



600 PENNSYLVANIA AVE SE  
SUITE 220  
WASHINGTON DC 20003

202.548.0111 p  
www.capalphadc.com

## **Congress Rewards BP for Bad Behavior**

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**James P. Lucier, Jr. and Robert J. Kaminski**

[james.lucier@capalphadc.com](mailto:james.lucier@capalphadc.com)

(202) 548-0072

**Key takeaway:** Call it the “BP Business Advancement Act.” That’s a good way to think of the so-called “dual-capacity taxpayer” language likely to clear the Senate this week or next.

It is one of several oil and gas tax hikes likely to be used as pay-fors in Senate energy legislation that may surface as soon as today.

The “dual-capacity” tax hike sounds like a purely technical tax change that has the effect of nicking big oil companies for a little additional revenue.

In fact, the tax hike is a form of double taxation. It can profoundly and permanently impact project economics outside the U.S., putting U.S. companies at a competitive disadvantage relative to BP and other non-U.S. based companies.

### **Discussion:**

Astonishing as it may seem, Congress is about to reward BP for its bad behavior and penalize U.S.-based firms for their exemplary safety records.

You could call it the “BP Business Advancement Act.” Congress will give BP a permanent tax advantage that will help it muscle aside its U.S. rivals in drilling deepwater wells around the world.

That’s what the so-called “dual-capacity taxpayer” provision does. It’s language likely to be included in the Senate oil spill response legislation to be introduced today.

### **How It Works**

The United States taxes U.S.-based companies on their worldwide income. Then, to avoid taxing the same income stream twice, it gives U.S. companies a credit for taxes paid overseas. It’s all supposed to net out.

But in foreign countries, U.S. majors often don’t pay a generally applicable corporate income tax. They pay a special oil industry tax or other levy spelled out in the terms of their production sharing agreements (PSAs).

The dual-capacity taxpayer provision says that if you pay an oil industry tax instead of the corporate income tax (that may not even exist in an underdeveloped economy) you don’t get the credit for foreign taxes paid.

It’s a form of flat-out double taxation. U.S.-based majors such as ExxonMobil, Chevron, or ConocoPhillips

would pay tax on the same income stream twice. Once to the foreign government and once again the United States.

Non-U.S. oil companies, such as BP, Shell, Total, or even PetroChina would thus have a permanent tax advantage over U.S. companies.

### **Measuring the Impact**

The Treasury Green Book says the dual-capacity taxpayer provision raises \$8.5 billion over the ten years from 2011 to 2020 and \$676 million in 2011. We regard these numbers as highly suspect for a number of reasons, but we will accept them as “illustrative” or “indicative” for purposes of this discussion. They are just not exact.

In the near term, budget scores from the Treasury Department and the Congressional Joint Tax Committee may be reasonably close to reality because scores for tax changes that impact only a small number of companies can be based on actual tax returns. But scores are unreliable in the out years as companies have more opportunity to restructure or exit businesses.

However, revenue impact to the U.S. government in year 1 is almost irrelevant to the business impact as this permanent tax change goes into effect.

Consider the impact on future business. A U.S. firm bidding against BP for a contract with a foreign sovereign is now less competitive going forward.

Consider the impact on existing business. The economics of an existing project may be uncompetitive.

### **Hypothetical Case: Qatar**

An oil industry source offered the example of Qatar, where the effective tax rate paid by a U.S. company developing natural gas is about 35%. With the dual-capacity tax hike, the U.S. tax company would pay an effective rate of 50%, we hear.

This not only makes the U.S. company uncompetitive for future deals, but it also profoundly impacts the economics of existing projects.

In this case, raising the effective tax rate 15 percentage points would lop off about a quarter—or 23%—of after-tax earnings. Depending on the commodity price environment, this could make plenty of projects uneconomic, in our view.

We’re looking for other examples to see if the numbers check out. But if this particular comparison holds true, BP or PetroChina could make a dollar after-tax on a project that would pay a U.S. company only 77 cents.

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