways.

Our local newspapers now, however, tell us that more roads will be needed in spite of the additional and rebuilt freeways, which means more traffic and more emissions.

We would like to see the public be given a range of options in the vehicles they buy. If people must drive their personal vehicles everywhere they go, let us have them drive clean-burning ones.

One last plug for the bill. Salt Lake Clean Cities is working with the Salt Lake Olympic Organizing Committee to bring AFVs to the Winter Games in Utah in the year 2002. We are developing a local resale program for all the AFVs provided by General Motors, who is an Olympic sponsor.

The goal is to keep those clean-fuel vehicles in our State as a legacy after the Games. Reducing the cost of alternative fuels would greatly help us market the AFVs, not just to fleets, but to the general public.

My hope for the future is to offer my friends and neighbors a clean-fuel vehicle they can afford to buy and to operate, and so I would appreciate your help in making that a reality.

Thank you very much, Senator, for this time. I appreciate being here.

Senator HATCH. Well, thank you so much. We are glad to have you here.

[The prepared statement of Ms. Miller appears in the appendix.]

Senator HATCH. Speaker Groscost, I was very impressed with your comments and what you had to say, and what Arizona is doing. I was also impressed with the contrast that you mentioned between Arizona and California, which has mandates. You have incentives, and your incentives have produced more, as I interpret it, actual vehicles on the road than has California, with 34 million people.

Mr. GROSCOST. We have. In fact, we do have fairly generous incentives, but they are incentives that first originated when we took a look at some incentives that we had put into one of our local power companies to put new stacks on one of their coal-generated stations. We realized just how large of a tax credit we had given them.

The thought process was, what would happen if we gave a small portion of that to our mobile sources, which are our constituents, the people that drive around in our non-attainment area every day? They are very generous incentives.

They do, in fact, motivate the market and they also, because they are tied not only to the fact that it is an alternative fuel, but beyond that to the pollution reduction of that vehicle.

We have actually seen a large competition among those who are converting vehicles to move those vehicles from just being a low-emitting vehicle up to an inherently low- or ultra low-emitting vehicle.

As a matter of fact, just before I left I was told of one of them that had, through the EPA, actually gained an ultra low-emitting vehicle certification on a Ford F-150 pick-up.

Now, the reason that that is significant, is because all of a sudden instead of a 30 percent grant, they get a 40 percent grant. In fact, what you say is accurate. Within 10 days after we passed the



legislation, it offered a positive tax credit, which basically means this is a grant from the general fund.

We had sold every Honda Civic that was described by the gentleman to my left in the entire country in Arizona, and there is at this point a six-month waiting list of about 1,000 vehicles that the individuals have put down \$2,000 deposits, even knowing that they are not going to see that car for up to 6 months.

So, in fact, those incentives, exactly as you have mentioned, have truly moved the market. They have got people engaged, and overcome the issues that we heard Ms. Miller talk about a moment ago.

Senator HATCH. Ms. Miller, if you had the same statutes in Utah as they have in Arizona, do you think you would increase our total vehicles?

Ms. MILLER. Well, we are going to find out come January 1, 2001. Our proposed change in the State tax credit is not quite as lovely as Arizona's, but it is certainly a step up.

Senator HATCH. So you are moving in that direction.

Ms. MILLER. We are moving in that direction, right. But I really do welcome the language in this proposed bill that talks about encouraging fuel use, because we have been putting money toward buying vehicles. In some cases, there is a choice of fuel. They are called bi-fuels. You can use gasoline or you can use propane or natural gas.

Frequently, the choice falls on the side of what is known, and that is gasoline. So in the State of Utah, you do not take your dedicated Honda Civic to Moab, because you will not be able to get back because there is no fueling down there.

You need a bi-fuel. You want to take a General Motors vehicle. Then you have a choice. But if the fuel use is encouraged, then whenever the opportunity is there to use the alternative fuel, the operator will make that choice. We have never done this before. This is a new concept.

Senator HATCH. That is great.

Mr. Kolodziej, what kind of growth have we seen over the last few years with regard to the number of fueling stations available to drivers of alternative fuel vehicles, and particularly natural gas vehicles? What are your projections for the next few years with regard to the growth of the availability of these fueling stations?

Mr. KOLODZIEJ. There are currently about 1,300 natural gas fueling stations around the country, which is a small number compared to the gas industry.

Senator HATCH. I understand if you have natural gas in your home, you can set up a special tap and refill your car right from your home.

Mr. KOLODZIEJ. Which is what I do at my home. There is a company called Fuel Maker that makes products, and there are others. As a matter of fact, there was just a report in the newspaper that said a British company is working on a small, inexpensive refueler.

For small applications or for businesses that take the truck back to a location and park it overnight, it is a great application, a great use of the fueling station. But for the market to really grow, you are going to need a growing network of fueling stations.

Like I said, there are 1,300 now. With this bill in place, with the incentives from this bill, there will be a sharp increase in interest

in natural gas vehicles, and with that will come a sharp interest in providing the stations.

Senator HATCH. I see.

Mr. Ball, you mentioned in your testimony that tax incentives are a very effective means for government to increase markets for these types of alternative fuel vehicles. Could you explain why you believe tax incentives are preferable to any other means in achieving this goal?

Mr. BALL. In our experience, market orientation in government policy is what really succeeds in the long run in moving markets and changing consumer behavior. A regulatory program which is a mandate has the potential of putting the manufacturer in conflict with the consumer.

The advantage to tax incentives is that they align the demand from the consumer with the natural market orientation of the business, so what you have done is improve the price/value relationship for the consumer. So, from a manufacturer's viewpoint, the incentives are very important.

Senator HATCH. Let me ask you this. What do you consider to be the biggest obstacle to growth of the market for electric-powered vehicles?

Mr. BALL. Certainly, there are two elements that are particularly important. When looking at electric vehicles, you can consider the propulsion, the battery, and the infrastructure.

On the propulsion side, the electric motors and controls, we are making very good progress in working through the generations of design. This is for battery-powered electrics.

The battery side is an area where there is a lot of research and development still being done. An example of some of the work that is being supported by the Federal Government is the United States Advanced Battery Consortium, where industry, government, and academic institutions have worked together to try and arrive at better formulations of materials for batteries. So, batteries is one area that is critically important for us to get longer range on the vehicle.

The second area that is critically important is infrastructure. Again, the legislation that you are proposing here provides an extension of the \$100,000 incentive in the way of a tax deduction for refueling property.

In the Rockefeller legislation, which you are co-sponsoring, there is also a provision for a \$30,000 credit for the actual cost of installation of refueling properties. Refueling properties' installation is sometimes a very important cost element.

Let me say, there is a second type of electric vehicle, which is the fuel cell electric vehicle. It uses the same propulsion systems, but rather than a battery it uses, potentially, a so-called stack and a reformer, to harness hydrogen and oxygen and generate electricity, and that then becomes the source of electricity for electric vehicles.

In that regard, the impediment here is further technological development. Some, I would note, in EVAA, including General Motors, believe that the important legislation that you have introduced could be enhanced by following the precedent established in EPACT and expand the incentives to all types of fuel cell vehicles, regardless of fuel type.

The reason here, is that the issues surrounding technical feasibility and commercial viability, including infrastructure, make it seemingly premature to limit the development paths, and possible delay or forego the energy efficiency, air quality, and public health benefits that might be associated with that technology.

Senator HATCH. Ms. Robinson, let me ask you a couple of questions. You stated that the transportation sector makes up to one-third of U.S. carbon emissions in our country and is the fastest-growing source of carbon contamination. I think I have that right.

Ms. ROBINSON. Yes.

Senator HATCH. Now, to what do you attribute this growth in transportation emissions?

Ms. ROBINSON. Well, of that 30 percent, a little over 20 percent of that 30 percent is cars and trucks. That really is the fastest-growing area, particularly, as I think everyone is aware, the light-duty truck or the sport utility vehicle, the pick-up truck sector, has obviously seen massive popularity across the country, so there are more of those vehicles on the road, they are using more gasoline at this point, so that is a part of the trend that is increasing the contribution from the transportation sector.

Senator HATCH. Well, why do you think it has taken so long for alternative fuel vehicles to catch on in the marketplace?

Ms. ROBINSON. Well, I think you have heard from others on the panel some of the key hurdles, and you have identified them yourself. Fortunately, I think what we have seen at the State level is a recognition that incentives are an important complement to the standards that have been set by EPA and other regulations at the Federal level.

At the State level, there has been a real push for incentives in a number of States in the Northeast, Arizona has probably the model program in the country now, Connecticut, others.

We mentioned California. Unfortunately, California does not have a complementary incentive program in place. They are doing other things with State dollars, but they have not put an incentive program in place along the lines of the comprehensive programs that other States have adopted. I think that would make a big difference in getting more vehicles onto the roads in that State.

But I think we also need to look both at the consumer issues that Beverly was mentioning. Individual consumers really need to know about the choices that are out there, understand the convenience involved, understand the cost savings involved, and that is an area where we need to continue to do education.

On the heavy-duty side, when we are talking about buses and trucks, delivery vehicles, garbage trucks, that kind of thing, that is an area where, for municipalities and State governments, we need to do some education at that level to help them understand that there is an opportunity here for their fleets to begin to turn over to cleaner fuels that will help them with their air quality problems, but they will also see savings in terms of operating costs.

Senator HATCH. That is great.

You know, Senator Bennett, my partner here in the Senate from Utah, just acquired one of these Honda hybrid cars and gets 60 miles to the gallon in the city, and up to 90 to 100 on the road. I have never seen anybody so proud of anything in my life. [Laugh-

ter.] He has taken almost every Senator for a ride in that car, including myself.

Ms. ROBINSON. It is fun to drive.

Senator HATCH. Well, it is. But it was interesting to me that the electric-powered part of it, when you are going downhill, it actually charges.

Ms. ROBINSON. Right.

Senator HATCH. So you really do not have to go and charge the batteries, they just kind of regenerate themselves.

Ms. ROBINSON. Right.

Senator HATCH. I was interested in that. So, Honda really has come up with a pretty interesting thing. I understand that GM is coming up with some very, very interesting vehicles.

Mr. BALL. Right. I think all of the manufacturers, as I indicated in the testimony, Senator, are pursuing that because it is a very interesting technology.

Senator HATCH. How many of them actually have cars on the road right now?

Mr. BALL. Currently, Honda is the one with the most experience in the United States. Toyota is bringing on the Prius. Ford has announced an Escape hybrid SUV vehicle for, I think, the 2003 time frame. Daimler-Chrysler has shown the hybrid Durango, which they are very interested in incentives for.

Then, finally, General Motors has announced it will have a hybrid electric within, the 3- to 4-year time frame, but has not revealed at this point what the architecture is that we are going to be using for it.

One of the points, if I might expand on Michelle Robinson's testimony for the points she was making, is that one of the great advantages to Federal incentives is that it provides incentives to consumers in all States, and that provides essentially an opportunity to showcase vehicles nationwide and to educate consumers nationwide, and to provide Federal leadership.

I think that is one of the important opportunities that is presented by the legislation that you and Senator Jeffords had proposed, and the legislation that you are co-sponsoring as well.

Senator HATCH. All right. Thank you.

Let me just ask you one other question, Ms. Miller, than I want to turn to Senator Robb for both his statement and any questions that he might have.

You have mentioned the mandated fleets in Utah. Could you talk about the private, non-mandated AFV fleets in Utah, and about your experiences, or about their experiences? Also, could you tell us a little more about your project with the Salt Lake Olympic Organizing Committee?

Ms. MILLER. All right. The mandated fleets in Utah are typically smaller fleets. They probably have a few of their available vehicles running on alternative fuel. There is one notable exception with that model, and that is a very large fleet that is completely dedicated to natural gas, in this case, and that would be the Newspaper Agency Corporation.

This is the company that is contracting with two daily newspapers to distribute the newspapers, and they put approximately 6 million miles a year on that fleet. They have 230 vans that are bi-

fuel, they are conversions, they are brand-new, dedicated. She has got everything in that fleet.

But they use only natural gas because that is the company's rule. The drivers are trained to not only know how to deal with this vehicle and the fuel, but they are trained to believe that it is the best thing for the environment and for the community.

So there again, NAC has simply given us a perfect model of how to go about getting a non-mandated fleet to comply or to take a leadership role in showcasing AFVs. The bottom line for NAC is tens of thousands of dollars annually saved in fuel costs, and maintenance costs are less.

The other fleets. Well, we have three fleets that have received some support through the Special Projects Grant Program. Every year, all Clean Cities Groups compete for a small pot of money, and then we turn that money around and put it right back into the community. Jordan School District has been buying school buses with it.

Flower Patch, which is a local floral company that distributes all over the valley, has replaced their entire 18-van fleet with alternative fuel vehicles. The advantage for them, however, is that we help make it possible.

So the incentives are really viewed favorably with the non-mandated fleets, but, in fact, some of them are taking a leadership role because they feel it is their contribution to the community. It is their way of being a good citizen.

So some of it is financial, but somebody gets over a hill somehow and realizes that there is view and vision on the other side, and that is where they want to be, and they take their company with them. So, broad-minded, forward-thinking leaders in businesses are essential in this effort.

Then the Olympic Committee project is really very exciting because they put a mandate on themselves to say that they would provide 10 percent of all vehicles to be used for the Olympic Games that would have to be clean-fuel vehicles. They are bringing 1,500 buses and coaches into the valley to service just the spectator portion of the Games. Fifteen hundred buses which are all diesel would be a nightmare.

Well, we are going to try to mitigate that slightly by making 10 percent of those being natural gas buses. My project then is two parts. One, to help fuel those 150 natural gas buses, in this case, in one location with a small, 24-hour window to do the refueling. So that is part of the project.

It may not be a legacy. We may not be able to take anything away from it after the Games and leave it there. I do not know. These things grow. We just kind of get excited and carried away, and look for possibilities up the road in Idaho and down the road in Zion National Park.

But the other part then, of course, is this legacy with the light-duty vans. All athletes will be moved to their various competition venues by vans. General Motors has come up with a new, natural gas van that will be used by the Olympic Committee, and they are all jazzed about this. The Olympic people are very supportive of the idea of using AFVs and selling them locally and keeping them in Utah. We will use those vans.

We will place them in certain places so that we can build infrastructure where we currently have holes. Take 30, 40, 50 of them, put them in the Bountiful area, and put a refueling site in there to serve them. So, obviously Questar Gas Company is a part of this project.

Senator HATCH. Well, thank you so much.

Ms. MILLER. Thank you.

Senator HATCH. I will turn to my colleague, Senator Robb, at this time.

**OPENING STATEMENT OF HON. CHARLES S. ROBB, A U.S.  
SENATOR FROM VIRGINIA**

Senator ROBB. Thank you, Mr. Chairman.

Let me first of all say that I had to excuse myself for just a moment. I heard all of the initial testimony, but you were voted by proxy and I made the quorum in the Intelligence Committee on which you and I both serve. So lest you be concerned, we reported out those two bills while this hearing has been taking place.

Second, let me just make a comment to all of those who are assembled for this particular hearing. I want to personally thank you for what you have done to advance the cause.

As some of you know, I have been driving a natural gas vehicle myself for the last 8 years. When I first made application for it from a manufacturer, they were concerned about giving it to me, so I had to ask them to send it to a conversion station out of State to be converted before it was actually delivered. But I have had nothing but success with that particular venture over a long period of time.

When we had the catalytic converter emissions measurement, they would look twice and wonder if they have actually got their machine hooked up because they are not getting any registration and it causes some deal of concern.

I was interested in the comments of the Speaker of the House in Arizona about the equivalent cost per gallon. I had been using 75 cents a gallon. I have not done the math recently. I have Fuel Maker, as well as the separate highway fuels tax that I pay on that particular Fuel Maker.

I used the earlier figure. You mentioned both 62 cents, and then you mentioned 42 cents a gallon. If either of those figures represents the kind of savings on the equivalency, because you cannot really call it gallons in the same way that we do it, but anything close to the equivalency, we did not need the current spike in gasoline prices to get the attention of the average motorist. It would seem to me that this really ought to get their attention at this particular point.

I would say to Ms. Miller, too, in terms of the possibility of using vehicles and then selling those vehicles after the fact, lots of large-scale enterprises do that. Professional golf tournaments do it, lots of others, when they make them available.

I think you have just given me one additional incentive to work to try to get the Olympics in the Washington-Baltimore corridor. We are not talking about 2012, but with the technology currently available and on the drawing boards to advance the cause, it would

seem to me that we might be able to make some progress by using the same philosophy here.

Mr. Ball, I would just tell you that I come to all of the alternative fuels and those that are going to help us achieve a cleaner environment and energy independence. When they first brought the EV-1 on the market, I asked if I could buy it and they said, not unless you move to Arizona or California.

So, there are some of us on the East Coast that would like very much to have additional opportunities to take advantage of some of the other alternative fuels that are available.

Mr. Chairman, again, I thank you. This really is important. It is one of those situations, chicken and egg, and we have to develop enough fueling stations and enough incentives and whatever to get the manufacturers and others to do what they need to do.

But certainly the incentive ought to be there, and the current spike in energy prices ought to be just enough of an attention-getter, particularly when you compare the fuel equivalency costs that the Speaker mentioned, that a lot of people ought to be taking a look at that.

I could amortize the cost of conversion and the cost of the Fuel Maker over about 5 years. At the current differential, my guess is you could amortize that cost in less than a year, and with the incentives in terms of the deferral or the payment of either the vehicle transfer tax or other incentives, it is probably even shorter than that right now.

So, we may be a whole lot closer than we think we are, but I am delighted to co-sponsor the legislation with you. I thank you for the hearing. I apologize for having to depart. I am way late for another appointment that I am supposed to be at right now, but this is very important.

Again, Mr. Chairman, I thank you.

Senator HATCH. Well, thank you, Senator Robb. I am delighted that you are such an influence in helping us with this legislation, and we look forward to working closely together.

Senator Murkowski wanted very much to attend the subcommittee's hearing, as chairman of the Energy Committee, but he is chairing a mark-up of a Conservation Investment bill at the Energy Committee. So he asked that his written statement be included in the record, which we will do at this time.

[The prepared statement of Senator Murkowski appears in the appendix.]

Senator HATCH. I want to thank all five of you. This has been really great. I will tell you, I am really impressed with Arizona. I always have been, but with regard to this particular set of issues, what you guys are doing down there is just terrific. I agree with Ms. Robinson that you are the model State. I think, Ms. Miller, you and I need to work on our people in Utah a little bit more.

Ms. MILLER. We sure do. I would welcome your assistance, definitely.

Senator HATCH. Well, it might be counterproductive for me to help.

Mr. GROSCOST. I am sure that all started, Mr. Chairman, as your intern 20 years ago.

Senator HATCH. I remember. I remember.

Mr. GROSCOST. I heard you would not.

Senator HATCH. No, no. I am very pleased to tell you that a lot of our interns have really amounted to something, and you are the lead, I think, in the crowd. So, we are really happy to have you here. Thank you so much.

All of you have contributed a great deal here, and I respect what you are doing. This is one of the most exciting bills that I am working on right now. I am working on a lot of important stuff, but this is really important because if we could get this moving in the way that we would like to, and you have made some suggestions here today that we should consider adding to this bill, if we could get this moving we could do an awful lot of good for our country, for health care, and, really, for cost savings, fuel savings, and so many other things that you have mentioned here today.

So, thank you so much. We appreciate having you all here.

We will now hear from our second panel which will discuss tax proposals to increase domestic production of oil and gas. Participating on this panel are Mr. A. Shawn Noonan, general tax counsel, Vastar Resources in Houston, TX. Mr. Noonan is here on behalf of the Domestic Petroleum Council, whose Tax Committee he chairs.

Ms. Alexandra Shultz, staff attorney for the U.S. Public Interest Research Group. We are happy to have her with us. Mr. Red Cavaney, president and CEO of the American Petroleum Institute. Mr. J. Andrew Horner, director of research for the Center for a Sustainable Economy; and Mr. John Swords, who is a partner at PricewaterhouseCoopers in Dallas. Mr. Swords is here on behalf of the Independent Petroleum Association of America.

So, we welcome each one of you. We really appreciate having you here today, and we look forward to hearing from you at this time.

So we will turn to you, Mr. Noonan, first, and we will go right on down the line.

**STATEMENT OF A. SHAWN NOONAN, GENERAL TAX COUNSEL,  
VASTAR RESOURCES INC., REPRESENTING THE DOMESTIC  
PETROLEUM COUNCIL, HOUSTON, TX**

Mr. NOONAN. Thank you, Mr. Chairman. It is a pleasure to be here. I know it is unusual to begin a tax discussion by exhibiting a rock, but I wanted to begin today with some information about this rock and the natural gas industry before I talk about a couple of tax incentives that relate to both of them.

My name is Shawn Noonan. I am the general tax officer for Vastar Resources in Houston, TX. As you mentioned, I am here today on behalf of the Domestic Petroleum Council. I chair the Tax Committee for that organization.

Natural gas is a premium fuel. We know that it is used in our kitchens for cooking and to heat and cool our homes and businesses. We also know it is the fuel of choice for generating new electricity to meet growing demand for electricity.

But as we heard earlier from the first panel, natural gas is also being used increasingly to meet our transportation needs. For example, vehicles are being built now to run on compressed natural gas and liquified natural gas.



Even in the area of fuel cells, there is fuel cell technology that generates electricity from natural gas. That, of course, has application in the transportation area as well.

Natural gas is a clean-burning, efficient fuel. The demand for it is expected to increase by approximately one-third over the next decade. That estimate comes from the National Petroleum Council, which is an advisory agency to the Department of Energy.

Where will all the natural gas come from? From places like this rock, which is from the Upper Cliffhouse formation in New Mexico. It feels very solid, but there are actually tiny pores in here where the natural gas is held. It will come from other places where we are allowed to explore for, and produce, natural gas.

The 23 members of the Domestic Petroleum Council account for approximately one-fifth of the natural gas that is produced in the United States. In 1999, they drilled 35 percent of all the oil and gas wells in the United States, and over 60 percent of all the wells drilled by independent oil and natural gas companies.

It takes expensive technology, such as 3-D Seismic, direct hydrocarbon indicators, and hydraulic fracturing to maximize this resource. The technology will have to continue to improve in order to meet the Nation's growing demand for natural gas.

The DPC is committed to the goal of providing natural gas and oil to meet America's energy needs, but we do face challenges. A couple of those challenges are imbedded in the Tax Code and the administration of the Code by the Internal Revenue Service.

The industry has recommended a tax reform package that includes, among other things, allowing a deduction for geological and geophysical costs, which, for shorthand, are G&G costs, and delay rentals.

While the DPC supports the entire tax reform package, the G&G costs and delay rentals issues are our most important tax items this year. President Clinton, earlier in the year, proposed that a tax deduction be allowed for these costs.

What are these costs? G&G costs are incurred to create and process data that is used to locate potential mineral deposits underground. Under current law, these costs must be suspended, meaning that there is no allowance whatsoever for tax purposes, until such time as the feasibility of acquiring leases and the feasibility of drilling a well is determined.

Then if a well is drilled successfully, the G&G cost remains suspended. In some cases, for example, in deepwater Gulf of Mexico, it can be up to 5 years or more from the time that the initial well is drilled until the lease is brought into production.

Delay rentals are payments that are required to be made under most leases by the lessee in order to postpone the date for drilling a well on property or otherwise improving the lease. Once operations on the lease commence, the obligation to pay the delay rentals ends.

Tax treatment for delay rentals has been unclear since 1986, when the Congress passed the Uniform Capitalization rules. The taxpayers believe that delay rental costs are unique and that they are a payment not to improve property, but to postpone improvement of the property so that they should not be capitalized. But the IRS has determined that they should be capitalized.

Adding to the confusion, there is an IRS regulation which still allows delay rentals to be deducted at the election of the taxpayer, but only this year, 14 years after the Uniform Capitalization rules, the IRS has proposed to amend that regulation.

So both G&G and delay rental costs are incurred very early in the exploration process, and for that reason it is a challenge to generate an after-tax return on those investments that is attractive to people, to investors through which the capital to do exploration and production is necessary.

So we think that allowing a deduction for these costs would improve the after-tax returns and encourage more domestic exploration and production, and reduce our reliance on foreign oil imports. It would also simplify tax administration and reduce compliance costs.

I have a copy of a summary of the tax legislation that has already been introduced and supported by Senators Hutchison, Murkowski, Domenici, and others and will be glad to leave a copy of that with the committee.

I thank you for your attention today.

Senator HATCH. We would be glad to have it. Thank you very much.

[The prepared statement of Mr. Noonan appears in the appendix.]

Senator HATCH. Ms. Shultz, we will take your testimony.

**STATEMENT OF ALEXANDRA SHULTZ, STAFF ATTORNEY, U.S. PUBLIC INTEREST RESEARCH GROUP, WASHINGTON, DC**

Ms. SHULTZ. Mr. Chairman, my name is Lexi Shultz and I am a staff attorney with U.S. PIRG, which is the national office for the State Public Interest Research Groups.

We are nonprofit, nonpartisan, public interest advocacy groups active in 38 States. On behalf of our members around the country who are interested in consumer issues and environmental issues, I very much appreciate the opportunity to testify here today on the need to develop an energy policy that will be better for the environment, better for national security, better for consumers, and better for public health.

But we are very concerned that what we have now, instead, is an over-reliance on oil and other fossil fuels which are extremely dirty, have used a great deal of taxpayer resources, have polluted the environment, put our health at risk, and cost consumers at the gas pump.

The recent high gas prices have served as a wake-up call as to the costs of oil to consumers, but the crisis is just the tip of the iceberg when it comes to some of the devastating consequences of oil production.

All aspects of oil have devastating consequences for our land, our water, our air, and our health. I will give you a few examples. Oil production and transportation causes leaks of at least 280 million barrels of petroleum every year which contaminates water supplies, poisons wildlife, and ruins landscapes.

The most infamous case, of course, is the 1989 Exxon Valdez spill, which poured 11 million gallons of crude into Prince William Sound. Eleven years later, the fishing industry is still in jeopardy,

and only 2 of 26 species have fully recovered. Yet, I want to point out that Exxon has not paid its \$5 billion fine, and we continue to hand tax dollars and give tax breaks to this company.

On top of the oil leaks from drilling and transport problems, oil refining is a major source of U.S. chemical releases, including toxic heavy metals like chromium, mercury, and also chemicals like benzene. Oil companies are also responsible for a large number of super-fund sites and have been fined for numerous Clean Water Act violations.

Then, as we have heard, oil is also a major factor in air pollution, also in global warming. Global warming, of course, has significant impacts on public health, as well as on the environment, as recent outbreaks of the West Nile virus in some areas of the country have shown.

In addition, burning oil produces smog-forming nitrogen oxides, causing an estimated six million asthma attacks and sending 150,000 people to emergency rooms each year.

Now, many people may realize some of the environmental and public health consequences caused by burning oil, but most people probably do not realize that we encourage this pollution by continuing to give handouts and tax breaks to the oil industry, and to other fossil fuels, I might point out.

This is an industry that has profits in the billions. In fact, profits for companies like ExxonMobil, BP Amoco, and some of the other big companies have gone up by billions of dollars over the same quarter of last year, as compared to the first quarter of 2000.

PIRG recently released a report called "Paying for Pollution," along with Friends of the Earth and Taxpayers for Common Sense, which documented that the oil industry received at least \$822 million in direct research spending and more than \$5 billion in tax breaks over the course of 5 years.

Last year, Donald Lubick, Assistant Secretary for Tax Policy for the U.S. Department of Treasury, testified that over 75 percent of corporations in the oil and gas extraction industry did not pay any domestic corporate income tax.

Mr. Lubick also stated that this is an industry that probably has larger tax incentives relative to its size than any other industry in the country, and we are very concerned that the oil industry is now seeking additional tax breaks and handouts, given that the profits are so high and the gas prices are also so high.

We believe that enough is enough, and that the handouts and tax breaks for this very polluting industry must stop. Really, the only way that we are going to be able to reduce our dependence on foreign oil in the long run is to reduce our dependence on oil.

With that in mind, I make four recommendations. First, we need to massively increase the amount of money that we are investing in clean sources of energy, in energy efficiency programs, and in renewable energy sources like solar and wind, which have been put at a huge competitive disadvantage by our handouts to the fossil fuel industry.

Second, we can save oil and protect consumers simultaneously by raising miles per gallon standards for vehicles.

Third, we need to preserve the wild places that are left rather than opening them up for more oil protection, because that will be

a short-term answer for what is ultimately a long-term problem. Conserving oil will remove the argument that we need to open up places like the Arctic National Wildlife Refuge.

Finally, the PIRG believes we need to stop subsidizing a mature and profitable oil industry at the expense of taxpayers, public health and the environment.

I thank you, again, very much for the opportunity to testify.

Senator HATCH. Thank you, Ms. Shultz.

[The prepared statement of Ms. Shultz appears in the appendix.]

Senator HATCH. We will turn to you, Mr. Cavaney.

**STATEMENT OF RED CAVANEY, PRESIDENT AND CEO,  
AMERICAN PETROLEUM INSTITUTE, WASHINGTON, DC**

Mr. CAVANEY. Thank you, Mr. Chairman.

I am Red Cavaney, president and CEO of the American Petroleum Institute. API's members are involved in all sectors of the U.S. oil and natural gas industry. We appreciate this opportunity to present their views on tax measures to reduce the level of imported oil.

For more than half a century, the U.S. has relied on imports for a portion of its oil needs. That dependence has both benefits and burdens. It provides consumers less costly energy supplies than what would otherwise be available, but it also exposes us to the potential short-term supply interruptions as well as adverse actions by OPEC.

The U.S. petroleum industry does not consist solely of producers of domestic oil and gas. Predominantly, upstream producers are involved in global operations, while U.S. drilling and support services companies are increasingly dependent on the global activities of these and other companies around the world.

Our industry's goal is the removal of barriers that currently impede our ability to compete, both domestically and abroad.

The problem is not one of imports, but one of preserving the competitiveness of U.S. industry, which must compete in the global marketplace.

Recent DOE and IEA forecasts expect worldwide demand for oil to grow by nearly 15 million barrels per day over the next decade. If allowed to compete, our industry has the capability to capture a significant share of this growth, thereby limiting OPEC's market share and contributing to the diversity of global supply.

However, current Federal policies severely restrict our ability to do so. Domestically, access to Federal lands has become an acute problem. Since 1983, access to Federal lands in eight western States has declined by more than 60 percent. In some of Alaska's most promising areas, it is more of the same.

Last year, a united oil and gas industry proposed a series of tax provisions designed to spur domestic oil and gas production. While not the sole answer to ensuring adequate domestic supplies, the following would encourage increased domestic activity: relief from the Alternative Minimum Tax, expensing of geological and geophysical costs, expensing of delay rental payments, a marginal well tax credit, and eliminating restrictions on percentage depletion for independent producers. In addition, expanding the enhanced oil re-

covery credit to include non-tertiary methods would also help increase domestic production.

Internationally, the U.S. has a strong strategic and economic interest in a vibrant U.S. oil and gas industry. However, the international activities of the U.S. industry have been threatened by two U.S. policies: first, the tendency to utilize unilateral economic sanctions against oil-producing countries as an instrument of foreign policy; and second, the adverse tax treatment of foreign-source income of U.S. oil and gas companies.

U.S. taxation of foreign-source income imposes a substantial burden on all U.S. multinational companies by exposing them to double taxation. Further, the complexities of the U.S. tax rules impose substantial compliance costs.

Significant additional tax restrictions are imposed on the oil and gas industry that place us in a less favorable position than U.S. industry in general.

In order to survive, the industry must operate where it has access to economically recoverable reserves. Since access to domestic opportunities has been substantially foreclosed, the tax treatment of international operations is critical to the industry's ability to supply consumers' needs.

Tax measures that would enable the U.S. oil and gas companies to better compete in the global oil and gas business include the repeal of the separate oil and gas foreign tax credit limitation and other items enumerated in my written statement.

In summary, our industry strongly supports efforts to encourage increased petroleum activity in the United States through more equitable tax rules to facilitate the use of new technologies for exploration, development, and production and to help maintain the economic viability of mature production sites.

Unless Congress also acts to reduce restrictions on access to Federal lands and to rationalize the overlapping, uncoordinated regulatory burden, the public benefit from these tax changes will not reach its full potential.

U.S. demand for oil and natural gas cannot be met solely through increased U.S. production. While U.S. reliance on imported oil can and should be reduced, maintaining the global competitiveness of the U.S. oil and natural gas industry will be crucial to ensuring that U.S. consumers continue to enjoy a readily available supply of affordable fuels.

Thank you for the opportunity to appear before the committee. Senator HATCH. Well, thank you, Mr. Cavaney.

[The prepared statement of Mr. Cavaney appears in the appendix.]

Senator HATCH. Mr. Hoerner, we will take your testimony.

**STATEMENT OF J. ANDREW HOERNER, DIRECTOR OF RESEARCH, CENTER FOR A SUSTAINABLE ECONOMY, WASHINGTON, DC**

Mr. HOERNER. Good afternoon, Mr. Chairman. I would like to thank the Taxation and IRS Oversight Subcommittee for inviting me to testify today.

I am director of research for the Center for a Sustainable Economy. CSE is a nonprofit, nonpartisan tax and economic policy orga-

nization. Our mission is to promote market-based policies that integrate the goals of long-term economic prosperity, environmental quality, and social fairness. We neither litigate, nor lobby.

My testimony today will address three approaches to dealing with the current high energy prices through the tax system: first, tax incentives for energy efficiency, renewable energy, and alternative fuel technologies; second, tax incentives for domestic oil and coal production; and finally, a moratorium on Federal motor fuels taxes.

Of these three policies, only the incentives for energy efficiency, renewables, and alternative fuels promote long-term energy security, economic growth, and environmental quality.

Subsidies to fossil fuel industries drain American reserves and ensure increased dependence on foreign oil, while cutting gas taxes plays into the hands of OPEC by transferring money directly from the pockets of U.S. taxpayers to foreign oil producers.

First, on energy efficiency incentives. CSE conducted a major study of the economic impact of the six incentives contained in the fiscal year 2000 Climate Change Technology Initiative. We found that the credits produce economic benefits to the public that far exceed their cost.

We used a survey of experts approach to estimate the impact of those proposed tax incentives with a panel of more than 80 experts. Our study found that the credit would cause substantial reductions in the price of eligible technologies.

Indeed, the present value of non-environmental economic benefits alone would be roughly five times the cost of the credits over the 2000–2018 period. In addition, the credits would cut local air pollution emissions enough to save Americans twice as much in health care and related costs as the U.S. Government would spend on the credits.

Thus, we find that the Climate Change Technology Initiative is somewhat misnamed, as it is justified based on economic considerations that ignore climate impacts.

Energy efficiency policies increase national energy security by making the U.S. less vulnerable to energy price shocks, whether foreign or domestic. Since the early 1970's, the share of energy in GDP has declined from 10 to 6 percent.

This is the major reason why the price hikes of the 1970's led to recessions, while the current shocks have had only minor macro-economic impact. Continued progress towards energy efficiency will make us less and less vulnerable over time.

In contrast, tax subsidies for domestic fossil fuel production will increase our vulnerability to foreign price shocks over time. Domestic oil reserves are finite, and subsidizing increased production can only lead to a more rapid decline in reserves.

U.S. oil production hit its peak in 1970 and has been declining every since. Subsidies to oil production might increase production in the short run, but such a "drain America first" policy would leave us at the mercy of foreign oil producers when we face world markets with depleted domestic reserves.

In addition, the oil and coal industries are already subsidized through the Tax Code by more than \$2.5 billion per year. These are

mature, well-capitalized, and highly polluting industries. They are poor candidates for further subsidy.

Finally, let us turn to the notion that we should respond to higher foreign oil prices by cutting domestic motor vehicle taxes. OPEC follows a slightly modified version of the monopolist's strategy. In other words, they charge what the market will bear. They increase price to the level where further increases risk cutting revenues by squeezing people out of the market.

Now consider a pricing game between the world's biggest oil supplier, OPEC, and the world's biggest oil consumer, the United States. If OPEC knew that the United States would respond to oil price increases by encouraging conservation, this would provide an incentive to keep prices low, as higher prices would lead directly to reduced demand.

If, on the other hand, OPEC knew that the U.S. would respond to higher prices with decreased motor fuel taxes, there would be no reason not to raise prices. Effectively, this strategy is a pure transfer of wealth from the U.S. taxpayers to foreign oil producers. It is the worst possible strategic response and amounts to capitulation.

In summary, incentives for energy efficiency and renewable energy technologies are good for the economy and good for the environment. They promote energy security and put us in a better bargaining position in world energy markets.

On the other hand, both subsidies to domestic fossil fuels industries and cuts in motor fuel taxes constitute expensive and unjustifiable give-aways to industries that are already heavily subsidized. They would harm our national security and put us at a bargaining disadvantage with OPEC nations.

Thank you. I welcome any questions.

Senator HATCH. Thank you, Mr. Hoerner.

[The prepared statement of Mr. Hoerner appears in the appendix.]

Senator HATCH. Mr. Swords, we will take your testimony now.

**STATEMENT OF JOHN SWORDS, PARTNER,  
PRICEWATERHOUSE COOPERS, REPRESENTING THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA, DALLAS, TX**

Mr. SWORDS. Mr. Chairman, I am John Swords, partner, PricewaterhouseCoopers, and chairman of the Independent Petroleum Association of America's Tax Committee.

Today I am testifying on behalf of the IPAA, the National Stripper Well Association, and 33 cooperating State and regional oil and gas associations.

Today's hearing is examining a critical issue confronting domestic petroleum and natural gas production: the role of the Tax Code with regard to the enhancement or deterioration of domestic exploration and production of natural gas and petroleum.

The Federal Tax Code plays an integral part in providing access to the capital, essential to develop domestic resources, both natural gas and petroleum. Federal tax policy has historically played a substantial role in developing America's natural gas and petroleum, but the converse is equally true.

For example, in the windfall profits tax, Federal tax policy extracted some \$44 billion from the industry that could have been otherwise invested in more production.

Then in 1986, as the industry was trying to recover from the last long petroleum price drop before the 1998-1999 crisis, Federal tax policy was changed to create the Alternative Minimum Tax that sucked millions more dollars from the exploration and production of petroleum and natural gas.

These changes have discouraged capital from flowing toward this industry, and without capital the ultimate result is lower production.

Now, independent producers are recovering from the low prices of 1998 and 1999. Today we have a domestic industry ready to find and produce energy for the Nation's consumers, but this inherently risky industry must compete for funds against high-flying technology investments and the lure of lower costs to produce foreign oil.

Hearings throughout Congress have echoed with the statements of members from producing and consuming States alike; what more must be done to increase domestic production? Much of that answer lies within this committee.

In the short term, there are a number of actions that can be taken. In fact, there is wide agreement on these actions from the administration, Congress, the Senate and House, both Republicans and Democrats.

First, action should be taken to clearly allow expensing of geological and geophysical costs and of delay rental payments. President Clinton has endorsed these changes and Congress has previously passed them.

Second, there is wide support for a counter-cyclical marginal well tax credit. This approach was recommended by the National Petroleum Council in its 1994 marginal well study. Energy Secretary Richardson has spoken of it repeatedly.

It has been introduced in many bills. This tax credit today can be crafted with a negligible impact on the Federal budget, but at the same time create an important safety net for the most vulnerable American producing wells, wells that produce petroleum roughly equivalent to the imports from Saudi Arabia, wells that are the Nation's true strategic petroleum reserve.

Third, Congress has suspended the property taxable limitation on percentage depletion for marginal wells through 2001. This suspension that was in place in 1998 and 1999 saved many marginal wells during the price crisis.

The property taxable income limitation should be eliminated to provide domestic producers of these wells an incentive not to plug the wells during a low price cycle. Once a well is plugged, the remaining reserves are lost forever.

Fourth, last year's tax bill also suspended the 65 percent net overall taxable income limit on percentage depletion. This constraint on independent producers limits the amount of capital that can be retained for reinvestment into existing and new production. It, too, should be eliminated.

Fifth, last year's tax bill extended the net operating loss carry-back period for independent producers to 5 years. Taken together



with the changes passed regarding percentage depletion, millions of dollars would be made available based on costs and losses already incurred to enhance domestic production. Collectively, these provisions have wide support. They would be of significant national value. They should be enacted now.

Equally important, however, they must be crafted in such a manner to assure that the Alternative Minimum Tax does not nullify the benefits that they would create.

In the longer term, the country needs to look toward tax policies to encourage domestic production of its petroleum and natural gas. Some of this focus needs to be directed to getting more out of existing resources. For example, the Enhanced Oil Recovery tax credit should be restructured and updated.

Equally significant, policies need to address encouraging more new development. For example, the Section 29 credit for non-conventional fuels proved to be a strong inducement to developing those resources, but the existing credit expires in 2003 and provides no incentive for current development, since the qualifying wells had to have been drilled before 1993.

Senate bill 595 contains another new development incentive proposal by creating an investment tax credit of 20 percent of the cost of new wells, up to \$1 million per year and 10 percent thereafter.

This type of proposal would reduce the cost of development of domestic wells and encourage capital formation, provided it was immediately beneficial.

In conclusion, if Congress wants to see more domestic petroleum and natural gas production it must recognize that Federal tax policy plays a critical role in whether capital will flow towards this industry in the production of this resource. That has always been the case, and it will continue to be.

Domestic producers have always been risk takers. During these times of plentiful investment opportunities, they need some assistance in attracting capital or retaining it for use internally. The time is right. The Nation is seeking a more stable energy supply, and Congress should act.

Thank you for the opportunity to come before you.

[The prepared statement of Mr. Swords appears in the appendix.]

Senator HATCH. Thank you. Thanks to each of you for giving us the benefit of your particular opinions in this hearing today.

I am very interested, Mr. Noonan, in your testimony. Well, all of yours, but particularly in regards to your testimony on the production of natural gas in this country.

I wonder if you could talk a bit about the availability of natural gas in the U.S. and whether you think we can keep up with the demand for it in the coming years.

Mr. NOONAN. Well, as I mentioned in my testimony, I think one of the big keys is continued improved technology. I think the National Petroleum Council credited the enhancements in technology with the increased oil and natural gas production in the United States domestically, and we just need to continue to improve that technology.

In addition, I would say that probably the single biggest issue facing us is access. There are a lot of areas where we are prohibited from exploring and producing natural gas. The consumer has

a choice between relying more on foreign imports or getting more domestic production and/or higher prices if we just do not have the domestic production to meet consumer need.

Senator HATCH. I understand natural gas in this country comes mostly from domestic sources. Can you explain why this is the case?

Mr. NOONAN. My understanding is that, unlike oil which is inexpensive enough currently to transport from overseas, we have a lot of foreign oil imports, gas is different at this time because the price just is not high enough to allow for imports from any great distance.

We do have imports from Canada, for example, which is close by. But when you try to get any further away from that, it just is not economical to bring natural gas from overseas to compete against domestic natural gas.

Senator HATCH. Can either the G&G costs or delay rental payment problems you discussed in your statement be resolved administratively by the Internal Revenue Service?

Mr. NOONAN. I think most of the guidance that we have for the tax treatment of G&G and delay rentals is either administrative rulings or regulations, but I just do not think the IRS is going to move away from their current positions without some Congressional directive. So, I would say that legislation is our best opportunity.

Senator HATCH. Thank you.

Now, Ms. Shultz, I found your testimony very interesting. In your written testimony you state that alternatives like solar and wind power should make up a third of our energy production in this country by 2020, I think it was. Yet, you also argue for preserving our open spaces.

From what I have seen, drilling for oil takes a minimal amount of open space. Do you have an estimate of how many acres of solar panels or windmills we would need to replace the energy of Anwar's \$3.2 billion barrels of oil?

Ms. SHULTZ. First of all, let me just say that I have seen varying estimates of how much oil is actually in Anwar. There are some estimates I have seen which put it closer to 3 million barrels of oil.

Senator HATCH. I have heard it was as high as 16 billion barrels.

Ms. SHULTZ. So there are varying estimates. I will definitely get you further information. I do not have any estimates as to how much actually, in acreage.

[The information appears in the appendix.]

Senator HATCH. Yes. One thing I am concerned about. Two of my daughters live down near Palm Desert and I have driven through there a number of times. I have to say, it is fun to see the windmills, and it is interesting to see them, and I think it is a great innovation.

But they take a lot of acres of very beautiful land that is just covered with these windmills that produce a minimal amount of energy in comparison to fossil fuels that we all wish we did not have to utilize.

Ms. SHULTZ. Well, I think that the wind energy is a growing energy source. I think it could grow tremendously more and produce far more power than it is currently if we invest in it.

Senator HATCH. But it looks to me like it is taking an awful lot of land in comparison to the minimal amounts of land that drilling for oil would. For instance, in Anwar, where I do not think it would affect the wildlife at all, according to what we found out from the pipeline from higher up.

Ms. SHULTZ. Actually, wind power has far less impact on the land that it uses. In the Midwest, there are wind farms that are being operated simultaneously with existing farms. The cows can graze immediately right up to the windmills. It is very non-polluting. Even where there are wind towers, they do not actually cause the kind of damage to the land that drilling for oil does.

Drilling for oil is very incompatible with any kind of open space, with any kind of environment. You certainly could not farm in an area around an oil well.

In Prudhoe Bay in Alaska, there was one oil spill or spill of some kind of chemical every 18 hours, and the consequences of that have been devastating to that area. The estimates that I have seen are that the same effects would happen to Anwar and to other places.

The answer is that, no matter how much land the wind towers use, they will not have the same kinds of devastating impacts that drilling for oil will.

Senator HATCH. I do not mean to beat this to death, but I am for wind power and solar power. I think we ought to develop every alternative fuel that we can.

Ms. SHULTZ. Right.

Senator HATCH. But when you estimate how many acres of solar panels and windmills it would take to replace one-third of our Nation's energy needs—and I look as I drive by those huge windmills, that whole land is gone. I mean, it is just filled with steel and windmills.

I have to admit, they are charming, as far as I am concerned, and it is something we should do. But I question whether you can provide one-third of the Nation's energy or power through solar energy and windmills.

Now, maybe we will come up with some real effective way of doing that, and I am for seeing if we can. But until then, it seems to me, it is going to be pretty hard to run the greatest economy in the world without oil and gas. It just seems to me that that is just something we are going to have to learn how to live with and do better with, and make cleaner to the extent we can.

That is why I think our bill really could have a dramatic impact on this country, because we would reduce the total amount of fossil fuels that would be necessary in our vehicles throughout our various large cities where we have this tremendous pollution.

Mr. CAVANEY, you have heard the testimony here today. What do you think about it? I am sure you are not against wind energy or solar energy either.

Mr. CAVANEY. No. Mr. Chairman, I think one thing that is very important is that we need all the forms of energy that we have.

Senator HATCH. Ms. Shultz here has indicated that the oil industry has a less than perfect record on protecting the environment, and I would like you to respond to that as well.

Mr. CAVANEY. I think in that regard, if you look at the recent record that the industry has done, the technology gains that have

been made, the amount of land space that is needed in order to drill a well, which in turn can then go ahead and serve multiple reservoirs, the environmental footprint is less than 10 percent of what it was 15 years ago. In other words, the spot on the space.

So we have learned a great deal. Technology has been a tremendous handmaiden. The environmental regulations and rules that we comply with are the tightest in the world. People from all over the world in the oil and gas business go up to Alaska as a showcase for how to do it right. I think you will find that if you check with anybody who is in the industry worldwide.

The important point I wanted to make was that if you look at the United States and the economic growth that it has enjoyed over the last couple of decades, in particular, you will find that energy consumption is still a very, very important driver in enjoying that economic growth.

Whether you are looking at the oil and gas industry or whether you are looking at the electricity grid, we need just about all the capacity that we have right now to continue to enjoy that growth.

What will evolve over time as these various new forms of energy come in, is they will find their place in the spectrum and they will find areas where they can do a good job, and they should belong in those spots. But when you end up looking at things like transportation fuels, you pretty much have to rely, at least at present, on gasoline and diesel fuel.

We are now evolving into natural gases you are talking about here. Before too long, we will have fuel cells, which are the next form, and it, too, will be very, very efficient and basically have no pollution coming from the evolution of hydrogen through those membranes.

So what we have ahead of us is a fairly attractive picture, and we should not end up prematurely moving away from one kind and ending up being energy short, because that, in turn, will hurt all consumers by curbing their economic growth.

Senator HATCH. Well, we have seen a drop in oil production in our country.

Mr. CAVANEY. We have.

Senator HATCH. Overall, how important are these tax proposals that we are talking about here today?

Mr. CAVANEY. Well, they are important because as long as we have to use fossil fuels, we need two things. In terms of crude oil, the current projections are that OPEC and their allies will end up providing more than 60 percent of our oil by the end of the next decade. In order to have leverage on these world markets, we need to increase our domestic production on crude oil.

Natural gas, as was mentioned earlier, is a pure North American fuel. Almost 100 percent of the U.S. usage of natural gas comes from North America. It does not travel well, it is not economical. About 15 percent of that comes from Canada, 85 percent comes from the United States.

Everyone projects in the range from 2 to 3 percent growth in natural gas. The production that we have made has been steady for the last 6 years. These kinds of tax incentives, coupled with access and us doing things in an environmentally compatible way, is the

path forward to realizing the kind of energy strength that we need to continue to grow our economy.

Senator HATCH. Well, thank you.

Mr. Hoerner, EPACT, the regulation requiring alternative fuel vehicle fleets, has been in place for a number of years now. Has EPACT lived up to your expectations or your organization's expectations?

Mr. HOERNER. Senator, I cannot honestly say that my organization had expectations at that time, since we are only 2 years old.

Senator HATCH. All right.

Mr. HOERNER. But I would say that I believe that the potential for alternative fueled vehicles is quite substantial, and I think that at this moment in time the best route towards alternative fueled vehicles is probably some sort of Federal incentive.

That being said, I think it is important to distinguish between the range of alternative fuels that are out there. There is a considerable menu of alternative fuels, some of which seem to have clearer basis for a governmental subsidy or environmental benefits than others.

I think it makes some sense to encourage technologies for the use of natural gas, bio gas, hydrogen, cellulose, ethanol. On the other hand, ethanol made from corn takes nearly as much energy to produce as it yields when it is burned. I think our history of trying to produce coal-derived liquid fuels has not been a happy one. The basis for public subsidy of those technologies is far from clear.

Senator HATCH. In your testimony you speak of the peaks and the declines in domestic oil production. To what do you attribute those, especially our most recent decline in production?

Mr. HOERNER. Oil fields have a natural life cycle. There is easily extractable oil, then there is oil that is extractable only with difficulty and expense. If you look around the world, you can see that oil fields follow a clear and consistent pattern of growth and then decline. The U.S.'s 48 States oil productivity peaked in 1970, and barring some dramatic improvement in oil extraction technology—and I would not rule that out—we are never going to get back to 1970 levels. It is just not going to happen.

The Alaskan fields, we saw a blip from the entry of the Alaskan fields. Those fields peaked production in 1988, and I do not think we are ever going to get back to the 1988 levels for Alaskan production.

Senator HATCH. All right.

Mr. Swords, in your statement you referenced a lack of an energy policy in our country. Could you please elaborate a little bit further on that?

Mr. SWORDS. There has not been a consistent energy policy in this country for a long number of years. An energy policy, to be consistent, should be applied in a manner that would encourage domestic production of oil and gas. We may or may not be able to completely reverse the production trends that we have seen of late. The question is, can we slow down the decline?

Clearly, natural gas is a fuel source within the domestic borders that is needed, it is clean-burning. It happens to come right along with petroleum, in many cases. So you cannot stop one segment of the industry and encourage the other, they kind of come together.

There are areas and ways that we can encourage these types of production. It includes a variety of things. Tax incentives are one way to help, access to lands are another way to help. If we had access to some of the lands that have been placed off limits right now, we might very well, even in the present pricing environment, be able to have more production domestically.

Without that, we need significantly more incentives to keep our producers here and not take our jobs and our technical expertise and export it to other countries.

Senator HATCH. Well, we have heard today about a number of things that government should do help increase domestic production, and things that the government does to stand in the way of domestic production. We have heard a little bit about both of these things.

In your opinion, what is the greatest obstacle that government has placed in the way of domestic oil production?

Mr. SWORDS. I think probably the access to Federal lands is the greatest obstacle for domestic production.

Senator HATCH. All right. Well, let me just say this to you. This has been an interesting hearing to me, because I was quite enthralled with the Arizona situation and the results that they have had. It seems to me we on the Federal level ought to get a little smart, too, and start encouraging people to use alternative fuels. Red, the oil business itself wants us to do this.

Mr. CAVANEY. Yes.

Senator HATCH. Because is it is in the best interests of the domestic oil people, and international oil people as well, for us not to be as dependent on foreign oil.

We would appreciate the help of all of you in helping to pass this legislation and any further suggestions that you might have that will help us to reform, reformulate, or perfect this legislation, because it is basically fairly simple.

Now, we do not have to make it complex, but there may be some other suggestions that you might have that we would be happy to listen to that might make this a piece of legislation that really everybody will support, and we are hopeful that they will anyway.

But each of you has a particular perspective that you have brought to this hearing and we are very grateful to you. We will keep the record open for any further statements you would care to make, and we will keep the record open for any written questions any members of the committee would like to send.

I would also place, immediately after my statement in the record, without objection, the statement of Senator Max Baucus on this hearing on Energy Security and Alternative Fuels.

[The prepared statement of Senator Baucus appears in the appendix.]

Senator HATCH. So with that, we want to thank you all. We appreciate your taking the time. I think this has been a good hearing, and we will go on from there. Thanks very much.

With that, we will recess until further notice.

[Whereupon, at 4:41 p.m., the hearing was recessed.]

# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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### PREPARED STATEMENT OF WILLIAM BALL

Good morning. My name is Bill Ball, and I am the Director of Strategic Planning for General Motor's Advanced Technology Vehicles. I am appearing today on behalf of the Electric Vehicle Association of the Americas, or EVAA. Currently, I am the automotive co-Chair of this national, not-for-profit association of electric utilities, automobile manufacturers and component suppliers, state and local governments and others who have joined together to support the greater use of electric drive technologies. A principal activity of our organization is to encourage the adoption of government policies, programs and incentives that will facilitate the development and use of electric modes of transportation. We appreciate the opportunity to testify today.

EVAA's testimony focuses on the specific, and important role that the family of electric drive technologies—which include battery-electric vehicles, hybrid-electric vehicles and fuel cell vehicles—can contribute to increasing efficiency and diversifying the fuel base upon which our transportation sector depends.

EVAA believes that targeted tax incentives—put in place immediately and remaining available until markets and infrastructure develop—are the most effective means by which government can partner with industry and consumers to build a long-term, sustainable market for electric drive and other alternative fuel technologies.

With over 100 years of technical development, current automotive transportation offers choices that are efficient, reliable, consumer friendly and affordable, with a convenient and nationwide refueling infrastructure. All of these attributes have yet to be proven for electrics and other modes of alternatively fueled personal transportation.

However, transportation, fueled by electricity, is a potential contributor to achieving energy diversity and more efficient use of energy resources, while at the same time contributing to greater domestic economic and energy security. Electricity is inexpensive, stable and generated from a variety of domestically controlled fuel resources. For each one percent of our rolling stock that is replaced with electricity fueled vehicles in the U.S., we can reduce our motor vehicle petroleum use by a commensurate one percent.

The Energy Policy Act of 1992 (P.L. 102-486 "EPAct") recognized this by including modest, targeted tax credits for battery, fuel cell and certain hybrid-electric vehicles. However, these tax credits are scheduled to begin phasing-out in 2002 and to expire in 2004. This timing will not provide the necessary incentives to support these electric drive technologies.

While every major automobile manufacturer now has offered battery-electric vehicles for sale and/or lease on a limited basis, these products entered the market later than anticipated, and subsequently, the market has not developed as quickly as envisioned when EPAct was enacted. In December 1996, GM was the first automaker to introduce a ground-up battery-electric vehicle, the *EV1*, to certain regional U.S. markets; since that time, the industry has delivered approximately 3,200 light-duty electric vehicles and approximately 200 electric buses.

In addition to current electric vehicles (EVs), several major manufacturers including Ford, Toyota and Nissan already have, or will soon, demonstrate and/or introduce small, two passenger, all electric vehicles into the U.S. market. These vehicles, often referred to as "city cars", have the potential to change our current perspectives on personal mobility. Much like we have added technology such as microwaves and cell phones to supplement and enhance food preparation and communications,

supplementing the traditional, "family car" with a generation of specialized mobility options may prove exceedingly attractive to consumers.

Another new member of the electric drive family that is premiering to high marks from environmental groups, automotive experts and consumers alike, is the hybrid-electric vehicle. Last year, Honda began selling its hybrid, the *Insight*, in the U.S. and has promised to make available other platforms in this unique, hybrid-electric option. Toyota introduces its hybrid-electric product, the *Prius*, to the U.S. market this month, having already sold over 30,000 in the Japanese market. All of the other major automakers have committed to sell hybrid-electric vehicles in the U.S. within the next 3 to 4 years. Hybrid-electric vehicles can provide excellent fuel efficiency, and can have excellent environmental performance, in addition to being an important step toward minimizing the transportation sector's use of imported oil and toward promoting development of electric drive, batteries and controls.

The "youngest" member of the electric drive family, fuel cell EVs, which harness the chemical energy of hydrogen and oxygen to generate electricity, have the potential to change the way we think about energy. Fuel cells are more efficient than other technologies that rely on direct combustion, and they produce zero, or near zero emissions. All of the major automakers are investing heavily to develop this technology and each has committed to attempting to commercialize fuel cell cars by the end of this decade.

The challenges to these electric modes of transportation, whether battery, hybrid or fuel cell, remain the cost of the current generation of technologies used in the vehicles, the limited availability of charging infrastructure, and the resulting, continuing lack of consumer awareness of, and experience with, the technology.

Mr. Chairman, the legislation you, Senator Jeffords and others have introduced, the Alternative Fuels Tax Incentives Act (S.2591), provides incentives that are critical to assuring that those electric drive technologies that use alternative fuels have a chance to become part of our 21st century transportation mix. EVAA endorses the legislation and applauds you for your proposal. By extending and enhancing current tax incentives for electric vehicles, S. 2591 assures that the necessary level of government support remains in place. Notable, proposed enhancements include:

A tax credit of between \$4,250 for light duty EVs to as much as \$42,500 for heavy duty EVs and buses, which is available until 2008; and,

A tax credit of \$6,375 for light duty EVs with a driving range of at least 100 miles and/or a payload capacity of 1000 lbs., which also is available until 2008.

We urge you and the Subcommittee to work collaboratively with your colleagues on the House, who also have proposed tax incentives for electric and other alternative fuel vehicles, to assure that legislation is enacted as quickly as possible.

Thank you again, Mr. Chairman, for this opportunity to testify.



# ELECTRIC VEHICLE ASSOCIATION *of the* AMERICAS



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May 25, 2000



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Carolina Power & Light	New York State Technology Enterprise Corporation
Central & South West Corporation	Nissan North America/Nissan R&D
CEREVEH	Northern States Power
Chattanooga Area Regional Transportation Authority	Northeast Sustainable Energy Association (NESEA)
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Connectiv	Sacramento Municipal Utility District
Copper Development Association	Salt River Project
Curtis Instruments	San Diego Gas & Electric Company/Sempra Energy
DaimlerChrysler Corporation	Solectria Corporation
Earth Options Institute	Southern California Economic Partnership
Ecostar Electric Drive Systems	Southern California Edison Company
Edison Electric Institute	Southern Company/Georgia Power Company
Electricité de France	Taiwan Power Company
Electric Transportation Engineering Corporation	Technologies M4
Electric Vehicle Infrastructure	Tennessee Valley Authority
Electric Vehicle Association of Canada	3M
Electric Vehicle Association of Great Britain	Tokyo Electric Power Company
Energy Conversion Devices/Ovonic	Toyota Motor Corporation/Toyota Motor Sales, USA
Enova Systems	Unique Mobility, Inc.
EPRI	University of California, Davis/ITS
Escuela Politecnica Nacional	University of South Florida
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General Motors Corporation	Virginia Power
GPU	Volkswagen
Hong Kong Electric Company, Ltd.	York Technical College

**Bold** denotes EVAA Board member.

### PREPARED STATEMENT OF HON. MAX BAUCUS

Mr. Chairman, this is an important hearing. In recent months, parts of the country have seen serious petroleum price spikes.

I think it has been pretty well demonstrated that these recent price spikes have little or nothing to do with the Clean Air Act's reformulated gasoline program, ethanol, gas taxes or any minor policy effects. Instead, they are a symptom of a much larger problem—our growing and expensive dependence on oil imports.

The Department of Energy estimates that the oil market upheavals of the last 30 years have cost the U.S. economy nearly \$7 trillion. In 2000 alone, we're looking at a \$1.28 billion loss to the economy due to OPEC's supply and price manipulation.

So, the question is, what is the appropriate Federal response to this expensive dependency—particularly in the transportation sector which is 97% dependent on oil?

First, we should be reducing demand through efficiency improvements. For several years now, Congress has looked the other way while average fuel economy has stagnated and vehicle miles traveled has increased. We have made some progress through the Partnership for a New Generation of Vehicles. But, by and large, Congress has let the market controlled by OPEC dictate our transportation energy policy.

Second, we also need to make alternative fuels options look more attractive. Fuel diversity can improve our energy security and benefit the environment. Most alternative fuel vehicles emit fewer greenhouse gases and criteria air pollutants than conventional gasoline engines. But a variety of factors make them appear more costly.

I have joined Senators Daschle, Bingaman and others in preparing a comprehensive energy security bill which includes tax incentives for energy efficient and alternative fuel vehicles. I am hopeful that these provisions, which are similar to those in the Chairman's bill and in the LottMurkowski bill, can be part of any year-end tax package that the Committee approves.

Efforts to reduce our dependency should be bipartisan. After all, this is really a national security matter.

As a nation, we need to kick the foreign oil habit. This will have some short-term costs. But in the longrun, our nation will be less vulnerable to oil price shocks and more prosperous.

Right now, in the Environment Committee, we are working on a measure to eliminate MTBE from the fuel supply. As many of you may know, it has contaminated ground water across the country.

I hope that measure will be an opportunity to replace MTBE with increasing amounts of renewable fuels, such as ethanol. That should help us cut back on our imported oil habit.

I applaud the Chairman for the timeliness of this hearing. But, we should also remember that this is a longterm problem that deserves our continuing attention.

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## PREPARED STATEMENT OF RED CAVANEY

### I. INTRODUCTION

These comments are submitted by the American Petroleum Institute (API) for inclusion in the record of the July 18, 2000 Senate Finance Committee Subcommittee on Taxation and IRS Oversight hearing on federal income tax issues relating to proposals to lower U.S. dependency on foreign oil. API represents almost 500 companies involved in all aspects of the oil and gas industry, including exploration, production, transportation, refining, and marketing.

For over half a century, the United States has relied to varying degrees on imports for a portion of its oil needs. As dependence on global oil markets has grown, we have learned that this dependence carries both opportunities and risks. On the one hand, it affords us access to energy supplies less costly than could be produced domestically. On the other hand, it exposes us to two inherent risks associated with that marketplace, namely the potential for short-term supply interruptions, and the potential for long run vulnerability to adverse actions by OPEC. But the experience of growing dependence has also taught us a few important lessons about the potential for U.S. policies to successfully manage these risks, and the hazards of misguided policies that have aggravated them. As this committee proceeds with its task, it is essential that we retain an awareness of these lessons.

At the start, we should be clear about the nature of the problem being addressed. It is frequently—too frequently—characterized as the “import problem” faced by the “domestic industry,” usually defined as the producers of domestic oil and gas. In this guise, our industry is often portrayed as hapless high cost producers seeking protection from the harsh discipline of the global marketplace in which they find themselves. This portrayal could not be further from the truth. First, the U.S. petroleum industry does not consist solely of producers of domestic oil and gas. Predominantly, upstream producers are involved in global operations, and drilling and support companies in the United States are increasingly dependent on the global activities of these and other companies around the world. Second, the U.S. petroleum industry is one of the most technologically advanced and competitive players in the world economy. Our recommendations to this committee are not a request for the construction of protectionist barriers, but a request for removal of the barriers that currently impede our ability to compete, both domestically and abroad. Seen in this light, the problem is not one of imports, but one of preserving the competitiveness of U.S. industry in the global marketplace.

Today, that global market is expanding. Oil is essential to sustaining the economic growth of both the U.S. and the global economy, and recent forecasts expect global demand to expand by over 15 million barrels per day in the next decade. While the U.S. industry is poised to play a key role in that expansion, current U.S. policies impede our participation. Domestically, U.S. oil production has fallen by nearly 3.7 million barrels a day since 1970, a loss of about 38%. Ironically, some of the most severe recent declines have been on our most promising frontiers, such as Alaska, despite increasingly optimistic assessments of the underlying resource base in those areas. Internationally, while the overseas production of U.S. companies has increased, it continues to lag the growth experienced by a host of competitors, due in part to U.S. tax policies that put these U.S. firms at a competitive disadvantage.

Realistically, we cannot expect to supply all of the oil required for the growth of the U.S. economy from domestic sources. Imports will be a part of any realistic scenario, and we need to accept that fact and work to maintain the global competitive position of the U.S. oil and gas industry. If U.S. companies cannot economically compete overseas, those foreign resources will still be produced. However, they will be produced without the security of supply that would be realized with U.S. firms producing the oil, any benefit to the U.S. economy and without U.S. companies, their shareholders, or American workers deriving any direct or indirect income from the foreign production activity.

One of the central lessons learned in our experience over the past several decades is that the principal risks associated with global oil markets have arisen from excessive concentration of supply into "pockets of vulnerability." These pockets may be regional, such as the Persian Gulf, economic, such as the OPEC cartel, or political, such as Iraq. As supply becomes unduly concentrated into such groupings, consumers grow increasingly vulnerable to supply interruptions or restrictions, whether intended or accidental. The only viable response to that risk, which is the one we now face—must be the sustained development of diverse sources of supplies—both domestically and internationally. We effectively countered OPEC in the 1980s with the development of massive new sources of supply—in Alaska, on the Outer Continental Shelf, in the North Sea, and in numerous new locations scattered throughout the globe. Competition was, and is, the key to reducing dependence on OPEC, and the challenge today is to renew the competitive fervor that so effectively managed this risk in the past.

Ironically, in much of the world this growth in non-OPEC supply continues, though not in the United States. Restrictions on the ability of U.S. firms to supply energy, both domestic and international, are increasingly imposed with casual regard to their implications for ensuring the future availability of oil supply.

Domestically, access to federal land has become an acute problem. Since 1983, access to federal land in eight Western states has declined by more than 60 percent. In Alaska, the industry is being denied access to some of the most promising areas of the domestic resource base, in the National Petroleum Reserve and the Arctic National Wildlife Refuge. Offshore, continued government moratoria on key acreage impedes development, and restricts the application of some of our most promising new technologies. These restrictions flourish despite the exemplary environmental record that the industry has compiled in its development offshore and in sensitive onshore areas. Internationally, the U.S. has a strong strategic interest in the growing availability of new supplies, both as a source of its own imports and as a source of energy to fuel economic prosperity elsewhere in the world. The U.S. petroleum industry has much to offer in terms of sustaining this supply diversity via the contributions of U.S. energy companies to supply growth outside of the United States. Numerous new opportunities have opened up worldwide over the past decade—in Russia, the Caspian Sea Region, Asia, West Africa and Latin America. Generally, U.S. firms in recent years have been welcomed by many of these new frontier countries for their experience, capital and technical prowess. Increasingly, however, these activities are being threatened by the unintended consequences of two sets of U.S. policies, namely the increasingly adverse tax treatment of foreign source income earned by U.S. companies operating overseas, and the growing tendency for the United States to utilize unilateral economic sanctions against oil producing countries as an instrument of foreign policy.

Changes in U.S. international tax policy will help to enhance the global competitive position of the U.S. oil and gas industry. The U.S. international tax regime already imposes a substantial economic burden on U.S. multinational companies by exposing them to potential double taxation, that is, the payment of tax on foreign source income to both the host country and the United States. In addition, the complexity of the U.S. tax rules imposes significant compliance costs. As a result, U.S. companies are forced to forego foreign investment altogether based on projected

after-tax rates of return, or they are preempted in bids for overseas investments by global competition. Congress can help to stem further losses in the global competitive position of the U.S. oil and gas industry by adopting tax measures that allow U.S. oil and gas companies to compete more effectively both at home and in the international marketplace.

We cannot afford to constrain the development of supplies at home and abroad without regard to the potential vulnerability threatened by such neglect. Recent Department of Energy (DOE) and International Energy Agency (IEA) forecasts expect daily demand for oil to grow by nearly 15 million barrels over the next decade. It must be remembered that oil and gas projects require large amounts of capital and are high risk, long lead-time ventures. The tax treatment of the financing and structuring of these ventures is one of the essential elements of decisions whether to proceed. If allowed to compete, our industry has the capability to capture a significant share of the expected growth in demand, limiting OPEC's market share and contributing to the diversity of global supply. But barriers to supply expansion offer the threat of renewed vulnerability. Given this prospect, the current crisis should be a wakeup call to begin to tear down these barriers.

## II. DOMESTIC TAX INCENTIVES

While most other countries encourage energy development, flawed public policies—especially discriminatory tax provisions and excessive restrictions on access to federal lands—continue to place substantial restrictions on the exploration and production of oil and gas in this country. The most important thing that Congress and the Administration can do is to change these policies to permit the economic recovery of domestic reserves, and thus help reduce U.S. reliance on imported oil.

In 1999, a united oil and gas industry proposed a series of tax incentives designed to spur domestic oil and gas production. The need for these incentives has only intensified over the last year as OPEC has reestablished its ability to profoundly impact the available supply of oil—and most importantly, the price paid by consumers. While not the sole answer to ensuring adequate U.S. oil and gas supplies, tax measures such as Alternative Minimum Tax (AMT) relief, expensing of geological and geophysical (G&G) costs and delay rental payments, a marginal domestic oil and natural gas well production credit, and eliminating limitations on use of percentage depletion of oil and gas by independent producers will promote U.S. exploration and production. Most of these items were previously adopted by both the Senate and the House of Representatives as part of the conference report to the Taxpayer Refund and Relief Act of 1999 (H.R. 2488), which was ultimately vetoed by President Clinton. Expanding the enhanced oil recovery (EOR) credit to include certain nontertiary methods would also serve to encourage increased domestic petroleum activity.

### *Alternative Minimum Tax*

The Alternative Minimum Tax was intended as an advance payment of federal income tax, and therefore, AMT payments are creditable in future years, though only against regular tax liability and not tentative AMT. However, companies within the capital intensive petroleum industry often find themselves in a position where they are consistently unable to use their AMT credits because their regular tax liability in future years does not exceed the tentative AMT. For those companies, the AMT constitutes a permanent tax increase and decreases the economic viability of certain domestic operations. In order to reverse the targeted adverse impact of the AMT on the U.S. oil and gas industry, Congress should, at a minimum, eliminate the preference for intangible drilling and development costs (IDC), eliminate the depreciation adjustment for oil and gas assets placed in service prior to 1999, eliminate the impact of IDC and depreciation on oil and gas assets from the Adjusted Current Earnings (ACE) adjustment, and permit the EOR credit and Section 29 credit to reduce AMT. This proposed AMT relief would phase in and out as oil and natural gas prices fall and rise between specified levels, thereby providing the greatest assistance to producers in times of low prices.

Another non-industry specific way to mitigate the adverse impact of the AMT would be to allow AMT credits to be applied against future tentative AMT. This specific provision was included in the vetoed 1999 tax bill.

### *Geological and Geophysical Expenses*

Oil and gas exploration companies incur huge up front capital expenditures, including geological and geophysical (G&G) expenses, in their search for new oil reserves. G&G expenses include costs incurred for geologists, surveys, and certain drilling activities, which are incurred to help oil and gas companies locate and identify properties with the potential to produce commercial quantities of oil and/or gas. Currently, these costs must be capitalized, suspended and then amortized over a pe-

riod of years in the form of cost depletion after production begins. Forcing oil and gas companies to capitalize G&G costs exacerbates the economic burden imposed by these significant cash outlays that must be made prior to or at the beginning of an exploration project. In order to encourage the discovery of new domestic oil and gas reserves, and thus increase domestic supply, Congress should pass legislation to permit the expensing of G&G costs.

In addition to having been included in the vetoed 1999 tax bill, H.R. 2488, the expensing of both G&G costs and delay rental payments, was included in President Clinton's proposal to "strengthen America's energy security," introduced earlier this year. In addition, these items were also part of subsequent legislation (S. 2265), introduced by Sen. Kay Bailey Hutchison in March of this year, as well as the National Energy Security Act of 2000 (S. 2557), introduced by Senate Majority Leader Trent Lott in May.

#### *Delay Rentals*

Delay rentals are paid by oil and gas exploration companies to defer the commencement of exploration and production on leased property without forfeiting the lease. Treasury regulations and case law clearly support the option on the part of a lessee to expense or capitalize delay rental payments, and until 1987, this right was essentially uncontested. However, with the 1986 enactment of the uniform capitalization rules of Section 263A, the IRS began to challenge the deductibility of delay rentals during audits. In 1997, the IRS unequivocally adopted the position that for tax years beginning after December 31, 1993, delay rentals had to be capitalized unless the taxpayer could establish that the lease was acquired for some reason other than development. This position ignores forty years of history and long-established regulations. Congress should pass legislation that clarifies and reaffirms the long-standing rule that has permitted delay rentals to be expensed rather than capitalized. By decreasing the economic burden of paying delay rentals, more capital will be available for exploration and production.

#### *Marginal Well Production Credit*

A marginal well production credit of \$3 per barrel for the first three barrels of daily production from an existing marginal oil well, and a 50 cent per thousand cubic feet (Mcf) tax credit for the first 18 Mcf of daily natural gas production from a marginal well, would help producers ensure the economic viability and slow the shutting-in of marginal wells. Like the proposed AMT relief, the credits would phase in and out as oil and natural gas prices fall and rise between specified levels providing the greatest benefit to producers when prices are low. Finally, the credit should be allowed against both regular and alternative minimum tax and to be carried back ten years.

This marginal oil and gas well production credit proposal was also included in S. 2265 and S. 2557, and the President pledged to continue to examine measures to preserve marginal well production in his March proposal.

#### *Percentage Depletion*

Another way Congress could assist the domestic industry would be to permit, by annual election, elimination of the 65 percent taxable income limitation on percentage depletion. In addition, independent producers and royalty owners should be permitted to carry forward percentage depletion deductions for ten years.

#### *EOR Credit*

Finally, the Enhanced Oil Recovery (EOR) credit provides a credit equal to 15 percent of costs attributable to qualified enhanced oil recovery projects. Since the enactment of the EOR credit in 1990, new technologies have greatly enhanced the ability of domestic producers to recover additional domestic reserves with minimal environmental impacts. Extending the EOR credit to horizontal drilling, gravity drainage, cyclic gas injection, and water flooding would greatly enhance the economic viability of these oil recovery methods as a means to increase domestic production.

### III. RELIEF FROM DISCRIMINATORY INTERNATIONAL TAX RULES

In order to survive, the oil and gas industry must operate where it has access to economically recoverable oil and gas reserves. Since the opportunity for domestic reserve replacement has been substantially restricted by both federal and state government policies, the tax treatment of international operations is critical to the industry's continued ability to supply the nation's hydrocarbon energy needs.

With OPEC market share and influence once again rising, a key concern of federal policy should be that of maintaining the global supply diversity that has been the keystone of improved energy security for the past two decades. The principal

tool for promotion of that diversity is active participation by U.S. firms in the development of these new frontiers. Therefore, while federal tax policy should promote domestic oil and gas production, it should also seek to enhance the competitiveness of U.S. concerns operating abroad, not reduce it with added tax burdens such as new limitations on the use of foreign tax credits.

Tax measures that would enable U.S. companies operating overseas to better compete in the global oil and gas business environment include, among others, repeal of Section 907, accelerate repeal of separate limitation basket requirement for dividends received from 10/50 companies (i.e., foreign companies owned between 10 and 50 percent by U.S. owners), provide look-through treatment for sales of partnership interests, provide look-through treatment for interest and royalties from 10/50 companies, allow recapture of overall domestic losses, extend carryback and carryforward periods for foreign tax credits, and modify the interest allocation rules to permit allocation on a world-wide basis. In addition, Congress should continue to reject Administration attempts to increase taxes on the foreign source income of U.S. oil and gas companies.

#### *The Foreign Tax Credit Is Intended to Prevent Double Taxation*

Since the beginning of Federal income taxation, the U.S. has taxed the worldwide income of U.S. citizens and residents, including U.S. corporations. The FTC is designed to allow a dollar for dollar offset against U.S. income taxes for taxes paid to foreign taxing jurisdictions in order to avoid double taxation.

#### *Basic Rules of the FTC*

The FTC is intended to offset only U.S. tax on foreign source income. Thus, an overall limitation on currently usable FTCs is computed by multiplying the tentative U.S. tax on worldwide income by the ratio of foreign source income to worldwide taxable income. The excess FTCs can be carried back two years and carried forward five years, to be claimed as credits in those years within the same respective overall limitations.

The overall limitation is computed separately for not less than nine "separate limitation categories." Separate limitations apply for income: (1) whose foreign source can be easily changed; (2) which typically bears little or no foreign tax; or (3) which often bears a rate of foreign tax that is abnormally high or in excess of rates of other types of income. In these cases, a separate limitation is designed to prevent the use of foreign taxes imposed on one category to reduce U.S. tax on other categories of income. Examples of foreign source income that must be placed in separate baskets include dividends received from 10/50 companies, gains on the sale of foreign partnership interests, and payments of interest, rents and royalties from non-controlled foreign corporations and partnerships.

#### *Foreign Oil and Gas Extraction Income and Foreign Oil Related Income: Code Section 907*

Under the separate basket rules, foreign oil and gas income falls into the general limitation basket for purposes of computing the overall FTC limitation. But before this limitation for general operating income, U.S. oil companies have to clear an additional tax credit hurdle.

Section 907 limits the utilization of foreign income taxes on foreign oil and gas extraction income (FOGEI) to that income multiplied by the current U.S. corporate income tax rate. The excess credits may be carried back two years and carried forward five years, with the creditability limitation of Section 907 being applicable for each such year.

Congress intended for the FOGEI and FORI rules to purport to identify the tax component of payments by U.S. oil companies to foreign governments. The goal was to limit the FTC to that amount of the foreign government's "take" which was perceived to be a tax payment versus a royalty as payment for the production privilege. But even the so identified creditable tax component should not be used to shield the U.S. tax on certain low-taxed other foreign income, such as shipping.

These concerns have been adequately addressed in subsequent administrative rulemaking and legislation. After several years of discussion and drafting, Treasury completed in 1983 the "dual capacity taxpayer rules" of the FTC regulations which set forth a methodology for determining how much of an income tax payment to a foreign government will not be creditable because it is a payment for a specific economic benefit. Such a benefit could, of course, also be derived from the grant of oil and gas exploration and development rights. These regulations have worked well for both IRS and taxpayers in various businesses (e.g., foreign government contractors), including the oil and gas industry. In addition, the multiple separate basket rules were enacted in 1986, restricting taxpayers from offsetting excess FTC's from high-taxed income against taxes due on low-tax categories of income.



Since the Section 907 legislation has been duplicated and improved in subsequent legislation and rulemaking, that Section has been rendered obsolete. Further, Section 907 has raised little if any additional tax revenue because excess FOGEI taxes would not have been needed to offset U.S. tax on other foreign source income. Nevertheless, oil and gas companies continue to be subject to burdensome compliance work. Each year, they must separate FOGEI from FORI and the foreign taxes associated with each category. These are time consuming and work intensive analyses, which have to be replicated on audit. Section 907 should be repealed as obsolete. This would promote simplicity and efficiency of tax compliance and audit with minimal loss of revenue to the government.

In fact, the Senate and House last year passed legislation that would repeal Section 907. Unfortunately, the President vetoed H.R. 2488.

#### *Dividends Received from 10/50 Companies*

The 1997 Tax Act repealed the separate basket rules for dividends received from 10/50 companies, effective after the year 2002. A separate FTC basket will be required for post-2002 dividends received from pre-2003 earnings. Because of these limitations, U.S. companies operating overseas will continue to forego foreign projects through noncontrolled 10/50 corporations. Accordingly, the repeal will remove significant complexity and compliance costs for taxpayers and foster their global competitiveness.

The repeal of the separate limitation basket requirement with respect to dividends received from 10/50 companies therefore should be accelerated. This provision has been included in the last few Administration budget proposals, as well as in the vetoed 1999 tax bill, H.R. 2488. In addition, the requirement of maintaining a separate limitation basket for dividends received from earnings and profits accumulated before the repeal also should be eliminated.

#### *Look-through Treatment for Sales of Partnerships*

The distributive share of an at least 10% U.S. partner of a foreign partnership follows the partnership's income FTC basket classification. On the other hand, no such look-through applies to the gain on the sale of a 10% or more partnership interest in a foreign partnership. U.S. tax rules treat the gain as separate basket passive income, thereby limiting the opportunity of FTC utilization.

Economically, any gain on the sale of the partnership interest is attributable to unrealized or undistributed income. It is not only inequitable but also counter intuitive for the legal form of the value realization to control the FTC basket characterization. Accordingly, for a 10% or greater partnership interest, look-through should apply to the gain in the same way that it applies to the distributive share of partnership income.

#### *Look-through Treatment for Interest, Rents, and Royalties With Respect To Non-Controlled Foreign Corporations and Partnerships*

U.S. companies are often unable, due to government restrictions or operational considerations, to acquire controlling interests in foreign corporate joint ventures. To align their position with general participation situations in foreign projects, they also should be granted the look-through treatment for interest, rents and royalties received from foreign joint ventures as in the case of distributions from a CFC (controlled foreign corporation).

Current tax rules also require that payments of interest, rents and royalties from noncontrolled foreign partnerships (i.e., foreign partnerships owned between 10 and 50% by U.S. owners) must be treated as separate basket income to the joint venture partners. Again, as in the case of corporate joint ventures, look-through treatment should be extended to these business entities. This would abolish distinctions in treatment of distributions that are based on participation percentages that may be beyond the control of the U.S. taxpayer.

#### *Recapture of Overall Domestic Losses*

When foreign source losses reduce U.S. source income (overall foreign loss or OFL) in a tax year, the perceived tax benefit has to be "recaptured" by resourcing foreign source income in a subsequent tax year as domestic source. Of course, this re-characterization reduces the ratio of foreign source income to total income, which in turn reduces the ratio of tentative U.S. tax that can be offset against foreign taxes. However, if foreign source income is reduced by U.S. source losses, there is no parallel system of "recapture." Taxpayers are not allowed to recover or recapture foreign source income that was lost due to a domestic loss, resulting in the double taxation of such income. The U.S. losses thus can give rise to excess FTC's which, due to the FTC carryover restrictions, may expire unused. Only a corresponding re-charac-

terization of future domestic income as foreign source income will reduce the risk that FTC carryovers do not expire unused.

#### *Foreign Tax Credit Carryover Rules*

The utilization of income taxes paid to foreign countries as FTC is limited to the U.S. tax that is owed on the foreign source income. Thus, an overall limitation on currently usable FTC's is computed by taking the ratio of foreign source income to worldwide taxable income and multiplying this by the tentative U.S. tax on worldwide income. The excess FTC's can be carried back to the two preceding taxable years, or to the five succeeding taxable years, subject in each of those years to the same overall limitation. If the credits are not used within this time frame, they expire.

Because of the ever-increasing limitations on the use of FTC's, coupled with the differences in income recognition between foreign and U.S. tax rules, excess credit positions are frequent. The present law's short seven-year carryover (two-year carryback and five-year carryforward) period easily results in credits being lost, most likely resulting in double taxation.

The long-standing policy of not taxing the same income twice dictates that the carryover periods for excess FTC's should be extended to allow for a five-year carryback and a 15-year carryforward.

#### *Allocation of Interest Expense*

Current law requires the interest expense of all U.S. members of an affiliated group to be apportioned to all domestic and foreign income, based on assets. The current rules deny U.S. multinationals the full U.S. tax benefit from the interest incurred to finance their U.S. operations. For example, if a domestically operating member of a U.S. tax consolidation with foreign operations incurs interest to finance the acquisition of new environmental protection equipment, a portion of the interest will be allocated against foreign source income of the group and therefore become ineffective in reducing U.S. tax. A U.S. subsidiary of a foreign corporation (or a U.S. corporation—or affiliated group—without foreign operations) would not suffer a comparable detriment.

Unless allocation based on fair market value of assets is elected, allocation of interest expense according to the adjusted tax bases of assets assigns too much interest to foreign assets. For U.S. tax purposes, foreign assets generally have higher adjusted bases than similar domestic assets because domestic assets are eligible for accelerated depreciation while foreign-sited assets are assigned a longer life and limited to straight-line depreciation. For purposes of the allocation, the earnings and profits (E&P) of a CFC is added to the stock basis. Since the E&P reflects the slower depreciation, the interest allocated against foreign source income is disproportionately high.

Rules similar to the Senate version of interest allocation in the Tax Reform Act of 1986 would alleviate the current anti-competitive results by permitting the taxpayer to elect to allocate interest on a worldwide basis. The allocation group would include all companies that would be eligible for U.S. tax consolidation but for being foreign corporations. The interest allocated to foreign source income under this worldwide taxpayer rule would be reduced by the interest that would be allocable to foreign source income. Second, as an exception to the "one taxpayer" rule, "stand alone" subsidiaries could elect to allocate interest on certain qualifying debt on a mini-group basis, i.e., looking only to the assets of that subsidiary, including stock.

Furthermore, taxpayers should be allowed to elect to use the E&P bases of assets, rather than the adjusted tax bases, for purposes of allocating interest expense. Use of E&P basis would produce a fair result because the E&P rules are similar to the rules now in effect for determining the tax bases of foreign assets.

This measure, too, was included in the 1999 tax bill, H.R. 2488, vetoed by President Clinton.

#### IV. SUMMARY

Our industry strongly supports efforts to encourage increased petroleum activity in the United States through tax incentives. These incentives would further promote the use of new technologies for exploration, development and production, and would help to maintain the economic viability of mature production sites. Notwithstanding the benefits that would be provided by adoption of these tax measures, their potential to help increase and sustain domestic petroleum production will be limited unless Congress also acts to reduce restrictions on access to federal lands and to rationalize the increasingly burdensome regulatory apparatus. Moreover, it must be recognized that expected growth in the demand for oil and natural gas—both in the United States and abroad—cannot be met merely through increased U.S. produc-

tion. While U.S. reliance on imported oil can be reduced, maintaining the global competitive position of the U.S. oil and gas industry will be crucial to ensuring that U.S. consumers continue to enjoy adequate and cost-competitive supplies of our industry's major products.

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PREPARED STATEMENT OF HON. ROD GRAMS

Thank you for holding this hearing today on our nation's growing reliance on foreign oil and our need to find ways in which we can reduce that reliance.

Mr. Chairman, for many, including the farmers, truckers, businesses, and families of our nation, the rising price of gasoline is quickly becoming a crisis. I look at the situation we're now facing with high fuel prices and have a hard time understanding why it's such a surprise to so many people in Washington.

It's important to remember that energy supply and price concerns are nothing new. We've had decades to respond to the threat of supply disruptions and to decrease our reliance upon foreign oil. The DOE was created by President Jimmy Carter in response to the energy crisis of the 1970s. At the time, we were reliant on foreign oil to meet 35% of our needs. Today, despite hundreds of billions of taxpayer money wasted, we're almost 60% reliant on foreign oil.

In fact, since 1992, U.S. oil production has been reduced by 17% while our consumption of oil has increased by 14%. In 1990, U.S. jobs in oil and gas exploration and production were roughly 405,000—today those jobs have been reduced to approximately 290,000, a 27% decline. And in 1990, the U.S. was home to 657 working oil rigs. Today, there are only 153 of them scattered across the nation—a 77% decline.

Those numbers represent overwhelming proof that our nation's domestic energy policies are the underlying cause of high fuel costs.

That is one of the reasons why I've joined many of my colleagues in the Senate in urging an immediate response to our reliance on foreign oil that considers both short and long-term remedies. Our nation must find a way to encourage increased domestic oil and gas exploration and production and I am pleased that your committee is looking at tax incentives that could help. Our nation has its own reserves of crude oil and natural gas, but current regulations and Administration policies have significantly impacted our ability to access those reserves.

I'm also a strong advocate of turning even more of our attention to the development of domestically produced renewable sources of energy. I've long been an advocate of the renewable energy programs because I know they're good for our economy and the environment. They can also lessen our reliance on foreign oil, which prompts me to urge your consideration of my ethanol tax bill today.

Mr. Chairman, Minnesota is now home to over a dozen operating ethanol plants with a capacity of over 200 million gallons annually. These plants mean new jobs with good wages and good benefits for people living in rural areas where these plants are built. According to a report by the Minnesota Legislative Auditor, those plants, and the resulting economic activity, are expected to create as many as 5,000 new, high-wage jobs.

In addition to its positive economic impact, ethanol production allows our nation to move away from our dependence on foreign energy sources. The United States Department of Agriculture estimates that for every gallon of ethanol produced domestically, we displace seven gallons of imported oil. Ethanol plays a role in increasing our national energy security by providing a stable, homegrown, renewable energy supply. Ethanol is estimated to reduce our demand for foreign oil by 98,000 barrels per day.

Today, I am introducing legislation that will allow small, farmer-owned cooperatives to access the full benefits of the small ethanol producer tax credit.

Mr. Chairman, current law provides for an income tax credit of 10 cents per gallon for up to 15 million gallons of annual ethanol production by a small ethanol producer. A small ethanol producer is one defined as having a production capacity of less than 30 million gallons per year. The credit was enacted as part of the Omnibus Budget Reconciliation Act of 1990 and championed by our former colleague, Senator Bob Dole. Unfortunately, the credit was enacted at a time when the growth and shape of the ethanol industry was still difficult to predict.

This has led to an unfortunate situation in Minnesota, Iowa, and in other areas where farmer-owned cooperatives have been unable to access the credit due to the way in which the original legislation was drafted. The original legislation certainly envisioned these small, farmer-owned cooperatives as being eligible for the tax credit, but the intricacies of the tax code have made it impossible for them to do so.

My proposal would simply provide a technical correction to ensure farmer-owned cooperatives are included in the definition of who can benefit from the small ethanol producer tax credit. My bill also expands the definition to include facilities with less than 60 million gallons in annual capacity.

I want to again stress that this proposal is consistent with the original intent of the 1990 law that created the small ethanol producer tax credit. Farmer-owned cooperatives were never intended to be excluded from receiving the benefits of the tax credit if they produce less than 30 million gallons. It was just hard to envision the role and growth of cooperatives when we passed the 1990 law. Cooperatives are not huge corporate ventures, but associations of small farmers.

In closing, Mr. Chairman, I believe reducing our nation's reliance on foreign oil will require a multifaceted approach that leaves no stone unturned in our quest for increased domestic energy production. I believe ethanol must play a strong role in reducing our reliance on foreign oil, and the legislation I'm introducing will help us achieve that vitally important goal.

Thank you, Mr. Chairman.

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## MATERIAL SUBMITTED BY JEFF GROSCOST

### STATE OF ARIZONA ALTERNATIVE FUEL PROGRAM 2000 CLEAN AIR ACT

#### *I. Qualifying Alternative Fuels*

- Natural Gas
- Propane Electricity
- Hydrogen
- Solar

#### *II. Qualifying Alternative Fuel Vehicles*

- Factory Manufactured
- Bi fuel or Dedicated
- Converted vehicles
- Bi fuel or Dedicated

#### *III. Alternative Fuel Vehicle Incentives*

- No city or state sales tax on the purchase of alternative fuel vehicles.
- One time registration.
- Unrestricted use of freeway high occupancy vehicle lanes (HOV).
- Grants
- Refundable tax credits

Arizona offers grants and or tax credits based on vehicle emissions. Applications for converted vehicles must include proof of compliance with Memorandum 1-A, as well as emissions data. If grant money is not available for a qualified application, a voucher shall be issued which allows a refundable tax credit to be claimed for the same amount as the grant.

#### *Grants are awarded as follows:*

- New LEV 30% of the cost or \$5,000, whichever is more.
- New ILEV or ULEV 40% of the cost or \$7,500, whichever is more.
- New SULEV or ZEV 50% of the cost or 10,000, whichever is more.
- New LEV over 12,000 GVW, 30% of the cost or \$30,000, whichever is more.
- Conversion of a vehicle over 12,000 GVW, the greatest of the following:
  - 30% of the actual price of the vehicle plus the cost of conversion.
  - 30% of the MSRP.
  - \$30,000.
- Conversion of any other vehicle the greatest of the following:
  - 30% of the actual price of the vehicle plus the cost of conversion.
  - 30% of the MSRP.
  - \$5,000
  - If the applicant can demonstrate that the converted vehicle meets ILEV, ULEV, SULEV or ZEV emission standards, then the corresponding grant may be claimed.

#### *Incremental cost*

- Alternative fuel vehicles are eligible for a refundable tax credit for the incremental cost of the purchase or conversion in addition to the grant.

#### *Other alternative fuel vehicle grants*

- Grants to previously converted fleets to bring them into working order.

- Grants for successful Memorandum 1-A certification tests on converted platforms by Arizona companies.

#### IV. ALTERNATIVE FUEL INFRASTRUCTURE INCENTIVES

- Refundable tax credits
- Grants

##### *Home Refueling Systems—Tax Credits*

- A refundable tax credit may be claimed for the cost of a home vehicle refueling apparatus.
- A refundable tax credit may be claimed for the cost of the infrastructure necessary for the installation of a home, vehicle refueling apparatus.

##### *Commercial Refueling Systems—Tax Credits*

- A refundable tax credit of 100% of the cost of construction, up to \$400,000, for each variation of an alternative fuel type dispensed by an alternative fuel delivery system.
- A refundable tax credit of 50% of the cost of construction, up to \$200,000, for each variation of an alternative fuel type dispensed by an alternative fuel delivery system.
- A refundable tax credit for the addition of variations of an alternative fuel type at an existing public facility, of not more than \$100,000 or 50% of the cost of construction, whichever is more.

##### *Commercial Refueling—Grants*

- Up to \$100,000 for each variation of an alternative fuel type dispensed by a commercial alternative fuel delivery system that is accessible to the general public.
- 100% of the cost of retrofitting or installing a card access machine to an existing facility.
- Grants of not more than \$50,000, or the cost of the alternative fuel delivery system, for each variation of an alternative fuel type dispensed by a commercial alternative fuel system not open to the general public.
- Grants of not more than \$50,000, for retrofitting private alternative fuel stations to make them accessible to the general public.
- Grants of not more than \$50,000, for retrofitting state, county, city or town alternative fuel stations to make them accessible to other governmental entities.
- Grants of \$100,000 or 50% of the cost, whichever is more, for adding variations of an alternative fuel type at one location. Must be accessible to the general public.
- Grant for the cost slow-fill refueling systems and vehicles for non-profit organizations.
- A grant of not more than \$350,000 for the cost of an alternative fuel delivery system at Northern Arizona University.

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#### PREPARED STATEMENT OF HON. ORRIN G. HATCH

Today, the Senate Finance Subcommittee on Taxation and IRS Oversight will examine legislation before the committee that addresses our growing dependency on foreign oil for transportation fuels. I would like to thank Chairman Roth for recognizing the importance of this issue and for his cooperation in scheduling this hearing. Our dependency on foreign oil is clearly one of the most pressing economic and national security issues we face at this time.

Many in attendance today will recall the energy crisis under President Jimmy Carter in 1973. The oil embargo by Arab nations at that time brought us skyrocketing gas prices and long lines at our local gas stations. Central to the crisis was our nation's dependency on foreign sources for 35 percent of our oil. What is striking, though, is that since the 1970s, our dependency on foreign oil has increased sharply from 35 percent to a whopping 56 percent.

Every day, Americans spend \$300 million on imported oil. This makes up a full third of our entire trade deficit. Is it any wonder that decisions made by oil producing nations across the globe have such a profound impact on our farmers, our truck drivers, and our economy as a whole?

Our second panel today will focus on tax proposals before the Finance Committee that would go a long way toward helping us to address our nation's dependency on foreign oil supplies by increasing our domestic oil and gas production.

Our first panel will discuss legislation to provide tax incentives to increase the use of alternative fuels in the United States. Because alternative fuels are produced

and distributed domestically, increasing their use will contribute to lowering our dependency on foreign oil. They also have the added environmental benefit of being clean burning.

Promoting alternative fuels is an important issue to me. I have played a principal role, together with Senators Rockefeller and Jeffords, in developing both alternative fuel bills that are before the Finance Committee. I would like to point out that during his last State of the Union Address, President Clinton proposed legislation to increase alternative fuel use, but six months earlier, Senator Rockefeller and I had already introduced S. 1003, the Alternative Fuels Promotion Act. And since the President's speech, Senator Rockefeller and I have joined with Senator Jeffords on a revised bill, S. 2591, the Alternative Fuels Tax Incentives Act. We were joined in this effort by Senators Bryan and Robb.

While our nation has made important technological strides toward the use of alternative fuels, three principal market barriers remain to their widespread use: One, the incremental cost of alternative fuel vehicles; two, the cost of the alternative fuel; and, three, the lack of alternative refueling stations in our nation. To be effective, legislation will need to overcome all three of these barriers.

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#### PREPARED STATEMENT OF J. ANDREW HOERNER

Good morning Mr. Chairman and members of the Subcommittee. On behalf of Center for a Sustainable Economy, I would like to thank the Taxation and IRS Oversight Subcommittee for inviting me to testify today. My name is Andrew Hoerner. I am Director of Research at Center for a Sustainable Economy. CSE is a non-profit, non-partisan tax and economic policy research organization. Our mission is to promote creative, market-based policies that integrate the goals of long-term economic prosperity, environmental quality and social fairness.

My testimony today will address three approaches to dealing with the current high energy prices through the tax system: first, tax incentives for energy efficiency and renewable energy technologies; second, tax incentives for domestic fossil fuel production; and finally, a moratorium on federal motor fuel taxes. Of these three policies, only the incentives for energy efficiency and renewables promote long-term energy security, economic growth, and environmental quality. Subsidies to fossil fuel industries drain American reserves and ensure increased dependence on foreign oil, while cutting gas taxes plays into the hands of OPEC by transferring money directly from the pockets of U.S. taxpayers into the hands of foreign oil producers.

First, on energy-efficiency incentives: CSE conducted a major study of the economic impact of the six tax incentives contained in the Fiscal Year 2000 Climate Change Technology Initiative. The incentives included investment tax credits for energy-efficient vehicles, homes, and building equipment and for rooftop solar systems and combined heat and power systems. They also included production credits for electricity produced from wind or biomass power. The wind and biomass credit was extended last year.

We used a survey-of-experts approach to estimate the impact of these proposed tax incentives, with a panel of 81 experts drawn roughly equally from industry, government, academia and non-governmental organizations.

Our estimate of the total cost for the six provisions is very close to the Joint Committee on Taxation estimate—the difference is less than 15 percent, within the margin of error for revenue forecasts. We found that the credits would cause reductions in the price of the eligible technologies that are greater than the cost of the credit to the government. Indeed, the present value of the non-environmental economic benefits will be roughly five times the cost of the credit over the 2000–2018 period. In addition, the credits would cut local air pollution emissions to a degree that would save Americans two times as much in health care and related costs as the U.S. government would spend on the credits. This does not include any valuation of potential climate benefits.

In some cases, other energy policies need to be adjusted to prevent the effectiveness of the credit from being undermined. For instance, cars receiving the energy-efficient vehicle credit must be excluded from the fleet fuel economy calculations used to determine compliance with Corporate Average Fuel Economy standards. If this is not done, the energy efficiency gains from the super-efficient vehicles will simply make it possible to produce a larger number of inefficient vehicles, with no improvement in average fuel economy.

Thus we find the Climate Change Technology Initiative is somewhat misnamed, as it is justified based on economic considerations that ignore climate impacts. However, the credits are also a very low-cost way of achieving reductions in greenhouse gas emissions. The cost of carbon savings from the credits averages eleven dollars

per ton of carbon. This is well below the cost of abatement through international trading as estimated by the President's Council of Economic Advisors.

The full text of our report, "Assessing Tax Incentives for Clean Energy Technologies: A Survey of Experts Approach" can be downloaded from our website at [www.sustainableeconomy.org](http://www.sustainableeconomy.org). The following table summarizes the present value of the costs and benefits of the six tax incentives. It assumes that a package of low-cost technology promotion measures is enacted along with those incentives.

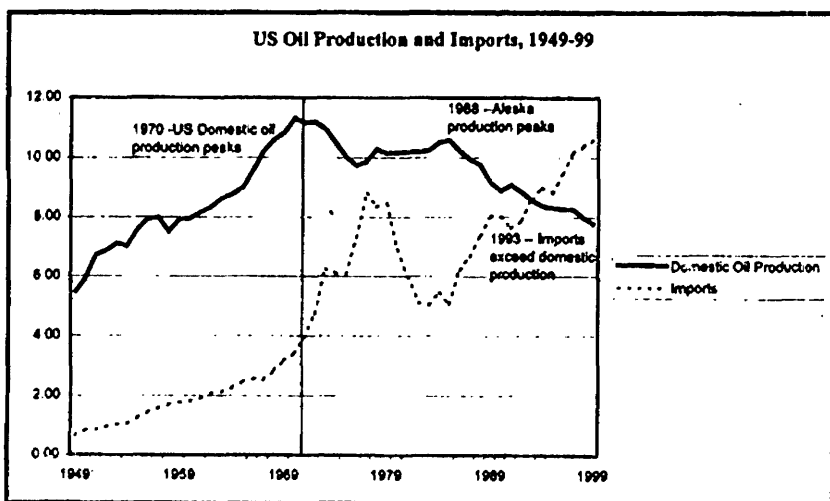
Value of Non-Environmental and Environmental Benefits from the Tax Credits, 2000-2018 (1999 dollars in millions)											
	Non-Environmental Costs and Benefits			Environmental Benefits*							
	Expenditure	Consumer Surplus	Spillover Benefits**	Local Environmental Benefits		Climate Related Benefits					
				Local Environmental Benefit	Local Environmental Benefits (Spillover)	\$500m Direct Carbon Benefit	\$500m Spillover Carbon Benefit	2050m Direct Carbon Benefit	2050m Spillover Carbon Benefit	10050m Direct Carbon Benefit	10050m Spillover Carbon Benefit
Vehicles	1,181	20,197	6,232	550	517	43	40	172	161	859	807
Homes	35	115	728	33/7	0.05/0	0.8/6	0.0/0.0	3/2	0.02/0.01	17/14	0.1/0.0
Building Envelop	108	146	N/A	190/18	N/A	6/5	N/A	24/19	N/A	120/96	N/A
CHP	208	4,674	N/A	5,016/46	N/A	92/58	N/A	366/229	N/A	1831/1144	N/A
Solar	358	406	N/A	132/8	N/A	9/7	N/A	38/30	N/A	189/151	N/A
Wind & Biomass	3,718	2,014	5,962	5,800/53	N/A	106/66	N/A	422/264	N/A	2112/1320	N/A
Total	5,608	27,552	73,921	11,721/682	517	256/180	40	1,025/716	161	5,127/3,584	507

\*The second figure in each cell is the value of the benefit when we assume that electricity savings displace emissions only from natural gas combustion rather than the forecast average fuel mix

\*\* Only the economic value of the spillover benefits from hybrid vehicles, energy efficient homes, and biomass are included in this table. Spillovers from wind and solar technologies are not included because of the difficulty distinguishing social benefits from mere redistribution of income

Energy efficiency policies increase national energy security by making the U.S. less vulnerable to energy price shocks, whether foreign or domestic. Since the early 1970s the share of energy in GDP has declined from ten to six percent. This is the major reason why the price hikes of the 1970s led to recessions, while the current shocks have had only minor macroeconomic impact. Continued progress toward energy efficiency will make us less and less vulnerable over time.

In contrast, tax subsidies for domestic fossil fuel production will increase our vulnerability to foreign price shocks over time. Domestic oil reserves are finite, and subsidizing increased production can only lead to a more rapid decline in production. Oil fields generally peak and then decline. U.S. oil production hit its peak in 1970, and has been declining ever since. There was a brief secondary peak in the late 1980s as the Alaskan oil field entered and peaked, but these fields have also been in decline since 1988. Subsidies to oil production might increase production in the short run, but such a "Drain America first" policy would leave us at the mercy of foreign oil producers when we face world markets with depleted domestic reserves.



In addition, between percentage depletion, expensing of intangible drilling costs, Section 29 credits, and various other tax breaks, the oil and coal industries are already subsidized through the tax code by more than two and a half billion dollars per year, based on the most recent tax expenditure estimates from Treasury and the Joint Committee on taxation. These are mature, well capitalized, and highly polluting industries. They are poor candidates for further subsidy.

Finally, let us turn to the notion that we should respond to higher foreign oil prices by cutting domestic motor vehicle taxes. OPEC has often had difficulty achieving member discipline, but when it does, it follows a slightly modified version of the monopolist's strategy. In other words, they charge what the market will bear. They increase the price to the level where further increases risk cutting revenues by squeezing people out of the market, whether through sheer inability to pay or through conservation decisions like buying more fuel-efficient vehicles or switching to alternative fuels for home heating.

Now consider a pricing game between the world's biggest oil supplier, OPEC, and the world's biggest oil consumer, the United States. If OPEC knew that the US would respond to oil price increases by encouraging conservation, this would provide an incentive to keep prices low, as higher prices would lead directly to reduced demand. If, on the other hand, OPEC knew that the US would respond to higher prices with decreased motor fuel taxes, then there would be no reason not to raise prices. OPEC would not face even the normal reduction in demand from a price increase. Effectively, this strategy is a pure transfer of wealth from U.S. taxpayers to foreign oil producers. It is the worst possible strategic response and amounts to capitulation.

In summary, incentives for energy efficiency and renewable energy technologies are good for the economy and good for the environment. They promote energy security and put us in a better bargaining position in world energy markets. On the other hand, both subsidies to domestic fossil fuel industries and cuts in motor fuel taxes constitute expensive and unjustified giveaways to industries that are already heavily subsidized. They would harm our national security and put us at a bargaining disadvantage with the OPEC nations.

Thank you.

#### PREPARED STATEMENT OF RICHARD R. KOLODZIEJ

##### INTRODUCTION

Mr. Chairman and Members of the Committee, the Natural Gas Vehicle Coalition (NGVC) appreciates the opportunity to share with you the continued need for and the benefits of natural gas as a motor vehicle fuel. I am here to speak in strong support of S. 2591, the Alternative Fuels Tax Incentives Act. My name is Rich



Kolodziej, and I am President of the NGVC. The NGVC is a national organization dedicated to the development of a growing, sustainable and profitable natural gas vehicle market. The NGVC represents more than 180 natural gas companies, equipment manufacturers and service providers, as well as environmental groups and government organizations.

Increasing the use of non-petroleum alternative motor fuels should be among the highest policy priorities of the federal government for at least two fundamental reasons. First, the recent rise in oil prices and the continued growth in oil import levels demonstrate beyond doubt that it is time to get serious about reducing our reliance on oil imports. The oil producing nations are in a monopoly position, and we are hostage to their decisions about production levels. American consumers must be provided a choice. Second, too many Americans live in urban areas with poor air quality. It is variously estimated that as many as 100 million Americans live in areas that are not in compliance with national ambient air quality standards. The result has been an alarming increase in the incidence of asthma and other respiratory ailments in children and the elderly. Increasing the use of alternative fuel vehicles—especially natural gas vehicles—helps address both these policy priorities simultaneously.

Now is the time to take action. Today, there are more alternative fuel vehicles in operation and models available than at any time before. Domestic natural gas is readily available. State and local governments across the country are adopting legislative incentives that will help pave the way toward more alternative fuel vehicles. In addition to the introduction of alternative fuel vehicles, federal, state and local incentives also have encouraged increased investment in alternative fuel infrastructure. However, no one state or group of states alone, can significantly alter the direction of any major national industry, such as the vehicle industry.

Therefore, while the future for alternative transportation technologies appears bright, much more must be done at the national level if we are to significantly reduce this country's reliance on imported oil, improve our air quality and develop profitable alternative fuel vehicle markets. Since consumers continue to be hesitant to buy many alternative fuel vehicles because of the costs involved and the lack of infrastructure, Congress needs to expand incentives for all alternative fuels, including measures that will bring down the cost of acquiring alternative fuel vehicles and purchasing alternative fuels. Congress should adopt incentives that support the development of alternative fuel infrastructure and reduce the incremental costs involved so users will have places to fill up their alternative fuel vehicles.

Mr. Chairman and Members of the Committee my concerns are addressed by the Jeffords Hatch bill, the Alternative Fuels Tax Incentives Act (S.2591), that was introduced earlier this year by you and other members of the Committee. The use of the tax code to stimulate investment and increase market activity in a developing, needed technology is consistent with the finest traditions of this Committee. The NGVC urges the Committee to strongly endorse these measures and looks forward to working with you to get the measure enacted.

### *1. The Need to Reduce Our Dependence on Foreign Oil is Greater Than Ever*

The US imports significantly more petroleum today than it did in 1992 when the Energy Policy Act was enacted. Net imports are up more than 2.5 million barrels a day while domestic production has declined by 1.24 million barrels a day. The combination of lower domestic production and increased demand means that oil imports also make up a larger share of total oil consumed in the US. In 1992, crude oil imports made up approximately 45 percent of domestic supply. Last year, crude oil imports accounted for 58 percent of total supply. The Energy Information Administration's (EIA) Short-Term Outlook (July 2000) forecasts that oil imports will approach 60 percent of total supply this year. EIA's long-term forecast (Annual Energy Outlook, 1999) has oil imports making up 66 percent of US supply by 2010, and more than 71 percent by 2020.

Persian Gulf and OPEC member countries supply an important part of US crude oil and petroleum imports. The EIA reports that in 1998 the US relied on OPEC members to provide approximately 50 percent of imported petroleum; Persian Gulf states alone provided more than 20 percent of total imports. While EIA's long-term forecast shows OPEC continuing to provide about 46 percent of US petroleum demand in 2020, the forecast shows Persian Gulf exports becoming a much more significant part of OPEC exports to the US, rising from 39 percent to 50 percent.

OPEC and Persian Gulf exports also make up a significant component of world oil supply. OPEC members currently provide about 40 percent of worldwide supply. OPEC's share of world oil supplies is expected to reach 51 percent by 2020, according to EIA's forecast. Persian Gulf oil is even more key to world oil supplies. Persian

Gulf exports in particular are of concern since this region has generally been unstable and continues to be the source of geopolitical conflicts.

Of particular concern is Iraq, which continues to be the wild card in international oil markets. The EIA projects that Iraqi oil production this year will average about 3.0 million barrels per day. This represents nearly four percent of world oil demand. This is a significant volume of oil and its removal from international markets at a time when reserve stocks are low could significantly affect world oil prices. Over the next two decades, the EIA projects that Iraq will more than double its oil production, ensuring that it continues to be an important player in international oil markets.

The recent curtailment of world oil production by OPEC members demonstrates the serious consequences of even small disruptions in the supply of oil to international markets, and proves that OPEC is capable of acting cohesively to control international oil markets. It is precisely because of their growing market power that they have been able to affect world oil prices. As the past year's events demonstrate, the economic effect of supply disruptions is not limited to any one region but rather reverberates across international commodity markets. The notion that the US has increased its energy security by reducing its overall reliance on OPEC oil simply is not true. Disruptions of oil supplies from the Persian Gulf and from OPEC members will still result in much higher prices being paid for oil imports regardless of their country of origin. In addition, while the market share for petroleum in the residential, commercial, industrial and power generation markets has declined substantially over the past 25 years, petroleum still has a virtual monopoly in our transportation sector.

An additional concern is the growing demand for oil by developing nations. It is estimated that by 2020 demand for oil worldwide will increase by over 50 percent. Much of this will occur because of economic expansion and growing vehicle populations in developing nations, especially China. This increased demand is expected to place significant upward pressure on world oil prices.

US reliance on foreign oil already is having a significant impact on our economy. Petroleum imports result in fewer dollars spent at home and more sent overseas. The Census Department reports that in 1999 petroleum imports accounted for some \$59 billion of the US trade deficit. This year that figure will jump considerably. Based on EIA estimates for crude oil demand (Mid-Case \$27.00 bl/oil), the NGVC estimates that US expenditures for imported crude oil will exceed \$88 billion this year. The past year's increase in petroleum prices already has had a significant impact on US consumers. In the first half of 2000, US consumers incurred \$26.3 billion in added costs for gasoline and diesel motor fuels compared with the same period last year. Consumers are expected to spend almost \$56 billion more this year on motor fuels than they did last year.

## *2. EPAct's Petroleum Displacement Goals Have Not Been Achieved*

To combat our reliance on oil imports, EPAct set a national goal of replacing 10 and 30 percent of the petroleum used in light duty vehicles with non-petroleum alternative fuels by 2000 and 2010, respectively. EPAct was intended to create a viable alternative fuels market. Its goal was to reduce US petroleum and crude oil imports and increase energy security by promoting reliance on domestic fuels.

A report released earlier this year by the US General Accounting (GAO) indicates that unfortunately today, even after almost eight years of EPAct implementation, alternative fuel use accounts for a very small amount of overall motor fuel demand. According to the 1998 figures compiled by the GAO, total alternative fuel use—including the oxygenated blending stocks for gasoline—account for less than 4 percent of all highway gasoline use. This is far short of the EPAct goal of 10 percent displacement by 2000. The amount of alternative fuel that is used in alternative fuel vehicles is even less. GAO reports that alternative fuel use in alternative fuel vehicles displaced only about 334 million gallons of gasoline or less than 0.3 percent of total gasoline consumption. The vast majority of the remaining amounts of non-petroleum fuel used in the country are comprised of MTBE or ethanol that is added to gasoline to meet the reformulated gasoline requirements of the Clean Air Act.

## *3. The Transportation Sector: The Key to Energy Security*

It was Congress' concerns regarding energy security and the transportation sector's reliance on petroleum motor fuels that led it to enact EPAct. While, as discussed above, the effort to increase alternative fuel use and to reduce the transportation sector's reliance on petroleum motor fuels has been disappointing, EPAct has nevertheless resulted in a number of positive developments. Today, the type and number of alternative fuel vehicles being sold, as well as the number of alternative fuel stations, has grown. The US is the world leader in the field of alternative fuel

vehicles and fueling infrastructure. The US automakers should be commended for their impressive array of low-polluting, alternative fuel vehicles. Yet, still more must be done.

Since the 1970s, all major energy-consuming sectors other than transportation have significantly reduced their dependence on petroleum. Today, the transportation sector remains almost totally dependent on petroleum motor fuels. The US transportation sector is responsible for more than two-thirds of all petroleum consumption and an astonishing 15 percent of world oil demand. The only way to break free of the reliance on petroleum fuels is to increase the use of alternative fuels. Efforts to increase fuel efficiency, while laudable, will not improve energy security. Improving fuel efficiency will simply slow-down the current growth in oil consumption. Fuel efficiency does not provide energy consumers with options for fueling their vehicles. A vehicle that gets 60 or even 80 miles per gallon is still 100 percent reliant on petroleum supplies.

Increasing the use of alternative fuels will provide consumers with real options when it comes to supply disruptions or price hikes. We cannot wait for the next supply disruption or price spike to create the necessary fueling infrastructure—those efforts must begin now. Given the significant amount of energy consumed by the domestic transportation sector, a strong US market for alternative fuels would put downward pressure on international oil prices. In addition, exports of US alternative fuels technologies would not only bolster our own economy but would further reduce world-wide dependence on foreign oil, further lessening the market power of certain oil exporting nations. News of growing international interest in alternative fuels increases daily. Countries such as China, Chile, Egypt and Mexico increasingly are looking at alternative fuels to combat air pollution and reduce oil imports.

#### *4. The Current Natural Gas Vehicle Market*

There are more than 90,000 natural gas vehicles in-use today. These vehicles are owned and operated by the federal government, local and state governments, and, increasingly, private fleets. These vehicles include passenger cars, light duty trucks, school buses, transit buses, refuse haulers, and many other types of vehicles. It is important to note that nearly all of the new natural gas vehicles placed in-service today are produced by original equipment manufacturers (OEMs). Such well-known companies as DaimlerChrysler, Ford Motor Company, General Motors, Honda, Toyota, Blue Bird, and Freightliner are manufacturing these vehicles. Nearly every manufacturer of transit buses now offers a line-up of natural gas buses. In addition, heavy-duty natural gas engines are now available from Caterpillar, Cummins, Detroit Diesel, John Deere and Mack.

While the number of NGVs in-use is still small in terms of the overall vehicle population, it is growing at an impressive rate. Since 1992, the number of natural gas vehicles in-use has increased four-fold. More impressive, the total amount of fuel consumed by these vehicles has increased more than six-fold. Today, natural gas vehicles displace more than 90 million gallons of gasoline a year, representing about 27 percent of all alternative fuel that is consumed in alternative fuel vehicles.

#### *5. The Environmental Benefits of Natural Gas Vehicles*

Natural gas is one of the cleanest alternative fuels. When compared to the average petroleum vehicles, NGVs reduce exhaust emissions of carbon monoxide (CO) by 50%, non-methane organic gas (NMHC) by 88% and nitrogen oxides (NOx) by 66%, and produce 20% fewer greenhouse gases. NGVs have been certified to be substantially cleaner than traditionally fueled vehicles. Several models already meet or exceed California's ultra-low emissions vehicle (ULEV) and super ultra-low emissions vehicle (SULEV) standards.

Heavy-duty vehicles powered by natural gas generally reduce emissions of particulate matter by 90 percent and NOx by more than 50 percent. Natural gas engines also produce significantly less air toxic emissions. Regulatory agencies across the country increasingly are looking to natural gas engines to displace diesel engines as an effective strategy for reducing pollution. Officials in California have decided that most new heavy-duty vehicles should be powered by natural gas or other alternative fuels. In addition, many transit agencies around the country have decided to exclusively rely on natural gas and other alternatively fueled buses when purchasing new buses for their fleets.

The Honda Civic GX illustrates the excellent attributes that natural gas has as a vehicle fuel. Even though they have been working with natural gas for only a few years, Honda has been able to achieve truly remarkable results with the Civic GX. In fact, the natural gas Honda GX, which was recently certified as SULEV, is the cleanest internal combustion engine powered vehicle ever commercially produced, producing far less pollution than even Honda's other low-polluting vehicles, includ-

ing their hybrid electric vehicle. Initially, regulators had difficulty even measuring the emissions from the Honda GX. A gasoline vehicle certified to just the minimum current federal standards emits nearly 194 times more pollution than the dedicated natural gas Honda Civic GX. In addition, vehicles produced by the DaimlerChrysler, Ford and General Motors also have met some of the most demanding emission standards in existence. For example, a one-mile trip to the corner grocery store and back in an average pickup truck emits as much smog forming hydrocarbons as is emitted by the Ford F-250 NGV in a 247 mile trip.

It is for this reason that regulators across the country are heralding the use of natural gas as an effective strategy to reduce emissions of criteria pollutants and air toxics. Enactment of S. 2591 will substantially increase the purchase and use of NGVs, which, in turn, will have substantial environmental benefits. Analyses performed for the US DOE and the private sector show that, in those areas not attaining Clean Air Act standards alone, the air quality benefit of S. 2591 would be the equivalent to removing 1.5 million gasoline powered light duty vehicles from the road. DOE also projects that these vehicles will displace 3 billion gallons of petroleum motor fuel.

Some people have questioned the continued need for alternative fuel vehicles, particularly since the US EPA recently has announced plans to make gasoline and diesel fueled vehicles of all sizes much cleaner. While there is no question that conventionally fueled vehicles have gotten cleaner and will continue to do so, natural gas vehicles too will continue to become cleaner. Alternative fuel vehicles will continue to be necessary to offset the increased number of vehicles and increased growth in vehicle miles traveled projected by the U.S. Department of Transportation.

Many people also believe that eventually the internal combustion engine will be replaced by hydrogen-based fuel cell vehicles. It is important to understand that natural gas provides an excellent bridge strategy to a hydrogen transportation future since natural gas can be used to supply the needed hydrogen for fuel cell vehicles. (In fact, almost all stationary fuel cells currently in commercial use derive their hydrogen from natural gas.) As the demand for hydrogen grows, natural gas could be converted into hydrogen at distribution centers or at refueling stations and supplied to hydrogen vehicles. The natural gas infrastructure that is develop today, including the existing pipelines, fueling stations, and fuel storage systems used for vehicles, can be used to support the hydrogen future. It also should be kept in mind that it will be decades before fuel cell vehicles could become a substantial percentage of the US vehicle population. Internal combustion engines will continue to power most vehicles for the foreseeable future. Natural gas and other alternative fuel vehicles offer a cleaner option for these vehicles.

More immediately, natural gas vehicles can provide critical emission reductions today. The recently announced EPA heavy-duty emission standards will not be fully implemented until 2010. Natural gas heavy-duty vehicles already meet the particulate matter levels called for in the proposed rules and are years ahead of diesel engines in terms of reducing NOx emissions. In addition, there are many uncertainties concerning the timing of EPA's proposed rules. Industry has indicated that they intend to fight the standards, especially the sulfur reductions for diesel fuel. It is possible that the emission benefits of the proposed rule will not be available until some time after 2010. In the meantime, natural gas vehicles are available now and they can deliver superior emissions performance with the added advantage of petroleum displacement.

#### *6. The Future of the Natural Gas Vehicle Market*

Mr. Chairman, the prospects for increased natural gas use for centrally fueled and other high fuel use fleet operations, such as taxicabs, refuse haulers, school and transit buses, airport shuttles and over-the-road trucks look very good. Our industry has generally chosen to focus on high fuel use fleets and heavy-duty vehicles because their fuel consumption and refueling patterns make them the best choice for early introduction of alternative fuels. Initially, suppliers of natural gas are looking for customers that will use sufficient amounts of fuel to justify the capital investment in retail and private fueling. Another advantage of focusing on high fuel use fleets and operators of heavy-duty vehicles is that replacing these vehicles with alternative fuels provides the greatest amount of emission reductions.

While NGVs are commercially available, they generally cost more than their gasoline or petroleum counterparts. Light-duty NGVs for example, generally cost \$3,500 to \$5,000 more; heavy-duty NGVs cost from \$25,000-\$50,000 more.

However, as more vehicles are sold, economies of scale will lower the incremental cost of NGVs. The Department of Energy estimates that light-duty NGVs will cost approximately \$800 more than comparable gasoline models when mass-produced. Unfortunately, we are still far from seeing the economies of scale that will result

from mass production. For example, Ford Motor Company produced over 100,000 Crown Victoria Sedans last year. Of these, only 1,000 were natural gas-powered.

Mr. Chairman, the increased demand for NGVs that will result from enactment of S. 2591 will help us achieve the economies of scale and reduced incremental cost that are critical to the long-term growth of the NGV market.

The NGVC is excited about the prospects for S. 2591, the Alternative Fuels Tax Incentives Act. This proposal is a market-driven non-regulatory approach to promoting alternative fuel vehicles and their use. A credit against income taxes is provided for individuals and businesses for the acquisition of alternative fuel vehicles. The cleaner the vehicle the higher the credit. A credit against income taxes also is provided to the retail sellers nationwide for the sale of alternative motor fuels. As you stated, Mr. Chairman, during the press conference that was held to announce the introduction of the bill, "cleaning our air should be a top priority." Promoting the use of alternative fuels will help us get there more quickly and more cost-effectively. Enactment of your legislation will result a significant increase in the purchase and use of NGVs and other alternative fuel vehicles, and will encourage expansion of a natural gas fueling infrastructure—producing significant air quality and national energy security benefits.

### *Conclusion*

Mr. Chairman, the incentives in your legislation are needed to encourage private, tax-paying fleets to switch to natural gas and other alternative fuels. Our goal as an industry is to have more than 1.6 million NGVs in operation by the beginning of the next decade. This number represents the industry's projection of the optimum number of NGVs that are likely to result over the next decade as our industry pursues high-fuel use fleets. It is based on passage of S. 2591 and the existence of state and local government-provided incentives. Unlike other alternative fuel industries, the natural gas vehicle industry has generally set its sights on marketing to fleets that are centrally fueled and that use a substantial amount of fuel. This targeted market represents the best opportunity to realize increased fuel utilization and return on investment.

According to our industry strategy, the 1.6 million NGVs by 2011 would use about 500 billion cubic feet or 0.5 trillion cubic feet of natural gas. This would displace the equivalent of 4.35 billion gallons of gasoline, or 4-1/2 times the amount of gasoline used in Utah in 1998. The industry strategy, however, is based on the expectation that our industry will continue to aggressively identify high-fuel use fleets that acquire alternative fuel vehicles and that Congress will adopt the Jeffords-Hatch incentives to increase the use of alternative fuels.

Mr. Chairman, this concludes my prepared remarks. I would be glad to answer any questions that you might have.

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### PREPARED STATEMENT OF BEVERLY MILLER

Mr. Chairman and Members of the Committee, I am Beverly Miller and director of the Salt Lake Clean Cities Coalition located in Salt Lake City, Utah. My grass-roots organization serves a metropolitan area of 1.7 million people along the Wasatch Mountains. It is my Honor to present testimony on behalf of Senator Hatch's proposed Alternative Fuels Tax Incentives Act, Senate Bill 2591.

Salt Lake Clean Cities, along with 70 other Clean Cities across the country, strives to place more alternative a fuel vehicles, or AFVs as we call them, on our community highways Utah has approximately 3,600 AFVs running primarily on natural gas and propane. We're also charged to help develop a self-sustaining AFV refueling infrastructure. We enjoy the fourth largest natural gas refueling infrastructure in the country, after California, Texas and Georgia. The infrastructure includes private onsite stations as well as public stations and much of it is networked together by a common credit card.

We're proud of our effort, and our successes. But 3,600 aren't a lot of vehicles, nor is that number quickly increasing. There are people within my organization whose job it is to market AFVs, such as the local auto dealers and the alternative fuel sales force. Many of the 55 volunteer stakeholder groups enthusiastically talk up AFVs. We've been steadily at it for five and a half years. Yet, the numbers haven't come.

It's our opinion the numbers haven't come for several reasons. People dislike change. In the early days of AFVs, some had a bad experience. People listen to, and believe rumors. When it comes to buying a vehicle, people like options, and they want those vehicles to be as good as, or better than, what they are used to. They

want refueling to be dead easy. There's also a cost factor; AFVs cost more, and so do the refueling sites.

The Clean Cities program was created to provide education, information, assistance and training to help change people's attitudes about alternative fuel vehicles, and we work hard at that job.

We also offer small financial incentives to buy down the cost of vehicles. Though helpful, the incentives haven't been significantly effective. Recently the National Conference of State Legislatures, located in Denver, CO, conducted a study to see what incentives would help move the AFV industry ahead. The results showed that incentives must be: big enough, easy to use, focused on infrastructure and focused on fuel use. Senator Hatch proposed Alternative Fuels Tax Incentives Act appears to meet those requirements, and with the proposed AFV credit, even goes beyond.

The recent increase in the cost of gasoline and diesel HAS made a difference by causing people to be more interested in AFVs. Because locally a gallon of natural gas is half the price of gasoline we've encouraged our AFV fleet managers to talk about what they save, sometimes tens of thousands of dollars, on fuel and maintenance. We've seen some buying activity, as a consequence.

But we are still a flyspeck on the wall. Petroleum provides 97 percent of this country's transportation fuel, leaving alt fuels with the remaining three percent. We need assistance, and that assistance is for the federal government to once again take a leadership position.

Senate Bill 2591 would compliment the action Congress took in 1992 when it passed the Energy Policy Act. It's important to note that nationwide, the largest AFV fleets today tend to be the three fleets that Congress mandated in 1992. The Energy Policy Act directed the federal government, all the states and all alternative fuel provider fleets to begin buying AFVs. Obviously that directive has been successful; the mandated fleets have AFVs in far greater numbers than non-mandated fleets.

Strong language and action from the federal government has greatly helped us get to where we are. It can help us again. But we're not asking for mandates. We need incentives.

Another reason to support Senator Hatch's bill is tied to the fact that the federal government is investing heavily in building and rebuilding the nation's roads, such as Salt Lake City's freeways. Our local newspapers now tell us that more roads are being planned, which means more traffic and vehicle emissions. Auto emissions produce more than 50 percent of air pollution in this country. AFVs can help offset the negative impact of all this traffic because they burn cleaner. It's also a matter of options. Help us give the public a range of choices in the vehicles they buy. If people must drive their personal vehicles everywhere they go, let's help them drive clean burning ones.

Before the Gulf War, the U.S. imported about 46 percent of its oil. Now it's closer to 55 percent. We rely too much on imported oil. Alternative fuels, in addition to being cleaner than petroleum, also tend to be domestic. A federal tax credit on domestic alt fuels would be the same as a financial investment in this country's economy.

One more plug for why I would love to see Senate Bill 2591 pass. My group is working with the Salt Lake Olympic Organizing Committee to bring AFVs to the Winter Olympic Games in 2002. We are developing a local resale program for all the AFVs provided by General Motors. The goal is to keep those clean fuel vehicles in our state as a legacy after the Games. Reducing the cost of alt fuels would greatly help us market those AFVs, not just to fleets, but to the general public. My hope for the near future is to offer my friends and neighbors a clean fuel vehicle they can afford to buy and to operate. Please help me make that hope a reality.

Alternative fuel vehicles, as we know them, will never replace traditionally fueled vehicles. But AFVs are an important strategy in dealing with air pollution and energy security. Right now, though, we aren't making as much of a contribution as we would like. Give us that chance.

Thank you for your considerate attention. And I welcome your questions.

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PREPARED STATEMENT OF HON. FRANK H. MURKOWSKI

Mr. Chairman, I commend you for holding this very important hearing on America's growing dependence on imported energy.

Over the past eight years domestic oil production has fallen 17% and foreign oil imports are up 14% over the same period. Currently, we are dependent on foreign sources for 56% of our oil. During some months this year, we imported up to 62%

of our supply. To put that in context, we imported just 35% of our oil at the time of the 1973 Arab Oil Embargo!

There are many reasons that we have grown so dependent on foreign oil but I would suggest to you that the most important reason is the failure of this Administration to encourage domestic exploration and development. No matter what tax incentives we provide, if it is the Federal government's policy to prevent exploration for more domestic oil, oil development will come to a screeching halt and we will grow ever more dependent on foreigners for oil.

Unfortunately, that has exactly been the policy of the current administration. Consider:

- The President, in 1995, vetoed a bill that would have allowed exploration of the most promising oil field in America, a tiny sliver of land on the Coastal plain of Alaska.
- This Administration has cut off access to the Rocky Mountain overthrust belt for energy leasing.
- They oppose any new offshore exploration. In fact, the Vice President says that if he's elected, he will even buy back existing leases.
- They propose that non-polluting hydroelectric dams in the Pacific Northwest be torn down. Where will the replacement fuel come from to keep the electricity on in the homes of people in Seattle?
- The Administration, as a matter of policy, said NO to nuclear power, going so far as to veto a bipartisan nuclear waste bill that could make nuclear a viable, emissions-free energy source for years to come.
- They said NO to coal, arguing that it's too dirty and emits too much carbon dioxide;

The predictable result of these policies: We have the highest gasoline prices in our history and are more dependent than ever on OPEC for maintaining the health of our economy.

It may surprise some of my colleagues, but the fastest growing source of oil for the United States is none other than Saddam Hussein. That's right, the same Saddam that we went to war with 9 years ago and the same Saddam who we've spent \$10 billion to keep from further aggression.

- In 1997, we imported 50,000 barrels/day from Iraq. In 1999, that figure rose to 750,000—a 1500 percent increase.. barrels/day in the last quarter of 1999.
- Even as we have become dependent on imports from Iraq and even though we know Saddam Hussein smuggles oil and diverts profits we have lifted some of the very sanctions designed to keep Saddam in check.
- And what is Saddam doing with the profits he generates from smuggling oil? He continues to develop missile technology as well as nuclear, chemical and biological weapons of mass destruction.

Mr. Chairman, 6 months ago, the primary focus was on the high cost of heating oil, especially in the Northeast. Now in the summer driving season, it's gasoline. What's next? I will tell you what's next: Natural gas prices.

- When the Administration cut OCS leasing and onshore energy exploration, our proven gas reserves went in sharp decline.
- Gas demand is 20 trillion cubic feet per year at present, expected to reach 30 or 35 trillion cubic feet per year by 2010.
- Proven reserves are down from 160 trillion cubic feet to 150 trillion cubic feet.
- We are only finding new gas at the rate of 10–12 TCF per year, so reserves are declining faster than they are being replaced.
- Since last winter, gas prices have climbed from around \$2.65 per thousand cubic feet to \$4.20 today. Prices are expected to climb above \$4.50 by next winter.
- Meanwhile, the National Petroleum Council estimates that it will require an investment of \$1.5 trillion to expand our natural gas delivery system to meet the anticipated demand as we shift more electrical generation to natural gas.
- So expect gas prices to go up and stay up to sustain future demand and underwrite an expanding delivery system.

Mr. Chairman, there are many promising technologies that hold promise for renewable energy—solar, wind, and geothermal.

I have supported the production tax credit for wind energy in the Finance Committee. I have also sought to "open" the "closed loop" biomass tax credit that would make biomass a more competitive source of electricity.

Much as I like renewable energy, there are limits to its ability to meet our energy needs. The wind doesn't always blow. The sun doesn't shine at night. There are no solar airplanes, cars, or trains. And we will not see them anytime in the foreseeable future.

We have spent \$17 billion to promote renewable energy over the past two decades... but less than 5% of our energy comes from non-hydro renewable energy.

- We have to be realistic... America will continue to rely on existing conventional sources of energy—including the oil, coal and gas that comprise 84% of our current energy mix—for quite some time.

For eight years, this Administration has been blind to these facts and lived in a renewables dream world. Today, the consumer is paying the price for these failed policies.

Current policies lead in a direction I certainly don't want to go. And that brings me to my final questions: What is the alternative to our current course? What should the next President do to enhance our energy security and supply?

Rather than pursue the failed energy strategies of this Administration, we need a new national energy strategy that recognizes the need for a balanced approach to our energy demand.

I, along with Senator Lott and others, have recently introduced called the National Energy Security Act of 2000 (S. 2557). The goal of our bill is to roll back our dependence on foreign oil to a level below 50%.

To do that our bill would:

- increase domestic energy supplies of coal, oil and natural gas by allowing frontier royalty relief, improvements in federal oil and gas lease management; and tax incentives for production.
- We would also allow exploration in Alaska's Arctic reserves, which may contain 16 billion barrels of oil or enough to displace our imports from Saudi Arabia for 30 years.;
- We would also guarantee some price certainty for small domestic stripper producers to keep them in production.
- We would assist clean coal technology by promoting a new technology program to reduce emissions and improve efficiency in existing facilities while stimulating deployment of advanced technologies in new facilities.

And we recognize the contributions that renewables can make in the overall effort to promote our energy security. So we are expanding tax credits for a variety of renewables.

Mr. Chairman, the unparalleled prosperity that we have grown accustomed to is based on an economy that must have stable, secure and cheap energy. The Clinton Gore administration has pursued policies that endanger our energy security.

And after eight years of neglect, we are not going to improve our energy security overnight. But a new Administration can change this dangerous energy dependence.

If we do not change our approach to energy security, the economic security of our country will be severely jeopardized.

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#### PREPARED STATEMENT OF A SHAWN NOONAN

Mr. Chairman and members of the Subcommittee, you may think it odd that someone would begin discussing tax matters by holding up a piece of sandstone rock.

But my name is Shawn Noonan, I am the General Tax Officer for Vastar Resources, Inc., and that is what I am doing as I testify today as the chairman of the Domestic Petroleum Council's Tax Committee.

I am pleased to be here, and to first share some background thoughts on this rock and natural gas before moving to tax issues that are directly related to both of them.

We know that natural gas is a premium fuel. It is clean, reliable and abundant. We cook with it. We use it to heat and cool our homes and businesses. And it is a strong underpinning of our economy, as an industrial feedstock and as the fuel of choice for generating new electricity to power the computers and the other elements of "the new economy."

In fact, the recent National Petroleum Council natural gas study projects that demand for natural gas will grow by more than one-third over the next decade. Nearly half of that demand growth will come from new electricity generation capacity—more than 90% of which will be gas-fired.

A portion of that demand growth will also undoubtedly result from increased transportation fuel use—whether as compressed gas or liquefied natural gas. For the longer term, fuel cells that generate electricity from natural gas by chemical reaction as opposed to combustion will play increasingly important roles in a variety of applications—including transportation.

So, where is all this new natural gas to come from?

This rock. And other places where our industry is able to explore for, develop and produce natural gas.



The 23 large independent exploration and production (E&P) company members of the Domestic Petroleum Council (or DPC) produce nearly one-fifth of the natural gas in this country. They find and produce it from sandstone like this everyday. (Yes, gas is actually trapped inside "tight" sands of the Upper Cliff House formation of New Mexico from which this sample was taken.)

Our industry produces natural gas from many types of geologic formations. Whether onshore or offshore, it takes expensive high technology like 3-D seismic, hydrocarbon indicators and hydraulic fracturing—and lots of capital—to produce natural gas.

As an example, forty percent of the capital spent by one of our DPC members, Samedan Oil Corporation, to continue production from the prolific Bowdoin field of Montana is for hydraulic fracturing.

These are the things we do everyday. And we know we'll need to even further enhance our technology and its application in the future to meet our growing natural gas demand.

The DPC companies drill 35% of all oil and gas wells in the United States and nearly 60% of all such wells drilled by independents. We are committed to continue to take on the challenges of providing gas and oil to consumers in the future.

But we do have challenges. Not the least of which relate to the Tax Code.

The DPC and other industry trade associations agreed last year that the key tax incentives for our industry were the following:

- allowing geological and geophysical (aka G&G) costs and delay rental payments to be deducted when incurred;
- alternative minimum tax reform;
- a marginal well tax credit; and,
- for small operators, certain percentage depletion enhancements.

While DPC continues to support all of these measures, the items of greatest importance to our members at this time are the allowance of deductions for G&G and delay rental costs. With the time remaining in this Congress, it would be a shame to miss the opportunity to seize a win-win opportunity by providing normal business tax treatment for G&G and delay rental expenses as is supported by the Administration as well as many Members of Congress, both Republicans and Democrats.

What are these expenses?

G&G costs are the costs incurred to gather and process seismic and other data in an effort to locate oil and natural gas deposits underground. The costs are routinely and continuously incurred as part of an active ongoing exploration program and are among the first costs incurred in the exploration effort. Because of the depleting nature of its resource base, an E&P company must acquire new reserves to stay in business.

Under current tax law, G&G costs are "suspended," meaning no deduction or amortization is allowed for tax purposes, while decisions are made as to whether the data is promising enough to warrant drilling a test well and if no leases have yet been obtained in the area, the feasibility of obtaining leasehold rights that will allow the well to be drilled.

If a test well is drilled and is successful, the G&G costs remain suspended with no recovery allowed for tax purposes until the lease begins production of the oil or gas. In many areas where exploration is now occurring, such as the deepwater GOM, the period of time from drilling a test well until commencement of production is often five years or more.

An E&P company, like any business, must generate a reasonable after tax rate of return on its capital to ensure that it will have access to new capital. Since G&G costs are incurred early in an exploration effort and a recovery on that G&G investment is often delayed for many years, it is very challenging for companies to generate acceptable after tax rates of return on their exploration capital. In addition, given the complexities of the current tax rules, a large amount of taxpayer administrative time and effort is expended to track and properly account for G&G costs. Further, the IRS and the taxpayer spend significant administrative time and effort auditing these costs.

Delay rentals are payments that are generally required to be made on an annual basis by the lessee to the lessor for the right to hold the lease throughout its primary term. If a lessee begins operations on the lease, typically by drilling a well, then the obligation to pay delay rentals ends as long as the operations on the lease continue. To put this in perspective, Vastar has some 27,000 active leases and pays delay rentals on about some 2,000 of them each year.

Prior to 1986, E&P companies were unquestionably entitled to deduct delay rentals for tax purposes. When the uniform capitalization rules were added to the tax Code (section 263A) that year, the treatment of delay rentals became less clear. During IRS audits the examining agents did not always take consistent positions

but in many cases determined that delay rentals should be capitalized under the uniform capitalization rules. The taxpayers in the industry believe that delay rentals continue to be deductible since they are costs that are paid to postpone improvement of the property—not to improve it. Adding to the confusion, a long standing regulation, which the IRS only this year has proposed to change, still provides that delay rental payments are deductible at the taxpayer's election.

Like G&G costs, delay rentals are an ongoing expense incurred by the industry very early in the process of exploration and production.

The members of the Domestic Petroleum Council believe that allowing G&G costs and delay rentals to be deducted for tax purposes when incurred will encourage domestic exploration and production efforts and over time help to reduce America's dependence on foreign energy resources. The Administration in March of this year proposed allowing these costs to be deducted for tax purposes.

While the DPC supports all of the industry recommendations mentioned earlier, the tax treatment of G&G and delay rental payments are the highest priority tax items for our members this year. If tax legislation is able to move forward this session, we urge you to include these changes in that bill.

I have a summary and examples of the legislative language that has been proposed in various bills that I will be glad to provide to the Subcommittee.

And I would be pleased to answer any questions.

Thank you.

Attachment.

#### G&G EXPENSING—LEGISLATIVE LANGUAGE APPROACHES

##### *G&G Expenditures*

With respect to the elective expensing of G&G expenditures, the legislative language contained in S. 2265, S. 325 and H.R. 2488 is identical except as noted below. Section 263 (related to capital expenditures) would be amended by adding the following new subsection:

(j) **GEOLOGICAL AND GEOPHYSICAL EXPENDITURES FOR DOMESTIC OIL AND GAS WELLS**—Notwithstanding subsection (a), a taxpayer may elect to treat geological and geophysical expenses incurred in connection with the exploration for, or development of, oil or gas within the United States (as defined in section 638) as expenses which are not chargeable to capital account. Any expenses so treated shall be allowed as a deduction in the taxable year in which paid or incurred.

The provision in S. 2265 differs in that it would apply to all G&G expenditures, not just those incurred within the United States. The proposed language of S. 2265 does not include the phrase "within the United States (as defined in section 638)." Clearly, a strong case can be made to support the option to expense both the domestic and foreign G&G expenditures incurred by U.S. taxpayers. At a time of tight oil and gas supplies, such a provision would encourage greater exploration and production both in the United States and abroad, which in turn would help to alleviate the tight supply situation in this country. Nevertheless, if the national policy priority and accompanying political reality appear to favor assisting the domestic oil and gas industry over easing overall supply concerns, then the preference may be to limit the G&G expensing option to domestic expenditures. The President's proposal appears to favor the latter in that it seeks to "support domestic exploration and production."

S. 2265 and S. 325 differ from H.R. 2488 in that they would provide for a transition rule that would permit 36-month amortization of the suspended portion of G&G expenditures incurred prior to the date of enactment that would have not yet been included in the cost of a property or otherwise deducted. The transition rule language has been amended in S. 2265 from the earlier S. 325 to more clearly define the suspended portion of previously incurred G&G expenses, which would be eligible for amortization. Such a transition rule is necessary to level the playing field for all producers and to finally put an end to the burdensome and costly recordkeeping requirements associated with tracking G&G expenditures to specific properties. Significant administrative time and cost savings would accrue to both taxpayers and the IRS.

The G&G transition rule legislative language is as follows:

(B) **TRANSITION RULE**—In the case of any expenses described in section 2630) of the Internal Revenue Code of 1986, as added by this subsection, which were paid or incurred on or before the date of the enactment of this Act, the taxpayer may elect, of such time and in such manner as the Secretary of the Treasury may prescribe, to amortize the suspended portion of such expenses over the 36-month period beginning with the month in which the date of the

enactment of this Act occurs. For purposes of this subparagraph, the suspended portion of any expense is that portion of such expense which, as of the first day of the 36-month period, has not been included in the cost of a property or otherwise deducted.'

#### DELAY RENTAL PAYMENT EXPENSING

#### LEGISLATIVE LANGUAGE APPROACHES

##### *Delay Rentals*

The legislative language contained in S. 2265, S. 325 and H.R. 2488 is identical with respect to the election to expense post-enactment delay rental payments. Section 263 would be amended by adding the following new subsection:

#### (k) DELAY RENTAL PAYMENTS FOR DOMESTIC OIL AND GAS WELLS—

(1) IN GENERAL—Notwithstanding subsection (a), a taxpayer may elect to treat delay rental payments incurred in connection with the development of oil or gas within the United States (as defined in section 638) as payments which are not chargeable to capital account. Any payments so treated shall be allowed as a deduction in the taxable year in which paid or incurred.'

Again, S. 2265 and S. 325 differ from H.R. 2488 in that they would provide for a transition rule that would permit 36-month amortization of suspended delay rental payments. As is the case with the G&G transition rule, a transition rule is necessary with respect to delay rentals in order to avoid disparate treatment of pre-enactment and post-enactment delay rental payments.

The delay rental transition rule legislative language is as follows:

(B) TRANSITION RULE—In the case of any expenses described in section 263(k) of the Internal Revenue Code of 1986, as added by this subsection, which were made or incurred on or before the date of the enactment of this Act, the taxpayer may elect, at such time and in such manner as the Secretary of the Treasury may prescribe, to amortize the suspended portion of such expenses over the 36-month period beginning with the month in which the date of the enactment of this Act occurs. For purposes of this subparagraph, the suspended portion of any expense is that portion of such expense which, as of the first day of the 36-month period, has not been included in the cost of a property or otherwise deducted.'

Delay rental audit issues open as of the date of enactment would not be adversely affected by passage of this legislation with the inclusion of the following report language:

'No inference is intended from the prospective effective date of this provision as to the proper treatment of pre-effective date delay rental payments.'

#### PREPARED STATEMENT OF MICHELLE ROBINSON

Thank you for the opportunity to speak on behalf of our over 80,000 scientist and citizen members across the country about the critical role for alternative fuels and advanced vehicle technologies in our transportation system.

The Union of Concerned Scientists has done a great deal of analysis in this area, so I am pleased to share some of what we've learned with you today. There are three compelling reasons to move more alternative fuels and advanced technology into our transportation system: clean air, a more stable climate, and energy independence.

As you are well aware, cars and trucks are responsible for a large share of our air pollution problem. One in two Americans breathe unhealthy air today with motor vehicles contributing over 50% to urban air pollution. It is true that due to tighter standards and technical innovation, emissions from conventional cars and trucks have been reduced substantially over the past thirty years. However, the number of vehicles on the road and the miles that they travel have increased exponentially offsetting the pollution reductions from individual vehicles.

Smog-forming pollutants and soot from gasoline and diesel-powered vehicles pose a serious health threat. Urban ozone and fine soot particles irritate the respiratory system and have been linked to increased hospital admissions for respiratory problems such as asthma. A recent study found that in areas with high levels of fine particulate pollution, the risk of early death was 26 percent higher than in less polluted areas. In addition, fine particles in diesel exhaust are considered a growing toxic threat to human health. Diesel exhaust contains over 40 chemicals that are listed by California and the US EPA as toxic air contaminants, probable human car-

cinogens, known human carcinogens and reproductive toxicants. In fact, over 70% of the cancer risk in the Los Angeles area is attributed to diesel particles.

The transportation sector accounts for 1/3 of US carbon emissions and is the fastest growing sector in terms of carbon contribution.

There has never been a more important time in our transportation history to invest in cleaner vehicles and fuels. The recent oil price fluctuations are an expensive reminder of the economic risks of relying on foreign oil sources for over half of our petroleum supply. We currently send \$180,000 per minute overseas to buy foreign oil, driving our trade deficit to record levels in recent months.

Clearly there is no silver bullet to address the multiple health and environmental challenges created by our transportation system. There is a role for government, industry, and the consumer in reducing the pollution created by cars and trucks. Greater investment in the success of alternative fuels and cleaner vehicle technologies is something Congress can do right now to set us on a path toward solving each of these problems.

Vehicles that use alternative fuels such as natural gas, electricity, and fuel cells are inherently cleaner than today's gasoline cars and diesel trucks and buses, offering large gains in combatting air and water pollution and protecting public health. To use buses as an example, the immediate environmental benefits from currently-available alternative fuel buses can be considerable. The reduced emissions of important precursors to smog and soot make operating a natural gas bus, instead of a new diesel bus, equivalent to taking 20 to 30 cars off the road that's a 40 percent reduction in those pollutants. Battery electric power has been a good match for smaller buses and shuttle services. Ultimately fuel cell buses, now being demonstrated in some US and Canadian cities, will offer zero or near-zero emissions of regulated pollutants with much lower emissions of the climate change gases.

Especially in this era of e-commerce, delivery trucks are another good example of fleets that are perfect candidates for alternative fuels. Cleaner, efficient natural gas and electric models are now on the market but incremental cost is the hurdle. Fortunately, a growing number of states such as Arizona and Connecticut have begun providing tax credits which businesses such as UPS are using to their advantage. It is now time for the Federal Government to follow suit.

All of us sit behind belching garbage haulers and send our children off to school in aging, gross emitting school buses. Tax policy that will bring down the initial costs to transit authorities, industrial customers, and individual consumers of vehicle technologies, cleaner-burning fuels, and appropriate infrastructure will make an enormous difference in the quality of life of your constituents.

Our work with state government, transit authorities, school districts, business and community leaders across the country convinces us that there is strong interest in finding new technological solutions to existing air quality and public health problems created by conventional vehicles. We encourage you to demonstrate your support for the consumer and environmental protection promised by alternative fuels and vehicles by supporting legislation such as the recently introduced Jeffords/Hatch Alternative Fuels Incentives Act.

Thank you for your time and attention.

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# U.S. Public Interest Research Group

## National Association of State PIRGs

Testimony of Lexi Shultz, Staff Attorney  
U.S. Public Interest Research Group  
July 18, 2000

Senate Finance Committee  
Subcommittee on Taxation and IRS Oversight

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Mr. Chairman and Members of the Committee, my name is Lexi Shultz and I am a Staff Attorney with U.S. PIRG, the national office for the State Public Interest Research Groups, non-profit, non-partisan public interest advocacy groups active in 38 states. On behalf of our members around the country, I appreciate the opportunity to testify on some of the existing incentives and dangers of oil production. We need to develop an energy policy for the future that will be better for the environment, better for national security, and will provide a long-term solution rather than relying on a short-term plan and a finite resource.

#### I. Environmental and Public Health Consequences of Oil Production and Consumption.

Before I discuss existing or proposed economic incentives for oil production, I am compelled to talk about the devastating environmental consequences of all aspects of oil use. Any oil policy that ignores those consequences paints an overly rosy picture and will worsen the existing problems. Here are some of the major dangers from oil, with some specific examples:

#### OIL SPILLS AND LEAKAGES:

Petroleum production and transportation results in the leakage of at least 280 million barrels of petroleum every year, contaminating water supplies, poisoning wildlife and ruining landscapes. For example:

- The by now most infamous case is the 1989 Exxon Valdez spill, which poured 11 million gallons of crude oil into Prince William Sound. Eleven years later, there is still oil on the beaches, the fishing industry is still in trouble, and only 2 of 26 species have fully recovered.
- Exxon should not be singled out – in 1999, a Chevron owned tanker spilled 110,000 gallons of fuel oil 30 miles south of San Diego because of a pipeline failure between the Chevron ship and an onshore storage facility.

- BP Amoco is responsible for a 400,000-gallon spill in 1991 that covered twenty square miles near Huntington Beach, California, including part of a wetlands wildlife sanctuary, killing endangered California brown pelicans.
- In Prudhoe Bay, Alaska, in 1997 alone, there were 500 different spills, leaking 80,000 gallons of oil, diesel fuel, acid, drilling fluid, biocide, and ethylene glycol, and other wastes into what was once a pristine wilderness – about 1 spill every 18 hours.

#### HAZARDOUS WASTE SITES AND WATER POLLUTION

On top of the oil leaks from drilling and transport problems, oil refining is a major source of chemical releases reported through the U.S. Toxics Release Inventory. Chemicals that have been released by oil facilities include benzene, selenium, chromium, and mercury. Oil companies are responsible for a large number of Superfund sites. For example, four of the biggest companies, BP Amoco, ARCO, Chevron and Exxon, are responsible for a total of 152 Superfund sites, with ARCO responsible for the largest Superfund site in the nation – in Montana, for which it agreed to pay the state \$215 million in damages and fines. In addition, each of these four companies has been fined for numerous Clean Water Act violations. To give just one example, in May 1992, Chevron agreed to pay \$8 million in fines for 65 violations of the Clean Water Act resulting from discharges from an oil platform off the California Coast.

#### AIR POLLUTION AND GLOBAL WARMING

The burning of oil is a major factor in the world's air pollution and the build up of carbon dioxide in the Earth's atmosphere. Because carbon dioxide is the basic product of fossil fuel combustion and not just a contaminant, there is no practical technology for preventing its release into the atmosphere when fossil fuels are burned. The potential consequences of unabated global warming from carbon dioxide include heat waves, infectious disease like the outbreak of West Nile Virus in some areas of the country, severe drought, floods, and damage to ecosystems, such as forests, coral reefs and wildlife habitats.

In addition, in 1997 alone, burning oil produced 14.7 million tons of smog-forming nitrogen oxides. Smog pollution causes an estimated 6 million asthma attacks and sends 150,000 people to emergency rooms each year. In 1997, burning oil also produced 3.9 million tons of sulfur dioxide, which lead to acid rain, and 1.5 million tons of dangerous particulate matter, which are severe respiratory irritants and have increasingly been linked to lung cancer.

Oil facilities have committed numerous nitrogen oxide emissions and other Clean Air Act violations. For example:

- In 1998, the Department of Justice filed a complaint against Exxon for nearly 200 Clean Air Act violations.
- In 1996, ARCO and Snyder Oil paid an \$875,000 penalty for violating EPA nitrogen oxide standards at a plant on the Wind River Indian Reservation.

- In 1992, Chevron agreed to pay \$1 million in penalties for illegal airborne emissions of benzene, a potent carcinogen, at its Philadelphia, Pennsylvania petroleum refinery.
- In 1985, the EPA won a \$6 million judgment against Chevron for Clean Air Act violations at an oil refinery in El Paso, Texas.

## OFF-SHORE OIL DRILLING

Both onshore and offshore oil drilling is involved with all of these kinds of environmental and public health dangers. But offshore oil drilling poses some unique dangers, threatening to disrupt the delicate balance of a vulnerable marine and coastal ecosystem and destroy scenic coastlines. Offshore oil drilling activities include sea floor dredging for pipelines, routine rig pollution and debris, and the releases of thousands of pounds of drilling muds containing toxic heavy metals. A single offshore rig emits the same quantity of air pollution as 7,000 cars driving 50 miles per day. These actions kill or disrupt the reproduction of many types of marine mammals and lead to the destruction of coastal wetlands, not to mention jeopardizing the health of coastal residents. FloridaPIRO has long campaigned against offshore oil drilling and we especially appreciate the work of Senator Mack (R-FL) in helping keep Florida's beaches oil rig-free. It's clear that Senator Mack understands the devastating environmental and economic consequences of offshore oil drilling.

## II. Existing Incentives for Oil Production

The PIRGs recently released a report called "Paying for Pollution," along with Friends of the Earth and Taxpayers for Common Sense. Together, these three groups make up the Green Scissors Campaign, which seeks to ensure that our tax dollars are not spent in ways that are wasteful or encourage pollution.

"Paying for Pollution" documents that, over five years, the coal, oil and nuclear industries received \$26.6 billion worth of direct subsidies and tax breaks. Of this, the oil industry alone received \$822.5 million in direct handouts and at least \$2.8 billion in tax breaks, not even including the sizable percentage depletion allowance tax deduction. Last year, Donald Lubick, Assistant Secretary for Tax Policy for the U.S. Department of Treasury, testified at a Ways and Means Committee hearing that, "over 75 percent of corporations in the oil and gas extraction industry did not pay any domestic, corporate income tax," and further stated that "[t]his is an industry that probably has larger tax incentives relative to its size than any other industry in the country."

These subsidies cost taxpayers money and pad the profits of an already profitable industry, whose profits are growing. For example, in the first quarter of 2000:

- ExxonMobil had a net income of \$3.35 billion, up 108% over the same period last year.
- ARCO had a net income of \$333 million, up 136% over the same period last year.
- Chevron had a net income of \$1.1 billion, up 291% over the same period last year.
- BP Amoco had a net income of \$2.68 billion, up 296% over the same period last year.
- Texaco had a net income of \$602 million, up 473% over the same period last year.

Subsidies to these and other oil companies are expensive to taxpayers and encourage our continued reliance on what we have seen is a very dirty and ultimately unsustainable energy source. Reducing these subsidies could reduce the pollution associated with oil and release public funding for cleaner, sustainable energy alternatives like solar and wind. The PIRGs are therefore very much opposed to any increased subsidies for the oil industry. In fact, we find it completely unacceptable that the oil industry would ask for more handouts just as their profits and gas prices are skyrocketing. It is clear that handouts to the oil industry have not benefited consumers, but are instead being pocketed by the industry.

Existing direct spending subsidies for the oil industry, worth \$822.5 million over five years, include the following programs:

- The Department of Energy's Petroleum Research and Development Program focuses on enhanced recovery, exploration, and refinement of crude oil in the U.S. Among the beneficiaries of the program are Chevron, Texaco, BP Amoco, ARCO, and Phillips Petroleum, mature companies that should not need government research dollars, especially given their current and growing level of profits.
- Gas and Oil Loan Guarantees, started in 1999, provides up to \$10 million in guaranteed loans to individual companies through private banking and investment institutions, with taxpayers providing the guarantees.
- Diesel Engine and Fuel Research and
- Oil Royalty Underpayment. On March 15<sup>th</sup>, the Minerals Management Service released rules to ensure that integrated oil companies use a fair market price on which to pay royalties to the federal government, thereby stopping \$66 million a year in royalty losses. Unfortunately, the oil industry, which blocked the release of these rules for years, has now sued to block these rules from taking effect.

Tax breaks for the oil industry are worth at least \$2.8 billion over five years, not including large deductions allowed under the percentage depletion allowance, for which I was unable to estimate the value to the oil industry alone. These tax breaks include:

- The Enhanced Oil Recovery Credit Program, which allows oil companies up to a 15% income tax credit for the costs of recovering domestic oil, including costs of equipment, labor, supplies, and injectants.
- Intangible Drilling Costs that allow integrated oil companies to immediately deduct 70% of their intangible costs, such as wages, fuel, repairs, hauling, supplies, and site preparations, while the other 30% may be deducted over 5 years. Other businesses must treat these costs as investments in a property, like the oil itself, and must deduct them over the lifetime of that property. By allowing faster deduction, these provisions save the oil companies money, at taxpayer expense.



- **Passive Loss Tax Shelters** that encourage investments in oil companies and promote continued oil exploration by providing tax breaks for investors and others deriving some income from oil companies.
- **Percentage Depletion Allowances**, which allow oil and gas companies to deduct 15% of capital investments to reflect the declining value of the well.

### III. Proposed Tax Incentives and Handouts:

Donald Lubick, Assistant Secretary for Tax Policy of the Treasury Department, recently testified that "the [tax] code has gone almost as far as it can go, and each marginal tax reduction.... is not going to help many people."

For that reason, current proposals to provide tax exemptions for marginal oil and gas wells, and deductions for the costs of oil and gas exploration and development are a bad idea. Not only will they continue to benefit an already profitable industry, at the expense of both taxpayers and renewable energy sources, but they will most likely not have the desired effects. Similarly, proposals to provide more royalty relief to companies that have already been underpaying what they owe by \$66 million a year flies in the face of reason.

Instead, we should be dedicating more tax credits and research dollars towards wind and solar power. We should also provide tax credits for consumers who purchase cars that are more fuel-efficient than current standards, with the credit increasing depending on how much above standards the vehicles are.

### IV. Recommendations for Steps Towards a Cleaner, More Economical and More Sustainable Energy Future

The ultimate goal in our national energy policy should be to move away from energy sources that are both dirty and non-renewable, such as oil and other fossil fuels, and turn to energy sources that are much cleaner and limitless in supply, such as solar and wind power. Such a shift will ensure better national security, as the only sure-fire way to eliminate our dependence on foreign oil will be to eliminate our dependence on oil altogether. Finding ways to make solar and wind our major energy sources will also ensure that we do not have energy shortages and that we leave our children and their children as clean and beautiful a place as possible in which to live.

Because oil is finite in supply, we will eventually be forced to make this switch. Whether we do so in full crisis mode after having destroyed irreplaceable natural resources and wilderness or in a planned fashion and with our last wild places still intact will depend on the policies we make today. With that in mind, I make the following recommendations:

1. **Increased Investments in Renewable Energy and Energy Efficiency:** By 2020, non-hydro renewable energy sources like solar and wind should produce at least one-third of the nation's power, and the energy efficiency of homes, buildings, transportation and industries should be doubled. To get to that point, we will need a massive increase in the amount of direct funds and tax breaks for the outspent renewable energy research and development

programs, and provide further tax incentives to improve the energy efficiency of buildings and of cars.

2. **Saving Oil and Protecting Consumers by Raising CAFE standards:** Until we are ready to switch to renewables, we should conserve the greatest possible amount of oil. To that end, raising CAFE standards by 6% per year for a decade would save more oil than we import from the Persian Gulf and what is projected to be in the Arctic Refuge and offshore California. Currently, the CAFE standards are the lowest they have been since 1980, despite the fact that Honda and Toyota are already marketing cars that can go up to 850 miles on a tank of gas. In 1975, when the CAFE standards were first imposed, oil consumption decreased by 3 million barrels a day. We must raise CAFE standards so that light trucks are held to the same pollution standards of cars, and all vehicles have a combined average standard of 45 miles per gallon by 2010 and 65 miles per gallon by 2020. This simple act will not only conserve oil but also protect consumers against the severe impact of fluctuating gasoline prices.
3. **Preserving Our Wild Spaces:** Conserving oil will remove any argument for drilling in wilderness and open spaces. Pristine wilderness areas like the Arctic National Wildlife Refuge, which has no roads or trails and is home to herds of caribou, muskox, bears, wolves and migratory birds, are irreplaceable. The U.S. Geological Service recently estimated that there are 3.2 billion barrels of economically recoverable oil in ANWR, which will last for only 6 months. It would be incredibly shortsighted to destroy this unspoiled ecosystem for such a small benefit.
4. **Stop subsidizing a mature and profitable oil industry at the expense of taxpayers and the environment:** Finally, we must stop encouraging, through tax breaks and direct handouts, our continued dependence on oil and other dirty fossil fuels. Enough is enough — oil companies are mature and profitable enough to pay for their own research. We should reserve our scarce tax dollars for the competitively disadvantaged renewable energy industry, and start encouraging the production and use of energy sources that will lead us into a cleaner and healthier future.

#### RESPONSE TO A QUESTION FROM SENATOR HATCH

**Question:** Do you have an estimate of how many acres of solar panels or windmills we would need to replace the energy of Anwar's 3.2 billion barrels of oil?

**Answer:** According to the American Wind Energy Association's website, [www.awea.org/faq/land.html](http://www.awea.org/faq/land.html):

"With today's wind turbine technology, wind power could supply 20% of this country's electricity, according to a recent study by Pacific Northwest Laboratory (PNL). . . . To provide 20% of America's electricity, 660,000 million kilowatt hours per year, only 0.6% of the land of the lower 48 states would have to be developed with wind power plants. This area, about 16,000 square miles, is about the size of four counties in Montana, distributed over the entire United States. Furthermore, less than 5% of this land would be physically occupied by wind turbines, electrical equipment, and access roads. Most existing land use, such as farming and ranching, could remain as it is now."

"The PBL study found that almost every region of the country has some areas of good wind energy resources. In fact, the Northeast, Northwest, Southwest and Atlantic coastal regions all contain significant wind energy resources. And some states, such as those that lie on the Great Plains from Texas to North Dakota, have a huge electricity-generating potential from the wind. The wind potential from each of these states far exceeds its current electricity consumption."

From the Department of Energy's Energy Efficiency and Renewable Energy Network's Concentrating Solar Power website: [www.eren.doe.gov/csp/csp-tech.html#map](http://www.eren.doe.gov/csp/csp-tech.html#map)

"The solar resource for generating power from concentrating solar power systems is plentiful. For instance, enough electric power for the entire country could be generated by covering about 9 percent of Nevada—a plot of land 100 miles on a side—with parabolic trough systems"

## PREPARED STATEMENT OF JOHN SWORDS

**STATEMENT OF JOHN SWORDS  
FOR THE  
INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA  
AND THE  
NATIONAL STRIPPER WELL ASSOCIATION  
AND**

California Independent Petroleum Association	Michigan Oil & Gas Association
Colorado Oil & Gas Association	Mississippi Independent Producers & Royalty Association
East Texas Producers & Royalty Owners Association	Montana Oil & Gas Association
Eastern Kansas Oil & Gas Association	National Association of Royalty Owners
Florida Independent Petroleum Association	Nebraska Independent Oil & Gas Association
Illinois Oil & Gas Association	New Mexico Oil & Gas Association
Independent Oil & Gas Association of New York	New York State Oil Producers Association
Independent Oil & Gas Association of Pennsylvania	North Texas Oil & Gas Association
Independent Oil & Gas Association of West Virginia	Ohio Oil & Gas Association
Independent Oil Producers Association Tri-State	Oklahoma Independent Petroleum Association
Independent Petroleum Association of Mountain States	Panhandle Producers & Royalty Owners Association
Independent Petroleum Association of New Mexico	Pennsylvania Oil & Gas Association
Indiana Oil & Gas Association	Permian Basin Petroleum Association
Kansas Independent Oil & Gas Association	Tennessee Oil & Gas Association
Kentucky Oil & Gas Association	Texas Independent Producers & Royalty Owners Association
Louisiana Independent Oil & Gas Association	West Central Texas Oil & Gas Association
	Wyoming Independent Producers Association

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Mr. Chairman, members of the committee, I am John Swords, Partner-Independents of PricewaterhouseCoopers LLP and Chairman of the Independent Petroleum Association of America (IPAA) Tax Committee. Today, I am testifying on behalf of the IPAA, the National Stripper Well Association (NSWA), and 33 cooperating state and regional oil and gas associations. These organizations represent independent petroleum and gas producers, the segment of the industry that is damaged the most by the lack of a domestic energy policy that recognizes the importance of our own national resources. NSWA represents the small business operators in the petroleum and natural gas industry, producers with "stripper" or marginal wells.

Today's hearing is examining a critical issue confronting domestic petroleum and natural gas production—the role of the tax code with regard to the enhancement or deterioration of domestic exploration and production of natural gas and petroleum. To put this issue in a clear perspective all we have to do is look to the recent National Petroleum Council Natural Gas study. This study concluded that U.S. demand for natural gas would increase by about 40 percent over the next ten years. It also identified four general areas that must be addressed to assure that this clean burning fuel will be adequately supplied to America's consumers. These are: access to capital, access to the national resource base, access to technology, and access to human resources. The federal government is a significant—if not pivotal—factor in two of them: access to the resource base and access to capital. The federal tax code plays an integral part in providing access to the capital essential to develop domestic resources—both natural gas and petroleum.

Federal tax policy has historically played a substantial role in developing America's natural gas and petroleum. Early on, after the creation of the federal income tax, the treatment of costs associated with the exploration and development of this critical national resource helped attract capital and retain it in this inherently capital intensive and risky business. Allowing the expensing of geological and geophysical costs and percentage depletion rates of 27.5 percent are examples of such policy decisions that resulted in the United States extensive development of its petroleum.

But, the converse is equally true. By 1969, the depletion rate was reduced and later eliminated for all producers except independents. However, even for independents, the rate was dropped to 15 percent and allowed for only the first 1000 barrels per day of petroleum produced. A higher rate is allowed for marginal wells which increases as the petroleum price drops, but even this is constrained—in the underlying code—by net income limitations and net taxable income limits. In the Windfall Profits Tax, federal tax policy extracted some \$44 billion from the industry that could have otherwise been invested in more production. Then, in 1986 as the industry was trying to recover from the last long petroleum price drop before the 1998–99 crisis, federal tax policy was changed to create the Alternative Minimum Tax that sucked millions more dollars from the exploration and production of petroleum and natural gas. These changes have discouraged capital from flowing toward this industry. And, without capital the ultimate result is lower production. Since 1986, domestic petroleum production has dropped by over 2.5 million barrels per day.

Now, independent producers are recovering from the low prices of 1998–99 that starved the industry of funds to maintain existing production and to explore and generate new production—production of both petroleum and natural gas. Today, we look at a world where petroleum production is perilously close to petroleum demand—where all but three or four producing countries are at full production. Today, we look at natural gas supply struggling to meet demand in the United States primarily because of the loss of capital when petroleum prices fell. Today, we have a domestic industry ready to find and produce energy for the nation's consumers, but this inherently risky industry must compete for funds against high flying technology investments and the lure of lower costs to produce foreign oil.

Hearings throughout Congress have echoed with the statements of members from producing and consuming states alike that more must be done to increase domestic production. The question is how. Much of that answer lies within this Committee.

#### *Short Term Actions*

In the short term there are a number of actions that can be taken. In fact, there is wide agreement on these actions from the Administration and the Congress, in the Senate and the House, between Republicans and Democrats. Numerous bills have been introduced in the House and Senate with substantial sponsorship. In the Senate they include S.2557 by Senators Lott and Murkowski, S.2265 by Senators Hutchison and Breaux, S.1833 by Senators Daschle, Baucus and Kerrey, S.1042 by Senators Hutchison and Breaux, S.595 by Senator Domenici, and S.325 by Senators Hutchison and Breaux. These bills are cosponsored by many Senators including many on this committee; a complete list of current cosponsors follows this testimony.

First, action should be taken to clearly allow expensing of geological and geophysical costs and of delay rental payments. President Clinton has endorsed these changes. Congress has passed these changes. They are included in S.2557, S.2265, S.1833, S.1042, S.595, and S.325. These changes would clearly aid the development of new wells and they reflect historic practice in treating these costs. (IPAA Fact Sheets detailing these issues follow this testimony.)

Second, there is wide support for a countercyclical marginal well tax credit. This approach was recommended by the National Petroleum Council in its 1994 Marginal

Wells study. Energy Secretary Richardson has spoken of it repeatedly. It has been introduced in many bills, including S. 2557, S. 2265, S. 1042, S.595, and S.325. This tax credit today can be crafted with a negligible impact on the federal budget, but at the same time create an important safety net for the most vulnerable American producing wells—wells that produce petroleum roughly equivalent to imports from Saudi Arabia—wells that are the nation's true strategic petroleum reserve. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Third, Congress has suspended the property taxable income limitation on percentage depletion for marginal wells through 2001. The tax bill passed by Congress last year would have suspended this provision through 2004. S.1833, S.1042, and S.595 would eliminate this limitation. The suspension that was in place in 1998 and 1999 saved many marginal wells during the price crisis. This provision should be eliminated to provide domestic producers of these wells an incentive not to plug the wells during a low price cycle. Once the well is plugged, the potential to produce the remaining reserves is lost forever. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Fourth, last year's tax bill also suspended through 2004 the 65 percent net overall taxable income limit on percentage depletion. S. 2557 would similarly suspend this provision. S.1833, S.1042, and S.595 would eliminate this limitation. This constraint on independent producers limits the amount of capital that can be retained for reinvestment into existing and new production. In an industry that typically reinvests 100 percent of its profits back into the industry, this constraint means less domestic petroleum and natural gas. It too should be eliminated. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Fifth, last year's tax bill extended the net operating loss carryback period for independent producers to five years. S.2557 and S.1833 also include this provision while S.595 would provide for a ten-year net operating loss carryback. Taken together with the changes passed regarding percentage depletion, millions of dollars would be made available based on costs and losses already incurred to enhance domestic production.

Collectively, these provisions have wide support. They would be of significant national value. They should be enacted now. Equally important, they must be crafted in such a manner to assure that the Alternative Minimum Tax does not nullify the benefits that they would create. The mistake of 1986 should not be repeated. When the industry is in desperate need of capital, it should not be stripped away.

#### *Next Steps*

In the longer term the country needs to look toward tax policies to encourage domestic production of its petroleum and natural gas. Some of this focus needs to be directed to getting more out of existing resources. For example, while the Enhanced Oil Recovery tax credit exists, it is based on technologies that are twenty or more years old. This provision should be restructured and updated. S.595 and S.325 include changes that would address this problem. (An IPAA Fact Sheet detailing this issue follows this testimony.)

Equally significant, policies need to address encouraging more new development. Proposals to encourage domestic exploration and production should be created. A number of concepts are already in play and need to be more fully evaluated.

For example, the Section 29 tax credit for unconventional fuels proved to be a strong inducement to developing those resources. It applies to wells drilled prior to 1993 and upheld completions thereafter. Just last week, the Federal Energy Regulatory Commission acted to reinstate its certification process to address many wells that would otherwise qualify for the Section 29 tax credit. But, the existing credit expires in 2003 and provides no incentive for current development since the qualifying wells had to have been drilled before 1993. S.595 contains a new development incentive proposal by creating an investment tax credit of 20 percent of the costs of new wells up to one million dollars per year and 10 percent thereafter. This type of proposal would reduce the cost of development of domestic wells and encourage capital formation provided it was immediately beneficial. Therefore, it would have to be creditable against both regular and AMT tax and any excess available for carryback and carryforward. S.595 contemplates such treatment. In the past, proposals for tax credits based on the first amount of new production have also been introduced. Which of these is the best approach or whether a better one exists is subject to debate. But, the key issue is that some approach needs to be created.

#### *Conclusion*

If Congress wants to see more domestic petroleum and natural gas production, it must recognize that federal tax policy plays a critical role in whether capital will flow toward this industry and the production of this resource. That has always been

the case and it will continue to be. Domestic producers have always been "risk takers". During these times of plentiful investment opportunities, they need some assistance in attracting capital (or retaining it for use internally). There are immediate actions that can and should be taken. The time is right. The nation is seeking a more stable energy supply. Congress should act.

Thank you for this opportunity.

### **Cosponsors of Energy Bills Referenced in Testimony**

#### **S.2557, National Energy Security Act of 2000**

Lott

Abraham

Allard

Craig

Hutchison

Murkowski

Santorum

Voinovich

#### **S.2265, Marginal Well Preservation Act of 2000**

Hutchison

Bingaman

Breaux

Brownback

Campbell

Cochran

Domenici

Gramm

Helms

Hutchinson

Inhofe

Landrieu

Lott

Nickles

Roberts

Smith, Bob

Thomas

**S.1833, Energy Security Tax Act of 1999**

Daschle  
Baucus  
Bayh  
Bingaman  
Byrd  
Inouye  
Kerrey

**S.1042, Domestic Energy Production Security and Stabilization Act.**

Hutchison  
Allard  
Bingaman  
Breaux  
Brownback  
Cochran  
Domenici  
Gramm  
Landrieu  
Lott  
Thomas

**S.595, Domestic Oil and Gas Crisis Tax Relief and Foreign Oil Reliance Reversal Act of 1999**

Domenici  
Allard  
Bennett  
Breaux  
Brownback  
Burns  
Cochran  
Hutchison  
Inhofe

Landrieu  
Lott  
Murkowski  
Nickles  
Roberts  
Thomas

**S.325, United States Energy Economic Growth Act**

Hutchison  
Allard  
Bingaman  
Breux  
Brownback  
Burns  
Cochran  
Conrad  
Domenici  
Enzi  
Gramm  
Inhofe  
Landrieu  
Lott  
Murkowski  
Nickles  
Roberts  
Rockefeller  
Stevens  
Thomas





## FACT SHEET

### Geological And Geophysical Costs

Geological and geophysical (G&G) surveys are used to locate and identify properties with the potential to produce commercial quantities of oil and natural gas, as well as to determine the optimal location for exploratory and developmental wells.

#### Proposal

*Allow current expensing of geological and geophysical costs incurred domestically including the Outer Continental Shelf.*

G&G expenses include the costs incurred for geologists, seismic surveys, and the drilling of core holes. These surveys increasingly use 3-D technology rather than the conventional 2-D technology used for most of the last seven decades. Previously only very large companies were able to utilize this state-of-the-art, computer-intensive, 3-D technology because of its high cost and the considerable technical expertise it requires. However, as the costs of computer technology have declined, more and more domestic independent producers are making use of this technology. Still, while 3-D seismic provides a vastly superior tool for exploration, it is far more expensive than 2-D technology. 3-D seismic surveys usually cost between five or six times more per square mile onshore than the older technology and, in some instances can account for two-thirds of the costs of some wells. Encouraging use of this technology has many benefits:

- **More detailed information.** Conventional 2-D seismic is only able to identify large structural traps while 3-D seismic is able to pinpoint complex formations and stratigraphic plays.
- **Improved finding rates.** Producers are reporting 50-85% improvements in their finding rate. In prior years a producer might have to drill three to eight wells in order to find commercially viable production.
- **Reduced environmental impact.** Because the use of advanced seismic technology significantly improves the odds of drilling a commercially viable well on the first try, this reduces the number of wells that are drilled and, thus, reducing the footprint of the industry on the environment.
- **Investment capital.** Many investors are requiring producers to provide 3-D seismic surveys of potential development before committing their capital to the project in order to minimize their risk.

**Current law treatment**

G&G costs are not deductible as ordinary and necessary business expenses but are treated as capital expenditures recovered through cost depletion over the life of the field. G&G expenditures allocated to abandoned prospects are deducted upon such abandonment.

**Reasons for change**

These costs are an important and integral part of exploration and production for oil and natural gas. They affect the ability of domestic producers to engage in the exploration and development of our national petroleum reserves. Thus, they are more in the nature of an ordinary and necessary cost of doing business.

These costs are similar to research and development costs for other industries. For those industries such costs are not only deductible but a tax credit is available.

Crude oil imports are at an all-time high, which makes the U.S. vulnerable to sharp oil price increases or supply disruptions. The National Petroleum Council *Natural Gas* study concluded that natural gas supplies need to increase by about 40 percent by 2010 to meet demand. Domestic exploration and production must be encouraged now to offset this potential threat to national security, to meet future needs, and to enhance our economy. Allowing the deduction of G&G costs would increase capital available for domestic exploration and production activity.

The technical "infrastructure" of the oil services industry, which includes geologists and engineers, has been moving into other industries due to reduced domestic exploration and production. Stimulating exploration and development activities would help rebuild the critical oil services industry.

Encouraging the industry to use the best technology available and to reduce its environmental footprint are important public policy reasons to clarify that these ordinary and necessary business expenses for the oil and gas industry should be expensed.

**Status**

The Taxpayer Refund And Relief Act Of 1999 included a provision to allow expensing of G&G costs. Unfortunately, the bill was vetoed. However, in March 2000, President Clinton announced his support for allowing expensing of G&G costs. Congress needs to pass legislation now to implement this common objective to enhance and preserve domestic oil and natural gas production.

July 2000



## FACT SHEET

### Tax Treatment of Delay Rentals

Delay rental payments are made by producers to an oil and gas lessor prior to drilling or production. Unlike bonus payments (made by the producer in consideration for the grant of the lease) which generally are treated as an advance royalty and thus capitalized, producers have historically been allowed to elect to deduct delay rental payments under Treasury Regulations 1.612-3(c). However, in September 1997, the IRS issued a coordinated issues paper stating that such payments are preproduction costs subject to capitalization under Section 263A of the Internal Revenue Code. The legislative history of Section 263A is unclear and subject to varying interpretation.

#### Proposal

*Clarify that delay rental payments are deductible, at the election of the taxpayer, as ordinary and necessary business expenses.*

#### Reasons for change

In passing the Section 263A uniform capitalization rules, Congress broadly intended to only affect the "unwarranted deferral of taxes." Congress did not intend to grant the IRS the authority to repeal the well-settled industry practice of deducting "delay rentals" as ordinary and necessary business expenses.

Treas. Reg 1.612-3(c) states that, "a delay rental is an amount paid for the privilege of deferring development of the property and which could have been avoided by abandonment of the lease, or by commencement of development operations, or by obtaining production." Such payments represent ordinary and necessary business expenses, not an "unwarranted deferral of taxes." Given the clear disagreement over the legislative history and the likelihood of costly and unnecessary litigation to resolve the issue, clarification would eliminate administrative and compliance burdens on taxpayers and the IRS.

#### Status

The Taxpayer Refund And Relief Act Of 1999 included a provision to clarify that delay rental payments could be expensed. Unfortunately, the bill was vetoed. However, in March 2000, President Clinton indicated his support for allowing expensing of delay rental payments. Congress needs to enact legislation to implement this common position if the Administration is unwilling to correct the current confusing interpretation of the tax code.

July 2000



## FACT SHEET

### Marginal Well Tax Credit

#### *Summary of Legislation*

The Marginal Well Production Tax Credit amendment to the Internal Revenue code will establish a tax credit for *existing* marginal wells. Marginal oil wells are those with average production of not more than 15 barrels per day, those producing heavy oil, or those wells producing not less than 95 percent water with average production of not more than 25 barrels per day of oil. Marginal gas wells are those producing not more than 90 Mcf a day. The amendment will allow a \$3 a barrel tax credit for the first 3 barrels of daily production from an existing marginal oil well and a \$0.50 per Mcf tax credit for the first 18 Mcf of daily natural gas production from a marginal well.

The tax credit would be phased in and out in equal increments as prices for oil and natural gas fall and rise. Prices triggering the tax credit are based on the annual average wellhead price for all domestic crude oil and the annual average wellhead price per 1,000 cubic feet for all domestic natural gas. The credit for the current taxable year is based on the average price from the previous year. The phase in/out prices are as follows:

OIL - phase in/out between \$14 and \$17

GAS - phase in/out between \$1.56 and \$1.89

The amendment would allow the tax credit to be offset against regular and the alternative minimum tax (AMT). In addition, for producers without taxable income for the current tax year, the amendment would provide a 10-year carryback provision allowing producers to claim the credit on taxes paid in those years. The carryback credit may be used to offset regular tax and AMT.

#### *Actions Taken*

When oil prices fell below \$14.00 per barrel in March 1998, IPAA initiated efforts to develop a marginal well tax credit bill based on legislation that had been introduced in previous Congresses and consistent with the recommendations of the National Petroleum Council's *Marginal Wells* report in 1994. This legislation was introduced April in the House by Representative Wes Watkins (R-OK) and in the Senate primarily by Senator Kay Bailey Hutchison (R-TX). During the remainder of the 105<sup>th</sup> Congress, IPAA pressed for passage of this legislation. A letter from IPAA and NSWA leadership was sent to President Clinton. Meetings were held with the Department of Energy to discuss the importance of the tax credit. In July 1998, IPAA sponsored a call-up of members to press for action on the tax credit if tax legislation was considered during this Congress.

The Dept. of Energy has evaluated the benefits of a bill and believes that it could prevent the loss of 140,000 barrels per day of production if fully employed during times of low oil prices. Energy Secretary Bill Richardson wrote to Treasury Secretary Robert Rubin expressing his support for the proposal and seeking a coordinated effort with the Treasury Dept. In November and December 1998, IPAA met with members of Energy Secretary Richardson's emergency task force urging action on Administration support for a marginal wells tax credit bill.

As the 106<sup>th</sup> Congress convened the bill was introduced in the House of Representatives by Rep. Wes Watkins with 12 original cosponsors as HR 53. In the Senate, the bill was introduced as a part of a larger bill (S. 325) by Sen. Kay Bailey Hutchison with 18 cosponsors. It was also included in other tax legislation addressing oil and gas production tax reform. IPAA testified before the Senate Energy and Natural Resources Committee, the House Committee on Commerce, and the House Ways and Means Committee regarding the need for tax reform, including the marginal wells tax credit. When the Department of Commerce initiated its Section 232 analysis under the Trade Expansion Act, IPAA urged consideration of a marginal wells tax credit as a component of a tax reform package. The Taxpayer Refund And Relief Act Of 1999 did not create any new tax credits and therefore did not include a marginal wells tax credit in the package of oil and gas tax reform measures in that bill.

In March, President Clinton stated his support for tax reforms to allow expensing of geological and geophysical costs and for delay rental payments. He also stated that the Administration was continuing to evaluate alternatives to maintain the nation's marginal well production. Subsequently, Sen. Kay Bailey Hutchison and 8 cosponsors introduced S. 2265 which includes the marginal wells tax credit, the expensing of G&G costs, and the expensing of delay rental payments. It has also been included in S. 2557 and HR 4805, comprehensive energy policy bills. Congress, in response to the high oil prices of the past winter, continues to consider a legislative response, including tax reforms.

As Congress continues to evaluate tax reforms for the oil and gas production industry, IPAA will continue to advocate a marginal wells tax credit as a component of those reforms.

July 2000



## FACT SHEET

# Eliminate The Net Income Limitation On Percentage Depletion

The net income limitation severely restricts the ability of independent producers to use percentage depletion, particularly with respect to marginal wells. Percentage depletion is already subject to many limitations. First, the percentage depletion allowance may only be taken by independent producers and royalty owners and not by integrated oil companies. Second, depletion may only be claimed up to specific daily production levels of 1,000 barrels of oil or 6,000 mcf of natural gas. Third, the deduction is limited to 65% of net taxable income. These limitations apply both for regular and alternative minimum tax purposes.

The net income limitation requires percentage depletion to be calculated on a property-by-property basis. It prohibits percentage depletion to the extent it exceeds the net income from a particular property. The typical independent producer can have numerous oil and gas properties, many of which could be marginal properties with high operating costs and low production yields. During periods of low prices, the producer may not have net income from a particular property, especially from marginal properties. When domestic production is most susceptible to being plugged, the net income limitation discourages producers from investing income to maintain marginal wells.

### Proposal

*Eliminate the net income limitation on percentage depletion.*

### Reasons for change

Marginal oil wells – those producing on average 15 barrels per day or less or producing heavy oil – account for approximately 20 percent of domestic oil production, an amount roughly equivalent to imports from Saudi Arabia. The U.S. is the only country with significant production from marginal wells. Once wells are plugged, access to the remaining resource is often lost forever. Eliminating the net income limitation on percentage depletion would encourage producers to keep marginally economic wells in production and enhance optimum oil and natural gas resource recovery.

The current requirement creates a paperwork and compliance nightmare for taxpayers and the Internal Revenue Service. Eliminating the net income limitation on percentage depletion would simplify recordkeeping and reduce the administrative and compliance burden for taxpayers and the IRS.

### Current Status

The Taxpayer Relief Act of 1997 created a two-year suspension of the net income limitation on percentage depletion; this suspension has been extended through 2001. However, it is time to

make this suspension permanent. If the country learned anything from the high oil prices of 2000, it is that America needs to maintain and enhance its domestic oil and natural gas production. This tax reform allows more capital to be retained by producers where it can do the most good – producing more domestic oil and natural gas.

July 2000



## ***FACT SHEET***

### **Percentage Depletion Expansion and Carryback Proposal**

Current tax law limits the use of percentage depletion of oil and gas in several ways. One of these, for independent producers and royalty owners, limits the allowance for percentage depletion to 65 percent of a taxpayer's taxable income for the year. Percentage depletion in excess of this 65 percent limit may be carried over to future years until it is fully utilized. Many independent producers have been limited in the past because they have spent their income on continuing development of their properties, thereby reducing their taxable income. When oil prices dropped to historically low levels independent producers are unreasonably constrained by these tax provisions limiting their cash flow. They cannot use these carried over deductions. Due to the alternative minimum tax (AMT), even if they could use the deductions currently, they may not benefit to the fullest extent possible from actual tax savings. This proposal would alleviate these limits by implementing the following changes:

- By annual election, the 65 percent taxable income limitation would be reduced or eliminated for current and future tax years.
- Carried over percentage depletion could be carried back for ten years subject to the same annual election on taxable income limitation.

#### **Status**

In the Taxpayer Refund And Relief Act Of 1999, Congress included two provisions that addressed these issues in a somewhat different manner. The bill included a 6 year suspension of the 65 percent taxable income limitation and a provision allowing independent producers to carryback net operating losses for 5 years. Unfortunately, the bill was vetoed.

Congress needs to include similar provisions in future tax reform bills and the Administration needs to support such provisions to enhance and preserve domestic oil and natural gas production.

July 2000



## FACT SHEET

### Enhanced Oil Recovery

Section 43 of the Internal Revenue Code provides an enhanced oil recovery (EOR) credit equal to 15 percent of the qualified enhanced oil recovery costs incurred in a tax year. Existing Treasury guidelines for the section 43 tax credit are very narrow, generally including only expensive EOR processes -- many of which are no longer in use. It excludes, however, many EOR processes that are the result of technological advances now considered common in the industry.

The Petroleum Technology Transfer Council (PTTC) in March 1997 compiled a list of EOR methods that should be included under section 43. This study was part of an industry effort to expand the EOR definition to include technologies that have proven potential for mitigating well abandonment and increasing oil production and resource recovery.

#### *Proposal*

*Have the IRS review and expand the definition of methods qualifying for the EOR tax credit.*

#### **Reason for Change**

The existing Treasury guidelines are based on 1979-vintage technology. This list has not kept pace with technology. A second rationale is the incentive generated by allowing domestic producers to position themselves to glean existing reservoirs in order to maximize production of existing reserves.

Two additional categories to the EOR list are proposed. Those categories include Enhanced Gravity Drainage (EGD) and Marginally Economic Reservoir Repressurization (MERR). Included under EGD would be horizontal drilling, multilateral well bores and large diameter lateral well bores. Included in MERR would be natural gas injection and waterflooding. Certain qualifiers and limiting factors include economic criteria for approved projects and incremental production limitations on each project.

By redefining the definition of EOR projects to include both EGD and MERR technologies, the EOR tax credit will encourage conservation measures to expand recovery of existing crude oil reservoirs and promote new drilling activity. This will enable the industry to recover more than 238 billion barrels of oil currently defined by the Department of Energy as "immobile."

July 2000



## COMMUNICATIONS

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### STATEMENT OF THE AMERICAN LUNG ASSOCIATION OF UTAH

(SUBMITTED BY WAYNE DAVIS, EXECUTIVE DIRECTOR)

Re: In support of S. 2591

Mr. Chairman and Members of the Committee, my name is Wayne Davis. I am the Executive Director for the American Lung Association of Utah, and am pleased to offer this testimony on behalf of Senator Hatch's proposed legislation.

The American Lung Association of Utah strives to prevent lung disease and promote lung health by protecting our lungs from the threat of environmental hazards. The air we breathe has a big impact on the health of our lungs. According to a study conducted by John Hopkins University's School of Public Health, particulate air pollution exacerbates heart and lung disease, increases hospitalizations, and promotes premature death (ALA).

According to a publication by the American Lung Association called "State of the Air," pollutant levels continue to violate the health-based standard of the Clean Air Act in many major cities. Salt Lake, Davis, Utah, and Weber counties all had unhealthy ranges of ozone levels between the years 1996-1998.

Mobile source pollution contributes more than 50 percent of the air pollution along the Wasatch Front, an area that houses more than 75 percent of Utah's population. Since motor vehicles are a major source of pollution, more needs to be done to address the current and future sources of emissions and poor air quality.

One reasonable strategy to cut down on the amount of pollutants in the air is to increase the use of clean fuel vehicles. Vehicles that run on natural gas, propane, or electricity are cleaner burning than those fueled by gasoline or diesel. These Alternative Fuel Vehicles (AFVs) provide a significant role in improving air quality.

We feel that Tax Credit legislation will provide an incentive to encourage people to use alternative fuels in place of gasoline and diesel. We appreciate your leadership and support for legislation that the Lung Association believes might help improve air quality and lung health.

The American Lung Association endorses this legislation for these reasons and hope Congress will see fit to enact the legislation for the benefit of all.

Thank you for this opportunity to provide this testimony.

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### STATEMENT OF THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS

(BY HARRY L. JEFFS, DIRECTOR, FLEET ADMINISTRATION)

Mr. Chairman and Members of the Committee my name is Harry Jeffs. I am Director of Fleet Administration for the Church of Jesus Christ of Latter-Day Saints (LDS Church), head quartered in Salt Lake City, Utah and I am pleased to offer this testimony on behalf of Senator Hatch's proposed legislation.

The LDS Church is a world wide organization with over eleven million members.

The LDS Church has a fleet of more than 7,000 vehicles that operate in all parts of the country. Recent gasoline price increases remind us of our national vulnerability to imported oil. For example, our gasoline prices have increased from \$1.20 to \$1.57 during the last 9 months. This 31 percent increase causes major concerns with our cash flow in our operations.

With more than 75 percent of Utah's population along the Wasatch Front, and mobile sources contributing more than 50 percent of the air pollution, the Wasatch Front continues to fall in non-attainment status. Alternative fuel vehicles (AFVs) provide a significant role in reducing our dependence on imported oil, while improving our air quality.

A major impediment to our use of AFV's is the significant cost difference between AFV's and gasoline vehicles. Incentives can help alleviate a portion of the cost barrier and we appreciate your efforts to create incentives to reduce the cost of these vehicles. And although the proposed vehicle tax credit will not have any direct benefit to the LDS Church or other tax-exempt entities, such as local governments, the credit will promote the increased production of AFV's which will improve the economics of scale and thus lower the cost of the vehicles to all consumers. On the other hand, the proposed 25 cents per gallon fuel credit will contribute to favorable economics for all tax-exempt entities.

Mr. Chairman and Members of the Committee, the LDS Church commends the sponsors of the bill for recognizing the win-win opportunity for all communities through the use of AFV's. . . promoting national security, cleaner air, and potential fuel savings.

The LDS Church endorses this legislation for these reasons and hopes Congress will see fit to enact the Legislation for the benefit of all.

Thank you for this opportunity to provide this testimony.

## STATEMENT OF THE FRIENDS OF THE EARTH

(PREPARED BY SEAN MOULTON, ECONOMIC INCENTIVES POLICY ASSOCIATE)

### INTRODUCTION:

Mr. Chairman and Members of the Committee, we respectfully submit these written comments for the record. Friends of the Earth represents environmentalists, consumers and citizens that are concerned with an efficient and effective energy policy. Among our staff, there are several experts who have spent years studying and tracking tax breaks and other government subsidies available to oil and gas industries.

Based on our research and study, we now strongly urge you to oppose any tax breaks for the oil and gas industry. Tax breaks would be unfair to U.S. taxpayers and harmful to the environment. The oil and gas industry already enjoys billions of dollars in federal subsidies, and it seems that no matter what the challenge faced, the industry always suggests the same solution—more tax breaks.

### FEDERAL TAX SUBSIDIES FOR ENVIRONMENTALLY HARMFUL INDUSTRIES

In December 1999, the non-partisan Joint Committee on Taxation (JCT), an analytical office of the U.S. Congress, issued its annual estimate of the cost of tax breaks, *Estimates of Federal Tax Expenditures for Fiscal Years 2000-2004*. The report presents new information about the range of tax breaks provided in the federal Tax Code.

While the JCT does not make estimates for all tax breaks, the analysis is one of the most thorough and credible sources for information on federal tax policy.

Friends of the Earth identified 10 tax breaks in the JCT report that reward industries that have troubling environmental impacts. These tax breaks reward corporations for polluting air and water, scarring landscapes, and clear-cutting forests. Friends of the Earth compared this year's estimate of the cost of these polluter tax breaks with estimates from earlier years.

### JCT FINDINGS:

Overall, the cost of tax subsidies for environmentally harmful industries is growing. For 2000-2005, JCT estimates that environmentally harmful tax breaks will cost \$20.1 billion. This is a significant increase from last year's (1999-2004) estimate of \$17.8. For 1998-2003, JCT estimated these tax breaks would cost \$15.3 billion.

The primary industrial beneficiaries of these environmentally harmful tax giveaways are the oil and gas industries, mining, timber and agribusiness. Oil and gas tax breaks have grown most rapidly, the cost for four oil & gas tax breaks tracked in this report rose from \$10.4 billion to over \$13 billion.

These subsidies not only cost ordinary U.S. taxpayers more in taxes, but they stunt the growth of emerging, environmentally friendly energy technologies, which are crucial to sustainable development.

### WASTEFUL ENERGY TAX SUBSIDIES

Friends of the Earth has tracked and analyzed additional energy tax subsidies beyond the JCT report. Below is a list and detailed description for each of these exces-

sive and wasteful tax breaks to the energy industry. Most of this information is derived directly from *Paying for Pollution: How Taxpayers Subsidize Dangerous and Polluting Energy Programs*, a joint report by Friends of the Earth, U.S. Public Interest Research Group, and Taxpayers for Common Sense. The report (available on the World Wide Web at: [www.foe.org/eco/payingforpollution/](http://www.foe.org/eco/payingforpollution/)) identifies more than \$26 billion federal government subsidies to the oil, gas, coal, and nuclear industries over five years. The nine tax subsidies to the energy industry totaled close to \$15 billion.

### Tax Subsidies

Tax Subsidies	5 Year Total
Capital Gains Treatment of Royalties on Coal	\$380 million
Enhanced Oil Recovery	\$300 million
Gas Guzzler Exemption for Mini-vans and Trucks	\$ n/a
Intangible Drilling Costs	\$2.4 billion
Mining Reclamation Deduction	\$200 million
Non-conventional Fuel Production Credits	\$7.1 billion
Passive Loss	\$ 125 million
Percentage Depletion Allowance for Uranium and Fossil Fuels	\$3.6 billion
Private Activity Bonds	\$600 million
Total	\$14.7 billion

#### CAPITAL GAINS TREATMENT OF ROYALTIES ON COAL

\$380 MILLION

#### Background

The Internal Revenue Code contains a provision allowing coal-mining companies to treat income from royalties as capital gains. This provision permits individuals who lease mining rights and receive royalty payments to treat these payments as capital gains rather than ordinary income. Treating the income as capital gains allows the companies to capture reduced tax rates instead of the higher tax rates normally applied to income. Special capital gains treatment for coal was granted in 1952.

#### Green Scissors Proposal

Repeat capital gains treatment for income generated from royalties. According to the White House Office of Management and Budget, this action would save taxpayers \$380 million over 5 years.

#### Project Hurts Taxpayers

Allowing coal companies to treat income from royalty receipts as capital gains gives these companies a higher profit margin at taxpayer expense. The tax break encourages leasing and unnecessarily subsidizes coal production. In 1996, 940 million tons of coal were consumed, and the total value of coal production was more than \$19 billion. Clearly the coal industry doesn't need this tax break.

#### Project Hurts Environment

Mountain top removal and strip mining for coal scar the landscape and pollute surrounding sources of water. This tax provision subsidizes an energy source that is a major cause of greenhouse gases and gives coal producers market advantages over cleaner, more efficient energy sources

#### ENHANCED OIL RECOVERY

\$300 MILLION

#### Background

Oil companies can qualify for a 15 percent income tax credit for the costs of recovering domestic oil as long as they use qualified "enhanced oil recovery" methods. Qualifying methods involve injecting fluids, gases, and other chemicals into the oil reservoir, or using heat to extract oil that is too viscous to be extracted by conventional techniques. Costs covered by the tax credit include the costs of equipment, labor, supplies, repairs, and injectants.

In addition, oil companies can expense, or immediately write off, so-called tertiary injectants used in enhanced oil recovery. Unlike other businesses, which have to deduct these costs over the lifetime of the investment, oil companies can deduct tertiary injectant expenditures within the year of the cost. Expensing allows companies to write off the costs of machinery and equipment faster than they actually wear out. The result is that the beneficiaries of this tax break, such as oil companies,

have lower tax bills and maintain higher profit margins while the Treasury and taxpayers lose revenue.

#### *Green Scissors Proposal*

Repeal the 15 percent credit for "enhanced oil recovery" and eliminate the expensing of tertiary injectants. This action would save taxpayers \$300 million over five years.

#### *Project Hurts Taxpayers*

The tax credit and immediate expensing for enhanced oil recovery encourage over production of domestic oil at taxpayer expense. These tax provisions promote oil production from sources that would not otherwise be economically viable.

#### *Project Hurts Environment*

The nation does not need more subsidized oil, no matter what the source. Moreover, this tax credit gives the already profitable petroleum industry an advantage over cleaner emerging technologies.

GAS GUZZLER EXEMPTION FOR LIGHT TRUCKS      \$N/A

#### *Background*

A federal "gas guzzler" tax is collected on new automobiles that have a fuel economy rating of less than 22.5 miles-per-gallon (MPG). Mini-vans, sport utility vehicles, and automobiles weighing more than 6,000 pounds are exempt from the tax. Without these special exemptions, two out of three light trucks sold in 1996 would have paid a gas guzzler tax. The tax ranges from \$1000 for automobiles with MPG standards of between 21.5 and 22.5 to \$7,700 for vehicles with MPG standards of less than 12.5.

#### *Green Scissors Proposal*

Close the loophole in the "gas guzzler tax" that exempts light-duty trucks (mini-vans and sport utility vehicles) and automobiles heavier than 6,000 pounds.

#### *Project Hurts Taxpayers*

This tax exemption allows auto manufacturers, such as Ford, General Motors, and DaimlerChrysler, to reap higher profits at taxpayer expense because money that should be going back to the Treasury is going into the manufacturers' coffers. This subsidy is at odds with another wasteful program called the Partnership for a New Generation of Vehicles (PNGV) that subsidizes the same auto manufacturers to develop more fuel-efficient vehicles.

#### *Project Hurts Environment*

Automobile pollution accounts for approximately 22 percent of CO<sub>2</sub>, 8 percent of the soot pollution and 30 percent of the smog pollution in the U.S. Estimates show that shutting down this huge loophole would improve fuel economy in the new truck fleet by about 10 percent and reduce greenhouse gas emissions by 20 million metric tons by 2010.

INTANGIBLE DRILLING COSTS      \$2.4 BILLION

#### *Background*

Provisions in the tax code allow integrated oil and gas companies such as Exxon-Mobil and Chevron to immediately deduct 70 percent of their intangible oil costs (IDCs). The other 30 percent must be deducted over five years. IDCs are generally defined as the cost of wages, fuel, repairs, hauling, supplies and site preparations associated with drilling. Under normal tax rules that apply to other businesses, such "capital" costs are investments in property like buildings or oil wells. Because these properties last longer than one year, their costs should be written off over time as the property wears out, or oil is depleted. Instead, immediate deduction, or expensing, allows companies to write off costs of machinery and equipment faster than they actually wear out, or the oil is depleted. The result is that tax bills in the earlier more profitable life of the investment are lower. Thus, oil and gas companies save by returning less to taxpayers and the Treasury.

#### *Green Scissors Proposal*

Repeal the tax provisions permitting oil and gas producers to immediately deduct "intangible" drilling costs and amend the provision so the costs are deducted over time. This action would save \$2.4 billion over the next five years.

*Project Hurts Taxpayers*

Immediate expensing of IDCs provides a tax subsidy for capital investments in the oil and gas industry. Capital costs covered by IDCs amount to 75 to 90 percent of the cost to get an oil or gas well into production. The special treatment of oil and gas expenses effectively sets taxes on oil income to zero. IDCs also cause investment decisions to be based on tax rather than economic considerations. While wealthy oil companies save, other taxpayers pay the bill for the subsidy.

*Project Hurts Environment*

The oil and gas industry enjoys many special tax breaks, creating incentives for irresponsible treatment of scarce natural resources and environmentally sensitive areas such as wetlands, estuaries, and bays.

MINING RECLAMATION DEDUCTION                      \$200 MILLION

*Background*

A provision in the U.S. tax code allows mining companies to deduct reclamation and closing costs as soon as they begin to mine, even though the eventual closing and reclamation of the mine site will not occur for some time. Without this provision, general tax rules would require the companies to wait until the mine site is closed, restored, and the costs associated with these activities are paid before being able to deduct these costs.

*Green Scissors Proposal*

Repeal the special rules that allow costs for mine reclamation to be deducted before they are actually paid. Require companies to post adequate reclamation bonds and establish a national program to clean up abandoned mines. These actions would save taxpayers \$200 million over five years.

*Project Hurts Taxpayers*

Taxpayers could get stuck paying for the closing and reclamation of mines for which mining companies have already claimed a deduction. A current deduction without a requirement to post an adequate bond raises the possibility that closing and reclamation will never occur. Simply put, there is no guarantee that there will be money available for clean up or mine closing, and taxpayers could conceivably get stuck with the tab.

*Project Hurts Environment*

Since 1977, there have been more than 6,000 coal mines closed but not reclaimed. Until proper standards exist to address the environmental impacts of mining, no tax subsidy should be available to the industry.

NON-CONVENTIONAL FUEL PRODUCTION CREDIT                      \$7.1 BILLION

*Background*

Section 29 of the Internal Revenue Code allows oil and gas companies to take a production tax credit for fuels produced from non-conventional sources. Qualifying fuels include oil produced from shale or tar sands, synthetic fuels produced from coal, and gas produced from either pressurized brine, Devonian shale, tight formations, or biomass and coalbed methane. The production credit is more than \$6.00 per barrel of liquid fuels and more than \$1.00 per thousand cubic feet for gaseous fuels. This production credit phases out when oil prices range from \$40 to \$50 per barrel.

*Green Scissors Proposal*

Repeal the "non-conventional" production credit for oil produced from shale or tar sands, synthetic fuels produced from coal, and gas produced from geopressurized brine, Devonian shale, and tight formations. This action would save taxpayers \$7.1 billion over 5 years.

*Project Hurts Taxpayers*

In theory, the credit was supposed to decrease American reliance on foreign oil by increasing the production of non-conventional fuel substitutes. Instead, most of the credit has gone to oil and gas production and has been used to develop drilling and production technologies. The subsidy has not led to major increases in alternative fuel production and has not helped to decrease U.S. reliance on foreign oil. Moreover, the program has significantly exceeded its original estimated costs.

*Project Hurts Environment*

A remnant of the \$88 billion "synfuel" program under the Carter Administration, the "non-conventional fuel" tax credit has had unintended environmental consequences. For example, coalbed methane developers in states such as Colorado, New Mexico, Wyoming, and Alabama have been overlaying a new grid of wells on top of older fields of abandoned oil and gas wells that have not been properly plugged. When new methane wells are drilled, the gas not only moves up into the new wells, but also can move into underground aquifers and escape through older oil and gas wells and water wells. The result has been contaminated drinking water and irrigation systems, and even explosions. As a whole, the credit simply adds to the volume of tax-subsidized fossil fuels and the pollution that results from burning them.

PASSIVE LOSS

\$125 MILLION

*Background*

Taxpayers with substantial sources of income from salaries or investments can eliminate or sharply reduce their taxable income by investing in "passive loss" tax shelters. The 1986 Tax Reform Act eliminated these tax shelters for virtually all other investments except those directed in the oil and gas industry.

*Green Scissors Proposal*

Eliminate the "passive loss" tax shelter for investors in oil and gas. This action would save taxpayers \$125 million over five years, according to the White House Office of Management and Budget.

*Project Hurts Taxpayers*

This tax break helps prop up the domestic oil industry with taxpayer dollars. Money that should be rightfully coming back to taxpayers and the Treasury should not be going to support this multi-billion dollar industry's profit margin. Furthermore, this tax shelter has not helped to prevent a decline in domestic production—its original intention. Instead, this tax break needlessly costs taxpayers millions of dollars every year.

*Project Hurts Environment*

Oil and gas are polluting, non-renewable resources. This oil and gas tax shelter attracts investors that might otherwise invest in cleaner, growing industries. In addition, the tax break encourages the overproduction of oil and gas, which causes environmental damage to air, land, water, and soil quality.

PERCENTAGE DEPLETION ALLOWANCE FOR URANIUM AND FOSSIL FUELS \$3.6 BILLION

*Background*

In the existing tax code, certain oil, gas, coal and uranium producers receive a huge subsidy through the percentage depletion allowance. Companies participating in these activities can deduct or "write-off" capital investments. This "write-off" reflects the declining value of the mine or well. Companies that mine fuel minerals or drill for fossil fuels can deduct 10 percent for coal mining, 15 percent for oil and gas and 22 percent for uranium mining. Deductions for independent oil and gas companies can amount to 100 percent of the net income for a drilling operation. Coal and uranium mines can deduct up to 50 percent of their taxable income. In both instances, total deductions can frequently exceed the original investment costs of buying and preparing the land for resource extraction.

*Green Scissors Proposal*

Eliminate the percentage depletion allowance for uranium and fossil fuels, saving taxpayers more than \$3.6 billion over five years.

*Project Hurts Taxpayers*

The percentage depletion allowance distorts the market by attracting investments that could be used more productively elsewhere in the economy. Furthermore, since the deduction can amount to 100 percent of net income for oil and gas companies, and up to 50 percent for coal and uranium companies, these companies can experience significantly higher profits at the expense of taxpayers and the Treasury.

*Project Hurts Environment*

Environmental Protection Agency studies show that carbon emissions could be reduced by 1.1 million metric tons by the year 2010 simply by eliminating this tax break. This subsidy also encourages the mining of uranium, a highly toxic fuel. The result is more tailing piles, toxic byproducts and disturbed habitats.

*Background*

Currently, 70 percent of all bonds used to finance solid waste facilities are private activity bonds (PABs). The federal government treats interest income earned from these bonds as tax exempt. Businesses and individuals that invest in PABs can reap tremendous tax-free benefits. These bonds encourage state and local governments to build solid waste incinerator plants.

*Green Scissors Proposal*

Subject tax-exempt bonds sold to finance waste incinerators to the private-activity annual volume cap. This requirement would save taxpayers about \$600 million over five years.

*Project Hurts Taxpayers*

Tax-exempt bonds in general distort investment decisions. Because the interest from the bonds is tax-free, wealthy investors buy them to shelter income rather than buying taxable corporate bonds or stocks. Furthermore, this kind of tax break violates the "polluter pays" principle. The creators of solid waste, not taxpayers, should pay for its disposal.

*Project Hurts Environment*

Although waste incinerators are called "renewable" energy facilities by the 1980 tax bill, incinerators are not environmentally friendly. They emit harmful levels of highly toxic substances such as cadmium, lead, and dioxins into the air. The EPA is completing the rule-making process regarding safe emission levels for incinerators. Providing tax benefits for the construction of incinerators before incinerators have met environmental standards is ludicrous.

## DON'T REPEAT THE PAST

The excessive tax breaks described above are already entrenched in our tax policy and will only be reduced or removed with great political effort. However, energy proposals continue to focus on increasing domestic energy supplies and even though the tax code has been thoroughly squeezed to encourage the domestic energy industry tax breaks and subsidies continue to be the primary vehicle for this policy. The only long-term solution to our dependence on foreign oil is to attack our consumption, or demand, of oil. Changes in the tax code to encourage energy efficiency, alternate fuels, and energy conservation could make tremendous strides in breaking the cycle of increasing demand for oil based energy and our increasing dependence on foreign oil. Unfortunately the most recent comprehensive energy policy proposal, the National Energy Security Act of 2000, indicates that the primary focus remains utilizing the tax code to encourage domestic energy exploration regardless of its decreasing effectiveness and the heavy cost to the environment.

## NATIONAL ENERGY SECURITY ACT OF 2000

Senate Majority Leader Trent Lott (R-MS) and Energy and Natural Resources Committee Chairman Frank Murkowski (R-AK) are pushing legislation to stabilize the national energy situation. They have offered the National Energy Security Act of 2000 (S.2557) as the next step in U.S. energy policy. The legislation's purpose is to "decrease America's dependence on foreign oil sources to 50 percent by the year 2010," according to Murkowski. Unfortunately, the proposal is mostly a smorgasbord of energy policies that waste taxpayers money and support dirty energy sources. What follows is a summary of the bill and its impacts on environmental protection and land conservation.

## OIL DRILLING IN THE ARCTIC REFUGE

The most outrageous and controversial proposal in S. 2557 is Title 5, the "Arctic Coastal Plain Domestic Energy Security Act." This provision would open the coastal plain of the Arctic National Wildlife Refuge to oil and gas exploration. This proposal has been hashed and rehashed in the Congress for more than a decade. Bipartisan opposition to opening the wildlife refuge to oil development is strong because it is the largest untouched wildlife refuge in the country. The bill arbitrarily declares Title 5 as the final and absolute decision on drilling in the Arctic Coastal Plain using a 13-year-old environmental impact statement as evidence that the proposal is environmentally sound. Another provision gives responsibility of enforcing safety and environmental regulations to the U.S. Department of Interior rather than with the stricter Environmental Protection Agency. Title 7 of the bill promotes the explo-

ration drilling in sensitive areas by reducing the royalty or leasing costs associated with exploratory wells in the Outer Continental Shelf.

#### THROWING TAX DOLLARS DOWN A MARGINAL HOLE

Another major environmental concern with S.2557 is the range of new subsidies for marginal oil wells. Marginal oil wells are domestic oil producers that simply do not produce enough oil or gas to remain economically viable. Several provisions in the legislation give support for these poorly producing wells at the taxpayers expense. Title 8, "Tax Measures to Enhance Domestic Oil and Gas Production" provides tax credits for such wells and also allows expensing of oil and gas exploration costs and the delay of rental payments not otherwise chargeable to capital accounts.

#### IN PURSUIT OF POLLUTION

A variety of other provisions in the bill would also have serious environmental impacts. One section proposes that the Department of Energy issue grants for the developing and demonstration of coal liquefaction technology, including the design and construction of a plant capable of producing commercial quantities of liquefied coal. Coal liquefaction is one of the most polluting forms of liquid fuel.

#### GETTING THE MOST BANG FOR THE TAX BUCK

While the exact cost of the bill is unclear, many of the provisions in S.2557 will waste tax-dollars by delivering most of its benefits to the domestic fossil fuel industry, which already receives billions in tax breaks annually. Under current law, the fossil fuel industry will get more than \$7 billion between 2000 to 2004 in tax breaks. Donald Lubick, Assistant Secretary for Tax Policy of the Treasury Department recently testified that "the [tax] code has gone almost as far as it can go and each marginal tax reduction—is not going help many people." Meanwhile, provisions which focus on effecting energy demand, rather than supply, by attempting to encourage increased energy efficiency, such as the Energy Efficient Affordable Home Act of 1999 (HR. 1358) languish in Congress with no action taken.

#### ENVIRONMENTAL BENEFITS FEW AND FAR BETWEEN

S.2557 does contain a few provisions to promote more environmentally sustainable energy sources and energy conservation. Title 3, "Provisions to Protect Consumers and Low-Income Families and Encourage Energy Efficiency" expands the federal weatherization program and authorizes an Energy Efficiency Science Initiative within the Department of Energy. Other sections focus on consumer cost/price controls rather than demand reduction. The title includes an education program promoting increased purchase and storage of heating oil when prices are low as well as the establishment of a Northeast Home Heating Oil Reserve.

Title 9 focuses on expanding use of renewable energy, improving energy efficiencies and converting to clean burning fuels. A provision is included to expand the tax credit for renewable energy sources to include wind and biomass facilities, and electricity produced from steel cogeneration. Another provision provides a tax incentive for residential use of solar power. However, much of the bill's focus is on consumer cost control, with a provision to allow expensing costs associated with home heating oil storage. This provision might protect against high home heating cost but could also result in increased use of oil.

#### CONCLUSION

Friends of the Earth believes that the U.S. energy industry, especially the oil & gas companies, already receive excessive and wasteful tax subsidies. These policies were implemented in an effort to promote greater domestic energy production. Those earlier tax breaks, which were enormous, focused on the most effective methods of supporting these industries and over the years new layers of tax breaks and subsidies for the oil & gas industry have been added each with diminishing returns for the tax dollar cost. Yet years later we still face an increasing dependence on foreign oil. That is because we continue to ignore or provide only trivial support to those programs and policies that focus on altering our demand for oil through increased energy efficiency, alternate fuels and energy conservation.

There are some proposals and bills that address these energy issues correctly, although they are often limited in their scope and get little action within Congress, such as the Energy Efficient Affordable Home Act of 1999 mentioned above. The Clinton FY 2001 budget request provides a good example of a more appropriate direction for current energy policies with proposals including budget increases for energy-efficiency programs, tax credits for efficient homes and cars, and a \$200 million



**Clean Energy Initiative.** The budget proposes \$4 billion over five years worth of tax credits promoting energy-efficient homes and building equipment, vehicles powered by fuel cells, electricity, or gasoline hybrid engines, and a variety of renewable energy technologies. The new home credit has increased revenue expenditure with the addition of a third year of eligibility for the credit for homes with an efficiency rating of 30 percent beyond the 1998 International Energy Conservation Code.

Do not repeat the mistakes of the past, as the recent Energy Security Act of 2000 recommends, and give additional tax breaks to the oil and gas industry in blind hopes that it will drastically alter the domestic supply of oil. Instead of attempting to squeeze out the last bit of support for a single supply industry focus on altering, nation wide, the use of energy, especially oil and its by products. Begin to implement long-term solutions to the U.S. dependence on foreign oil by adding a new and effective level to the energy tax policy focusing on influencing how much and what types of energy we use. Friends of the Earth recommends exploring the tax code for the opportunities it contains to provide tremendous incentives to industries and individuals through the economy to increase energy efficiency, explore and utilize alternative energy sources, and conserve energy use whenever possible. Develop energy demand tax policies with the same comprehensive coverage, as the extensive energy supply tax policies already in place. Utilize that tax code to encourage and support the responsible and conservative use of energy as the next step in energy policy for the U.S. in the new millennium.

## STATEMENT OF THE NATIONAL CHILD SUPPORT ENFORCEMENT ASSOCIATION

### RESOLUTION ON FATHERHOOD INITIATIVES

(ADOPTED BY THE NCSEA BOARD OF DIRECTORS ON JULY 29, 2000)

#### *Introduction*

The 1996 PRWORA legislation established a new paradigm for U.S. social policy, making family self-sufficiency the ultimate goal of the welfare system. With the establishment of this time-limited and work-oriented family support system, the purpose of the Child Support program similarly evolved to give greater emphasis to promoting family self-sufficiency instead of the historical welfare cost recovery purpose. NCSEA endorses this change and supports policies and initiatives to promote responsible fatherhood as a path to family self-sufficiency.

Research increasingly shows that responsible loving fathers make a valuable contribution to the well-being of their children and to society; that a majority of unwed fathers and mothers are involved at the time of the birth of their child; and that young unwed fathers and mothers both need services in order to support their families. More than any other agency of state government, the Child Support program has the responsibility and is in a position to reach out to fathers who need supportive services, and to benefit by working cooperatively with fatherhood initiatives that provide these services. Child Support agencies are already involved in forging relationships with fathers through partnerships with community-based organizations. Further, Child Support agencies provide a natural link to coordinate with TANF agencies and with Workforce Development Boards to develop family self-sufficiency.

*Therefore, The National Child Support Enforcement Association (NCSEA) resolves that:*

Fathers are important to their families and low-income fathers need services to help them provide emotional and financial support.

Financial obligations for low-income fathers of fragile families must be based on ability to pay, including a realistic assessment of earning capacity.

The role of the IV-D agency in fatherhood initiatives is to participate in partnerships with community-based organizations and other public agencies to help fathers negotiate the Child Support system, rather than IV-D agencies directly providing such services.

Legislation is needed to fund community-based organizations to provide services for low-income fathers to help them establish paternity and meet their financial and emotional responsibilities and thereby promote child well-being.

The child support community should have an active participatory voice in all funding decisions related to initiatives designed to aid family self-sufficiency, especially with regard to the TANF, WIA and Welfare to Work programs.

### *Background*

Recent research has reinforced findings on the importance of fathers. It shows that responsible, loving fathers make a valuable contribution to the well-being of their children and to society. Children who grow up without a responsible father in their lives are more likely to be poor, to drop out of school, to end up in foster care or juvenile justice facilities, to bear their own children out-of-wedlock, and to be under-employed as adults. Research also shows that at the time of the birth four out of five unwed mothers and fathers are romantically involved, over half of unwed parents of low-income children are living together, and over two-thirds say their chances of marriage of 50-50 or better. Further, mothers reported that fathers provided support to them during the pregnancy, and over ninety percent of the mothers said they wanted the father to help raise the baby.

Finally, research shows that the profiles of young, unwed fathers are remarkably similar to those of the mothers. Of the poor non-custodial fathers who do not pay child support and the poor custodial mothers who do not receive child support, 43% of these fathers and mothers were high school dropouts. Additionally, 40% of these fathers had been out of work for up to 3 years, and 32% had been out of work for more than 3 years. Corresponding figures for mothers were 31% and 34% respectively. Finally, total family income was \$4,861 for fathers and \$7,408 for mothers. Thus, both partners need services to support to their children.

More than any other agency in state government, the child support program has a responsibility, and is in a position, to reach out to fathers, and to benefit from supporting fatherhood initiatives. As the Child Support program requires fathers to pay support, so it must also help them position themselves to be able to assume this responsibility. Fathers have a long-term responsibility for their children starting at birth. Under the PRWORA system of time-limited assistance to families, Child Support is the primary agency with long-term responsibility for children. Because of this, Child Support must work with both parents, and both parents must work with child support, to provide the best financial and emotional support possible. This must include a Child Support commitment to obligations based on current ability to pay and a realistic assessment of capacity to earn, as well as to expeditiously modify orders.

Child Support agencies are already involved in forging relationships with fathers through partnerships with community-based organizations providing services to fathers. This activity is often at the initiative of community-based organizations who recognize the importance of establishing paternity and paying child support as a key element of responsible fatherhood. Thus, child support agencies have learned the need to exercise flexibility in working with the fragile family population. They have also learned that the success in working with low-income fathers will help the Child Support program meet performance goals.

Child Support agencies provide a natural link to coordinate with TANF agencies and with Workforce Development Boards to develop family self-sufficiency. An effective fatherhood initiative for fathers of fragile families should be coordinated with the state TANF agency and the state Workforce Development Board so that there is a comprehensive strategy to develop self-sufficiency for the family. Child Support agencies already have such a relationship with the TANF agency, including computer data links between mothers and fathers, and are establishing relationships with the Workforce Development Boards. This linkage is crucial to the successful operation of a fatherhood initiative.

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#### STATEMENT OF THE NEWSPAPER AGENCY CORPORATION, THE SALT LAKE TRIBUNE/ DESERET NEWS

(SUBMITTED BY DOMINIC WELCH, PRESIDENT, NEWSPAPER AGENCY CORP.)

*Re: In Support of S. 2591*

Mr. Chairman and Members of the Committee, my name is Dominic Welch, President of Newspaper Agency Corporation, headquartered in Salt Lake City, Utah. I am pleased to offer this testimony supporting the "Alternative Fuels Tax Incentive Act" (S. 2591).

Each year Newspaper Agency Corporation vans travel about six million miles delivering *The Salt Lake Tribune and Deseret News* to hundreds of locations along the Wasatch Front. We began using alternative fuels in 1980. Since 1994, nearly 90% of our vans have been fueled by natural gas or propane. We made the decision to use alternative fuel vehicles (AFVs) for two main reasons: we believed that our

clean-fuel vans would help improve Utah's air quality and it would not cost any more to do so. Both assumptions are still true.

With the recent price increase in gasoline, we've become very concerned over our continued dependence on imported oil both from a national security standpoint and as a consumer. Our gasoline prices have increased from \$1.14 to \$1.64 during the last seven months, a 70% increase. This volatile price increase could cause major cash flow disruptions in our operations.

Due to the 232 natural gas vehicles we operate in our Salt Lake City location, we have the convenience of a refueling station on sight which costs us \$.70 per equivalent gallon and generates approximately \$20,000 per month in fuel savings.

We are also concerned with the continuous population growth in Utah and its impact on the environment and quality of life in Utah. Vehicle emissions contribute more than 50 percent of the air pollution along the Wasatch Front. As a result of this growth, the Wasatch Front continues to fall in non-attainment status. AFVs can provide a significant role in reducing our dependence on imported oil, while improving our air quality. Also, AFVs will work in conjunction with the newly I-15 reconstruction to improve air quality.

The "Alternative Fuels Tax Incentive Act" is necessary to legislation to help jump start the AFV market through adequate incentives for all consumers. We look to these incentives to generate more AFV demand to improve economies of scale, which will allow manufacturers to reduce the cost of AFVs.

Mr. Chairman and Members of the Committee, Newspaper Agency Corporation commends the sponsors of this bill for recognizing the win-win opportunities for all communities through the use of AFVs...promoting national security, cleaner air, and potential fuel savings that all Americans can benefit from.

With the 2002 Olympic games approaching, we need to work on contributing to the success of the games, including having clean air, a high priority for all residents of Utah. Newspaper Agency Corporation endorses this legislation for these reasons and hopes Congress will see fit to enact the legislation for the benefit of all.

Thank you for this opportunity to provide this testimony.

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STATEMENT BY QUESTAR CORP.

(SUBMITTED BY CURT BURNETT, VICE PRESIDENT, PUBLIC AFFAIRS)

*Re: In Support of S. 2591*

Mr. Chairman, my name is Curt Burnett. I am Vice President of Public Affairs for Questar Corporation, a \$2.3 billion corporation headquartered in Salt Lake City, Utah. I am pleased to offer this testimony on behalf of Senator Hatch's legislation.

Questar is one of the West's leading diversified natural gas companies. Our operations include oil and gas exploration and production; gas gathering and processing; interstate gas transmission and storage; marketing; retail gas distribution; and telecommunication and information technologies.

Our subsidiary, Questar Gas, provides service to nearly 700,000 customers in Utah and portions of Wyoming and Idaho.

The company currently operates a fleet of some 750 compressed natural gas vehicles (NGVs) and has constructed an extensive refueling infrastructure throughout the service territory. In fact, our NGV infrastructure—in terms of numbers of refueling stations—ranks only behind Georgia, Texas and California. This represents a major commitment by a comparatively small company in a small state to clean, alternative fuels. WE believe natural gas and other alternative fuels have a significant role to play in meeting the growing need for transportation fuels, reducing our dependence on foreign oil, and improving the quality of the air we breathe. We commend Senators Hatch and Jeffords for introducing legislation that will provide a critical shot in the arm for reaching the important objectives.

This legislation is especially important in helping fast-growing metropolitan areas, such as Utah, to cope with deteriorating air quality. Utah is growing at about twice the national average, and we are in the midst of a massive \$1.5 billion project to expand our freeway system to accommodate this growth. We commend Senator Hatch and the other members of the Utah Congressional delegation for obtaining the necessary federal funding for this project. We also commend Senator Hatch for recognizing that expanded freeways inevitably mean more traffic and higher automobile emissions, and for introducing S. 2591 as a solution. In Utah, the major remaining source of pollution is not from stationary sources, but from gasoline and diesel-fueled vehicles.

S. 2591 will provide necessary incentives to encourage greater numbers of individuals, businesses and local and state governments to purchase clean-fuel vehicles. Interestingly, if only 5% of Utah's 1.4 million cars and trucks were converted to NGVs, the pollution reduction would help assure that the metropolitan area would remain in attainment under the Clean Air Acts National Ambient Air Quality Standards for years to come. I would suspect that the same could be said for many other urban areas around the country. There is no other single piece of legislation before this Congress that offers such immediate and tangible benefits for air-quality improvement.

With regard to the other major benefit of S. 2591—reducing our dependence on foreign oil—natural gas is a North American fuel. More than 95% of our natural gas comes from the United States and Canada through ultra-efficient pipeline and distribution systems. As we use more natural gas—to heat our homes, generate electricity and fuel our cars—we are helping to improve our balance of trade. From a pure economics standpoint, government should be doing everything possible to provide incentives for greater natural gas use—and S. 2591 is an important step.

From a consumer standpoint, Jeffords-Hatch will make it possible for millions of Americans to afford to switch to clean-fuel vehicles. Consumers will also benefit from the significantly lower cost of natural gas at the pump and lower operating costs. In addition, rising consumer demand for clean-fuel vehicles will create economies of scale for manufacturers and eventually lower vehicle purchase prices.

Mr. Chairman, Questar commends the sponsors of the bill for recognizing the need to provide intelligent tax incentives to move America down the road toward cleaner air and energy security. Thank you.

#### STATEMENT OF THE SOLID WASTE ASSOCIATION OF NORTH AMERICA (SWANA)

[SUBMITTED BY JOHN H. SKINNER, PH.D., EXECUTIVE DIRECTOR AND CEO]

The Solid Waste Association of North America (SWANA) appreciates the opportunity to submit this statement for inclusion in the record of the above referenced hearing. SWANA is a membership organization composed of over 6700 solid waste management professionals in the public and private sectors of the United States and Canada. One of SWANA's objectives is to support federal policies that advance the practice of environmentally and economically sound solid waste management, including practices that provide energy related benefits and environmental benefits to the communities served by our members. Accordingly, SWANA wants to take this opportunity to describe a particular solid waste management practice that can promote the use of alternative fuel vehicles: the capture and utilization of landfill gas as a vehicle fuel. However, the feasibility of constructing new projects that can produce this alternative vehicle fuel at the nation's many landfills depends on the availability of a federal tax incentive.

##### *Landfill Gas and Its Utilization*

Landfill gas (LFG) is created when the organic waste material disposed in a municipal solid waste landfill naturally decomposes. The gas, if left uncontrolled, is odorous, a potential fire hazard and adversely impacts air quality. Landfill gas is approximately 50% methane, the primary component of natural gas, which is a greenhouse gas 21 times more potent than CO<sub>2</sub>. Congress recognized the energy value of LFG and encouraged construction of projects that collect and make the gas available for energy uses by qualifying these projects for the non-conventional fuel production tax credit under Section 29 of the tax code. As a result, there are currently 300 such LFG projects operating in the United States, two thirds of which generate electricity. The remaining third of these LFG projects are "direct gas use projects" that sell the gas as a supplement to natural gas supplies or as a fuel for heating, industrial boilers, other commercial and industrial purposes where fossil fuel is normally used and, recently, for fuel cells and for clean burning vehicles. The 300 LFG projects provide over 110 trillion BTUs of energy annually.

Most of the 300 existing LFG projects came on line before EPA issued a Clean Air Act (CAA) regulation requiring owners of larger landfills to put gas collection systems in place, once their landfill emissions exceed a specified level, and to simply flare the gas into the atmosphere. Of course, installation of a LFG project is a superior option since it conserves this valuable energy resource, maximizes its capture and can generate revenue to defray the cost of the collection system. Even after the CAA regulations were promulgated, the incentive of the Section 29 tax credit resulted in LFG projects being installed at the larger landfills years before the emis-

sion threshold specified in the regulations occurs, as well as at the numerous landfills not subject to the CAA.

EPA has estimated that there are 500 additional LFG projects that potentially could be placed in service at the nation's landfills. Over a third of the new LFG projects would be direct gas use projects since many of the larger landfills, where LFG is generated in amounts needed to justify generation of electricity, have already been tapped for this purpose. The 500 LFG projects could provide an additional 170 trillion BTUs of energy a year.

#### *Landfill Gas as an Alternative Vehicle Fuel*

At the District's Puente Hills landfill, LFG is used to generate electricity and provide a nearby college with boiler fuel. Excess LFG, which previously was flared, is now processed into a compressed natural gas (CNG) for use as a gasoline and diesel fuel substitute to power the District's vehicles, off-road heavy duty equipment and a limited number of refuse trucks. The District's CNG project uses 250 cfm of LFG collected and made available from the landfill. The LFG is dewatered, purified by membrane separation technology, and pressurized to produce 100 cfm of high quality CNG containing an average of 97.5% methane. The fuel is stored at high pressure in steel cylinders and dispensing from equipment which is designed for automatic, unattended outdoor operation. The CNG complies with the specifications of the California Air Resources Board's specifications for compressed natural gas and can be used in any natural gas vehicle. The 150 cfm of waste gas (28% methane) is sent to the electric generating project.

The total cost of the District's CNG processing facility was approximately \$1 million and can produce a clean alternative vehicle fuel at an equivalent gasoline cost in the range of \$.50 to \$1.00 per gallon. These costs, however, do not reflect the significant cost of the wells, piping, equipment and other infrastructure needed to collect and supply the LFG gas to the CNG facility. These additional costs have generally made collection and supplying LFG for energy uses uneconomical in the absence of the Section 29 tax credit.

#### *Need for A Tax Credit Incentive*

The tax credit for LFG projects under Section 29 is not available for new LFG projects if placed in service after June 30, 1998. The feasibility of installing additional LFG projects at municipal solid waste landfills, however, and the multiple environmental and energy benefits they produce, depends on the continued availability of a federal tax credit. Since the June 30, 1998 deadline, no new LFG projects have been brought on line. At the same time, Congress has resisted extending Section 29.

Last year the Senate twice approved a tax provision making the tax credit of Section 45 of the tax code available to LFG projects that produce electricity. Each time the provision was dropped in negotiations with the House. Section 45 currently provides a 1.7¢/kW-hr tax credit for electricity generated by wind, closed-loop biomass and poultry waste projects. Under Section 29, LFG projects producing gas to generate electricity and those that make the gas directly available as an alternative fuel were both eligible for the tax credit. The majority of the approximately 100 existing direct-gas use LFG projects, including the project located at the Puente Hills landfill, were made feasible by the Section 29 tax credit, as were the existing LFG projects at which electricity is generated. Accordingly, SWANA and the LFG industry have proposed that LFG projects producing the gas for direct use, such use as an alternative vehicle fuel, also be allowed to qualify for the Section 45 tax credit on a "kW-hr equivalent" basis, where each 10,000 BTUs used would be the equivalent to 1 kW-hr of electricity produced.

#### *Conclusion*

Landfill gas-to-energy projects have a multitude of environmental and economic benefits, including reducing the U.S. reliance on foreign oil. Landfill gas can be used as an alternative vehicle fuel. However, new projects to collect and process the LFG before it can be used as a fuel, will be economical only if a tax credit is provided to replace the expired Section 29 tax credit. A tax credit would spur development and refinement of new vehicle engines that can more easily utilize the LFG as a fuel. It would also spur continued refinement of fuel cell technology, which has the potential of powering vehicles, that can use LFG as a source of hydrogen.

Consequently, SWANA urges the Members of the Senate Finance Committee to amend Section 45 this year so its tax credit can be used to incentivize construction of new LFG projects. Importantly, if development of alternative vehicle fuel is a national objective, the Section 45 tax credit should be provided not only to LFG projects at which electricity can be generated, but also to LFG projects that provide the gas for direct use, such as use as an alternative fuel for vehicles.

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## Why Alternative Fuels?

*Jason Mark*  
www.ucsusa.org

May 10, 2000

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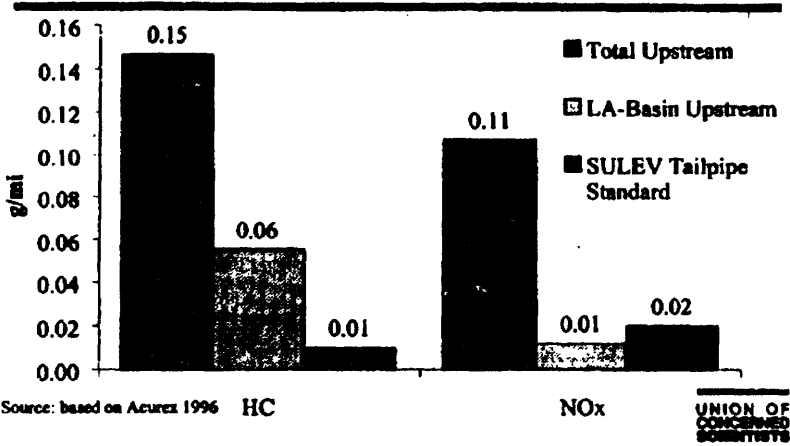
## The Transportation Challenge

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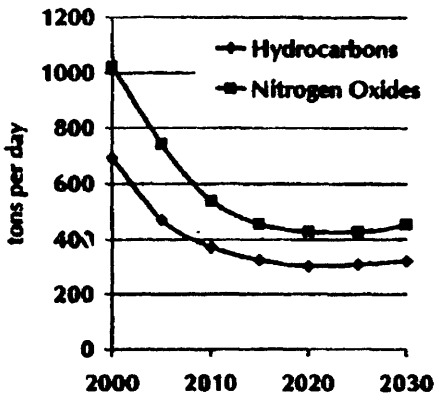
- **Air Quality**
  - 1 in 2 Americans breathe unhealthy air
  - motor vehicles contribute >50% to urban pollution
  - *new health standards en route*
- **Climate Change**
  - transportation accounts for 1/3 of US carbon emissions
  - fastest-growing energy sector in carbon contribution
  - *Kyoto Protocol*
- **Oil Dependence**
  - US imports 1/2 of oil it consumes
  - direct value of oil imports: \$180,000/minute
  - *impending production peak?*

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## Upstream Emissions from Gasoline Vehicles

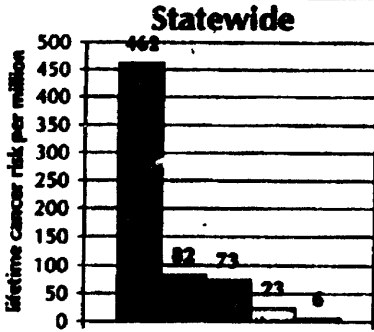


## Future Air Quality Challenge *Highway Vehicle Emissions, LA Basin*

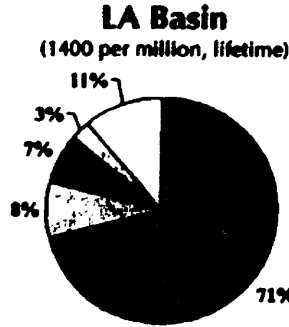


- Projected emissions, including new tailpipe standards
  - Autos: 99% reduction vs. pre-control emissions
  - Trucks: 85% control
- Rising vehicle travel offsets new regulations

# Air Toxics Cancer Risk



Source: CARB



Source: SCAQMD

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## Climate Change Challenge

- Climate Change and the US transportation sector
  - Transportation accounts for 1/3 of US carbon emissions
  - Motor vehicles (light-duty vehicles and freight trucks) account for 1/4 of US carbon emissions
- US transportation sector breakdown, CO<sub>2</sub> Emissions\*
  - Cars and Light Trucks 58%
  - Freight Trucks 16%
  - Aircraft 13%
  - Other 13%
  - US light-duty vehicle sector alone emits 1/5 of US carbon emissions, more CO<sub>2</sub> than the total emissions of all but three countries in the world (China, Russia, Japan), and about as much as Germany

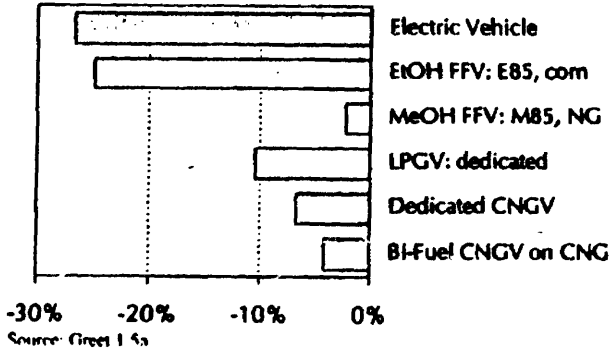
\* Jeff Allen, "Light-Duty Policy Issues in a Post-Kyoto World", presentation at NAMVECC '98, 3/25/98.

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## Greenhouse Gas Emissions Benefits from Today's AFVs

Changes in Greenhouse Gas Emissions  
(vs. Today's Gasoline Vehicle)



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## Environmental Benefits of AFVs

- **Air Quality**
  - **Vehicle Emissions**
    - Intrinsically cleaner burning
    - Evaporative benefits for many fuels
    - Potential toxics savings
  - **Upstream Emissions**
- **Water Quality**
  - Oil spills
  - MTBE
- **Climate Change**
  - Immediate savings
  - Pathway to lower-carbon fuels
- **Energy Security**
  - Fuel diversity
  - Consumer protection

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STATEMENT OF THE STATE OF UTAH, DEPARTMENT OF COMMUNITY & ECONOMIC DEVELOPMENT DIVISION OF COMMUNITY DEVELOPMENT OFFICE OF ENERGY SERVICES

(SUBMITTED BY LISA YODER, ALTERNATIVE FUELS AND TRANSPORTATION PROGRAM MANAGER, STATE OF UTAH)

*Re: In support of S. 2591*

Mr. Chairman and Members of the Committee, my name is Lisa Yoder. I am the Alternative Fuels and Transportation Program Manager for the Utah Office of Energy Services and am pleased to offer this testimony on behalf of Senator Hatch's proposed legislation.

As Alternative Fuels and Transportation Program Manager at the Utah Office of Energy Services, the bottom line of resistance to driving clean fuel vehicles is a financial one. Legislation S. 2591 will significantly reduce that financial barrier. The result will be a substantial contribution to replace gasoline and diesel-burning vehicles with dedicated clean fuel vehicles.

A well-established fact, mobile sources generate more than 50 percent of the air pollution along the Wasatch Front, home to more than 75 percent of Utah's population who look through a brown haze of pollution on a regular basis. The Wasatch Front continues to fall in non-attainment status, a measure we can identify with. But let's look at it from a simpler perspective: If we make a mess, we clean it up. It's the right thing to do!

Cars pollute—we must clean them up. And it costs money to get the technology out of the research stages (for the third time around since the oil crisis in the 70's) and into automotive production lines. This legislation will provide the necessary incentives to motivate consumers and offset the incremental costs. The rewards are many: clear views, clean air to breathe, and reduced dependence on imported oil.

The Utah Office of Energy Services endorses this legislation and encourages Congress to enact the legislation for the benefit of all.

STATEMENT OF THE STATE OF UTAH, DEPARTMENT OF ADMINISTRATIVE SERVICES

(SUBMITTED BY STEVEN W. SALTZGIVER, DIRECTOR, DIVISION OF FLEET OPERATIONS)

*Re: In support of S. 2591*

Mr. Chairman and Members of the Committee my name is Steven W. Saltzgiver. I am Director for The Division of Fleet Operations for the Department of Administrative Services, Salt Lake City, Utah and am pleased to offer this testimony on behalf of Senator Hatch's proposed legislation.

The Division of Fleet Operations provides a various array of fleet services to many State agencies. We currently manage over 4,500 light duty vehicles, 500 which are equipped with an alternative fuel option. We support the Alternative Fuel programs.

*Issue 1: How the proposed legislation could benefit the State of Utah*

We are very concerned over our continued dependence on imported oil both from a national security standpoint and as a consumer. Our State gasoline prices have increased from .8115 to 1.327 during the last 12 months, a 64% increase. This exponential price increase causes major cash flow disruptions in our operations. This cost increases taxes of all the Utah citizens.

Natural gas sells for 70.1 cent per equivalent gallon which saves us approximately \$7,512.00 per month based on current average prices of 1.327 and using 12,000 gallons per month.

*Issue 2: How the proposed legislation can benefit our community*

Because of the tremendous population growth in Utah, environmental protection has moved to the forefront of Utah's agenda.

Mobile source pollution contributes more than 50 percent of the air pollution along with Wasatch Front, an area that houses more than 75 percent of Utah's population.

The Wasatch Front continues to fall in non-attainment status, clearly, there is still work to be done.

AFVs provide a significant role in reducing our dependence on imported oil, while improving our air quality.

AFVs can assist in improving air quality in Utah. In conjunction with the newly I-15 reconstruction AFVs can continue to improve air quality.

The reconstruction of I-15 freeway is but the first step toward a long-term solution to improving our quality of life in our communities.

*Issue 3: Passage of Legislation*

This legislation will help jump start the AFV market and will obtain a sustainable market for all consumers.

Incentives for AFVs allow all consumers to afford AFVs and with improved economies of scale, manufacturers will be able to reduce the cost of AFVs to all consumers.

Mr. Chairman, Fleet Operations commends the sponsors of the bill for recognizing the win-win opportunity for all communities through the use of AFVs . . . promoting national security, cleaner air, and potential fuel savings. All Americans benefit.

AFV incentives will encourage the citizens of all states to make environmentally sound transportation choices for the 21st century that meet price, performance and other needs.

Cleaner air, decreased amounts of imported oil, and expanded competition in the motor fuel market means everyone wins.

As the 2002 Olympic games approach, we want to do everything possible to contribute to the success of the games, including having clean air, a high priority for all residents of Utah.

State of Utah, Fleet Operations endorses this legislation for these reasons and hope Congress will see fit to enact the legislation for the benefit of all.

Thank you for this opportunity to provide this testimony.

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STATEMENT OF SWIRE COCA-COLA, USA

(SUBMITTED BY JEFF EDWARDS, VICE PRESIDENT OF DISTRIBUTION)

*Re: In support of S. 2591*

Mr. Chairman and Members of the Committee, my name is Jeff Edwards, Vice President of Distribution for Swire Coca-Cola, USA in headquartered in Draper, Utah. I am pleased to offer this testimony on behalf of Senator Hatch's proposed legislation.

Swire Coca-Cola, USA is a producer/distributor of soft drink products in the ten western United States. We employ 1700 people and use over 1000 vehicles in all of our operations. For six years we have operated 35 CNG light duty vehicles and 40 CNG forklifts. We also have onsite CNG refueling at three of our locations in Utah and Idaho.

We are very concerned over our continued dependence on imported oil both from a national security standpoint and as a consumer. Our gasoline prices have increased by more than 40 percent during the past 12 months. This exponential price increase creates serious strains on our bottom line profitability. Because of our on-site refueling capabilities, our CNG cost is \$0.56 per equivalent gallon, a tremendous savings over fossil fuels.

Because of the tremendous population growth in Utah, environmental protection has moved to the forefront of Utah's agenda. Mobile source pollution contributes more than 50 percent of the air pollution along the Wasatch Front, an area that houses more than 75 percent of Utah's population. Since the Wasatch Front continues to fall into non-attainment status, there is still much work to be done.

AFVs provide a significant role in reducing our dependence on imported oil, while improving our air quality. AFVs can assist in improving air quality in Utah. In conjunction with the I-15 reconstruction, AFVs can continue to improve air quality. The reconstruction of I-15 freeway is but the first step toward a long-term solution to improving our quality of life in our communities.

This legislation will aid in advancing the AFV market and will obtain a sustainable market for all consumers. Incentives will make AFVs more affordable to all consumers. Further, with improved economies of scale, manufacturers will be able to reduce the cost of AFVs to all consumers.

Mr. Chairman, Swire Coca-Cola, USA commends the sponsors of the bill for recognizing the importance of and positive opportunities through the use of AFVs. AFV incentives will encourage the citizens of all states to make environmentally sound transportation choices for the 21st century that meet price, performance and other needs. Cleaner air, decreased amounts of imported oil, and expanded competition in the motor fuel market means everyone wins.

As the 2002 Olympic games approach, we want to do everything possible to contribute to the success of the games, including having clean air. This is a high priority for all residents of Utah.

Swire Coca-Cola, USA endorses this legislation and hopes that Congress will see fit to enact the legislation for the benefit of all.

Thank you for this opportunity to provide this testimony.

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STATEMENT OF THE UTAH TRANSIT AUTHORITY

(SUBMITTED BY ANDREW L. GALLEGOS, MARKETING MANAGER)

*Re: In support of S. 2591*

Mr. Chairman and Members of the Committee, I am Andrew L. Gallegos, Marketing Manager for the Utah Transit Authority (UTA) of Salt Lake City, Utah and am pleased to offer this testimony on behalf of Senator Hatch's proposed legislation.

The Utah Transit Authority is the sole mass transit entity providing light rail, bus, special needs and van pooling transportation services to approximately 1.5 million people living within the Wasatch Front which encompasses the Ogden, Salt Lake and Provo, Utah metropolitan areas.

Mobile source pollution contributes more than 50 percent of the air pollution along the Wasatch Front and the UTA has made significant strides in our attempts to reduce its portion of mobile source pollution. To this end we have completed the first light rail system along the Wasatch Front and are beginning construction of the first spur to that line. We joined with our local utility and the State of Utah in 1992 in a pilot project and purchased 5 natural gas powered buses. The lessons learned from that cooperative effort have aided many in taking the necessary steps toward creating cleaner-burning, more energy efficient transit buses. In 1999 UTA Rideshare purchased 10 natural gas vans for our vanpool program and all are currently leased by companies or employee groups.

As I am certain you are aware, however, the Wasatch Front continues to fall in non-attainment air quality status. Clearly this is an indication that there is still work to be done. The proposed Alternative Fuels Tax Incentives Act (S. 2591) is a vital tool in assisting Utah in coping with its tremendous population growth and the associated environmental challenges that come with population increases. The UTA views this legislation as an integral building block for the foundation of a cleaner environment within our community.

In addition, the current pricing of standard vehicle fuels has clearly shown that as a Nation we must strive to do everything in our power to reduce our continued dependence on imported oil both from a national security standpoint and as a consumer. Alternative Fuel Vehicles (AFV's) will provide a significant role in reducing our dependence on imported oil, while improving our air quality.

We are all cognizant of the fact that nothing comes without a price and the building blocks of a clearer environment are no exception. The price of AFV's are significantly higher than those of their standard fuel counterparts and any incentive which will aid the consumer in embracing a clean-air solution for our environment is a tremendous step toward returning not only the Wasatch Front but hundreds of communities in this Nation to the pristine environs which are forefathers enjoyed not-so-many years ago.

Mr. Chairman, the Utah Transit Authority commends you all for recognizing the great opportunity which this legislation affords all our communities by aiding to clear the air, promote energy independence and lowering the cost of "doing the right thing" for every American.

The UTA clearly embraces this legislation and is hopeful that Congress will see fit to enact the legislation for the benefit of all.

Thank you for this opportunity to provide this testimony.

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STATEMENT OF WASATCH CLEAN AIR COALITION

(SUBMITTED BY KATHY VAN DAME, DVD.KVD@JUNO.COM)

Mr. Chairman and Members of the Committee:

Since 1990, the Wasatch Clean Air Coalition (WCAC) has worked to improve air quality along the Wasatch Front in Utah through educating ourselves and others, exploring and promoting less polluting ways of doing things, monitoring, and providing input for the Utah Division of Air Quality, working with other organizations, identifying and taking helpful actions. Part of our efforts has been to promote the use of alternative fuel vehicles, primarily for their significant air quality benefits, but also for benefits to national security by decreasing dependence on foreign oil.

There is a growing awareness in Utah's Division of Air Quality, and among the environmentally aware that the area of mobile sources is the next big challenge. All the easy things have been done to improve air quality. Though overall air quality has improved over the past several decades, rapidly increasing vehicle miles driven will soon overtake improvements and we will be in worse shape than before.

Clean fuel vehicles emit vastly less pollutants than standard gasoline and especially diesel powered vehicles. Clean fuel vehicles are one part of what will have to be a multi-faceted approach to the problem of providing our citizens healthy air to breathe.

We are grateful for the opportunity to provide testimony on behalf of the "Alternative Fuels Tax Incentives Act" (S. 2591). This bill will have the effect of replacing high emission vehicles with clean fuel burning vehicles. We believe this tax incentive will have a strong positive impact on our air quality. That improved air quality will benefit the health of all citizens, especially our vulnerable youngest, oldest, and chronically ill.

Thank you for this opportunity to provide input on this important bill.

