

108TH CONGRESS  
1ST SESSION

# S. 696

To amend the Internal Revenue Code of 1986 to allow a tax credit for marginal domestic oil and natural gas well production and an election to expense geological and geophysical expenditures and delay rental payments.

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## IN THE SENATE OF THE UNITED STATES

MARCH 24, 2003

Mrs. HUTCHISON (for herself, Mr. BREAUX, Ms. COLLINS, Mr. DOMENICI, Mr. BAUCUS, Ms. LANDRIEU, Mr. CHAFEE, Mr. ALLARD, Mr. INHOFE, Mr. LOTT, and Mr. THOMAS) introduced the following bill; which was read twice and referred to the Committee on Finance

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## A BILL

To amend the Internal Revenue Code of 1986 to allow a tax credit for marginal domestic oil and natural gas well production and an election to expense geological and geophysical expenditures and delay rental payments.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. TAX CREDIT FOR MARGINAL DOMESTIC OIL**  
4 **AND NATURAL GAS WELL PRODUCTION.**

5 (a) PURPOSE.—The purpose of this section is to pre-  
6 vent the abandonment of marginal oil and gas wells re-

1 sponsible for half of the domestic production of oil and  
 2 gas in the United States.

3 (b) CREDIT FOR PRODUCING OIL AND GAS FROM  
 4 MARGINAL WELLS.—Subpart D of part IV of subchapter  
 5 A of chapter 1 of the Internal Revenue Code of 1986 (re-  
 6 lating to business credits) is amended by adding at the  
 7 end the following new section:

8 **“SEC. 45G. CREDIT FOR PRODUCING OIL AND GAS FROM**  
 9 **MARGINAL WELLS.**

10 “(a) GENERAL RULE.—For purposes of section 38,  
 11 the marginal well production credit for any taxable year  
 12 is an amount equal to the product of—

13 “(1) the credit amount, and

14 “(2) the qualified crude oil production and the  
 15 qualified natural gas production which is attrib-  
 16 utable to the taxpayer.

17 “(b) CREDIT AMOUNT.—For purposes of this sec-  
 18 tion—

19 “(1) IN GENERAL.—The credit amount is—

20 “(A) \$3 per barrel of qualified crude oil  
 21 production, and

22 “(B) 50 cents per 1,000 cubic feet of  
 23 qualified natural gas production.

24 “(2) REDUCTION AS OIL AND GAS PRICES IN-  
 25 CREASE.—

1           “(A) IN GENERAL.—The \$3 and 50 cents  
 2 amounts under paragraph (1) shall each be re-  
 3 duced (but not below zero) by an amount which  
 4 bears the same ratio to such amount (deter-  
 5 mined without regard to this paragraph) as—

6                   “(i) the excess (if any) of the applica-  
 7 ble reference price over \$15 (\$1.67 for  
 8 qualified natural gas production), bears to

9                   “(ii) \$3 (\$0.33 for qualified natural  
 10 gas production).

11           The applicable reference price for a taxable  
 12 year is the reference price for the calendar year  
 13 preceding the calendar year in which the tax-  
 14 able year begins.

15           “(B) INFLATION ADJUSTMENT.—In the  
 16 case of any taxable year beginning in a calendar  
 17 year after 2004, each of the dollar amounts  
 18 contained in subparagraph (A) shall be in-  
 19 creased to an amount equal to such dollar  
 20 amount multiplied by the inflation adjustment  
 21 factor for such calendar year (determined under  
 22 section 43(b)(3)(B) by substituting ‘2003’ for  
 23 ‘1990’).

1           “(C) REFERENCE PRICE.—For purposes of  
 2           this paragraph, the term ‘reference price’  
 3           means, with respect to any calendar year—

4                   “(i) in the case of qualified crude oil  
 5                   production, the reference price determined  
 6                   under section 29(d)(2)(C), and

7                   “(ii) in the case of qualified natural  
 8                   gas production, the Secretary’s estimate of  
 9                   the annual average wellhead price per  
 10                  1,000 cubic feet for all domestic natural  
 11                  gas.

12          “(c) QUALIFIED CRUDE OIL AND NATURAL GAS  
 13 PRODUCTION.—For purposes of this section—

14                  “(1) IN GENERAL.—The terms ‘qualified crude  
 15                  oil production’ and ‘qualified natural gas production’  
 16                  mean domestic crude oil or natural gas which is pro-  
 17                  duced from a qualified marginal well.

18                  “(2) LIMITATION ON AMOUNT OF PRODUCTION  
 19 WHICH MAY QUALIFY.—

20                  “(A) IN GENERAL.—Crude oil or natural  
 21                  gas produced during any taxable year from any  
 22                  well shall not be treated as qualified crude oil  
 23                  production or qualified natural gas production  
 24                  to the extent production from the well during

the taxable year exceeds 1,095 barrels or barrel equivalents.

“(B) PROPORTIONATE REDUCTIONS.—

“(i) SHORT TAXABLE YEARS.—In the case of a short taxable year, the limitations under this paragraph shall be proportionately reduced to reflect the ratio which the number of days in such taxable year bears to 365.

“(ii) WELLS NOT IN PRODUCTION ENTIRE YEAR.—In the case of a well which is not capable of production during each day of a taxable year, the limitations under this paragraph applicable to the well shall be proportionately reduced to reflect the ratio which the number of days of production bears to the total number of days in the taxable year.

“(3) DEFINITIONS.—

“(A) QUALIFIED MARGINAL WELL.—The term ‘qualified marginal well’ means a domestic well—

“(i) the production from which during the taxable year is treated as marginal production under section 613A(c)(6), ex-

cept that ‘22 degrees’ shall be substituted  
for ‘20 degrees’ in applying subparagraph  
(F) thereof, or

“(ii) which, during the taxable year—

“(I) has average daily production  
of not more than 25 barrel equiva-  
lents, and

“(II) produces water at a rate  
not less than 95 percent of total well  
effluent.

“(B) CRUDE OIL, ETC.—The terms ‘crude  
oil’, ‘natural gas’, ‘domestic’, and ‘barrel’ have  
the meanings given such terms by section  
613A(e).

“(C) BARREL EQUIVALENT.—The term  
‘barrel equivalent’ means, with respect to nat-  
ural gas, a conversion ratio of 6,000 cubic feet  
of natural gas to 1 barrel of crude oil.

“(d) OTHER RULES.—

“(1) PRODUCTION ATTRIBUTABLE TO THE TAX-  
PAYER.—In the case of a qualified marginal well in  
which there is more than one owner of operating in-  
terests in the well and the crude oil or natural gas  
production exceeds the limitation under subsection  
(c)(2), qualifying crude oil production or qualifying

1 natural gas production attributable to the taxpayer  
 2 shall be determined on the basis of the ratio which  
 3 the taxpayer's revenue interest in the production  
 4 bears to the aggregate of the revenue interests of all  
 5 operating interest owners in the production.

6 “(2) OPERATING INTEREST REQUIRED.—Any  
 7 credit under this section may be claimed only on  
 8 production which is attributable to the holder of an  
 9 operating interest.

10 “(3) PRODUCTION FROM NONCONVENTIONAL  
 11 SOURCES EXCLUDED.—In the case of production  
 12 from a qualified marginal well which is eligible for  
 13 the credit allowed under section 29 for the taxable  
 14 year, no credit shall be allowable under this section  
 15 unless the taxpayer elects not to claim the credit  
 16 under section 29 with respect to the well.”.

17 (c) CREDIT TREATED AS BUSINESS CREDIT.—Sec-  
 18 tion 38(b) of the Internal Revenue Code of 1986 is amend-  
 19 ed by striking “plus” at the end of paragraph (14), by  
 20 striking the period at the end of paragraph (15) and in-  
 21 serting “, plus”, and by adding at the end the following  
 22 new paragraph:

23 “(16) the marginal oil and gas well production  
 24 credit determined under section 45G(a).”.

1 (d) CREDIT ALLOWED AGAINST REGULAR AND MIN-  
 2 IMUM TAX.—

3 (1) IN GENERAL.—Subsection (c) of section 38  
 4 of the Internal Revenue Code of 1986 (relating to  
 5 limitation based on amount of tax) is amended by  
 6 redesignating paragraph (4) as paragraph (5) and  
 7 by inserting after paragraph (3) the following new  
 8 paragraph:

9 “(4) SPECIAL RULES FOR MARGINAL OIL AND  
 10 GAS WELL PRODUCTION CREDIT.—

11 “(A) IN GENERAL.—In the case of the  
 12 marginal oil and gas well production credit—

13 “(i) this section and section 39 shall  
 14 be applied separately with respect to the  
 15 credit, and

16 “(ii) in applying paragraph (1) to the  
 17 credit—

18 “(I) subparagraphs (A) and (B)  
 19 thereof shall not apply, and

20 “(II) the limitation under para-  
 21 graph (1) (as modified by subclause  
 22 (I)) shall be reduced by the credit al-  
 23 lowed under subsection (a) for the  
 24 taxable year (other than the marginal  
 25 oil and gas well production credit).



1                   “(B) MARGINAL OIL AND GAS WELL PRO-  
 2                   DUCTION CREDIT.—For purposes of this sub-  
 3                   section, the term ‘marginal oil and gas well pro-  
 4                   duction credit’ means the credit allowable under  
 5                   subsection (a) by reason of section 45G(a).”.

6                   (2) CONFORMING AMENDMENTS.—Subclause  
 7                   (II) of sections 38(c)(2)(A)(ii) and 38(c)(3)(A)(II)  
 8                   of such Code is amended by inserting “or the mar-  
 9                   ginal oil and gas well production credit” after “em-  
 10                  ployee credit”.

11                  (e) CARRYBACK.—Subsection (a) of section 39 of the  
 12                  Internal Revenue Code of 1986 (relating to carryback and  
 13                  carryforward of unused credits generally) is amended by  
 14                  adding at the end the following new paragraph:

15                       “(3) 10-YEAR CARRYBACK FOR MARGINAL OIL  
 16                   AND GAS WELL PRODUCTION CREDIT.—In the case  
 17                   of the marginal oil and gas well production credit  
 18                   (as defined in section 38(c)(4))—

19                       “(A) this section shall be applied sepa-  
 20                   rately from the business credit (other than the  
 21                   marginal oil and gas well production credit),

22                       “(B) paragraph (1) shall be applied by  
 23                   substituting ‘10 taxable years’ for ‘1 taxable  
 24                   years’ in subparagraph (A) thereof, and

25                       “(C) paragraph (2) shall be applied—

1 “(i) by substituting ‘31 taxable years’  
 2 for ‘21 taxable years’ in subparagraph (A)  
 3 thereof, and  
 4 “(ii) by substituting ‘30 taxable years’  
 5 for ‘20 taxable years’ in subparagraph (B)  
 6 thereof.”.

7 (f) COORDINATION WITH SECTION 29.—Section  
 8 29(a) of the Internal Revenue Code of 1986 is amended  
 9 by striking “There” and inserting “At the election of the  
 10 taxpayer, there”.

11 (g) CLERICAL AMENDMENT.—The table of sections  
 12 for subpart D of part IV of subchapter A of chapter 1  
 13 of the Internal Revenue Code of 1986 is amended by add-  
 14 ing at the end the following item:

“45G. Credit for producing oil and gas from marginal wells.”.

15 (h) EFFECTIVE DATE.—The amendments made by  
 16 this section shall apply to production in taxable years be-  
 17 ginning after December 31, 2003.

18 **SEC. 2. ELECTION TO EXPENSE GEOLOGICAL AND GEO-**  
 19 **PHYSICAL EXPENDITURES AND DELAY RENT-**  
 20 **AL PAYMENTS.**

21 (a) PURPOSE.—The purpose of this section is to rec-  
 22 ognize that geological and geophysical expenditures and  
 23 delay rentals are ordinary and necessary business expenses  
 24 that should be deducted in the year the expense is in-  
 25 curred.

1       (b) ELECTION TO EXPENSE GEOLOGICAL AND GEO-  
2   PHYSICAL EXPENDITURES.—

3           (1) IN GENERAL.—Section 263 of the Internal  
4       Revenue Code of 1986 (relating to capital expendi-  
5       tures) is amended by adding at the end the following  
6       new subsection:

7       “(j) GEOLOGICAL AND GEOPHYSICAL EXPENDI-  
8   TURES FOR DOMESTIC OIL AND GAS WELLS.—Notwith-  
9   standing subsection (a), a taxpayer may elect to treat geo-  
10   logical and geophysical expenses incurred in connection  
11   with the exploration for, or development of, oil or gas with-  
12   in the United States (as defined in section 638) as ex-  
13   penses which are not chargeable to capital account. Any  
14   expenses so treated shall be allowed as a deduction in the  
15   taxable year in which paid or incurred.”.

16           (2) CONFORMING AMENDMENT.—Section  
17       263A(c)(3) of such Code is amended by inserting  
18       “263(j),” after “263(i),”.

19           (3) EFFECTIVE DATE.—

20           (A) IN GENERAL.—The amendments made  
21       by this subsection shall apply to expenses paid  
22       or incurred after the date of the enactment of  
23       this Act.

24           (B) TRANSITION RULE.—In the case of  
25       any expenses described in section 263(j) of the

1 Internal Revenue Code of 1986, as added by  
 2 this subsection, which were paid or incurred on  
 3 or before the date of the enactment of this Act,  
 4 the taxpayer may elect, at such time and in  
 5 such manner as the Secretary of the Treasury  
 6 may prescribe, to amortize the suspended por-  
 7 tion of such expenses over the 36-month period  
 8 beginning with the month in which the date of  
 9 the enactment of this Act occurs. For purposes  
 10 of this subparagraph, the suspended portion of  
 11 any expense is that portion of such expense  
 12 which, as of the first day of the 36-month pe-  
 13 riod, has not been included in the cost of a  
 14 property or otherwise deducted.

15 (c) ELECTION TO EXPENSE DELAY RENTAL PAY-  
 16 MENTS.—

17 (1) IN GENERAL.—Section 263 of the Internal  
 18 Revenue Code of 1986 (relating to capital expendi-  
 19 tures), as amended by subsection (b)(1), is amended  
 20 by adding at the end the following new subsection:

21 “(k) DELAY RENTAL PAYMENTS FOR DOMESTIC OIL  
 22 AND GAS WELLS.—

23 “(1) IN GENERAL.—Notwithstanding subsection  
 24 (a), a taxpayer may elect to treat delay rental pay-  
 25 ments incurred in connection with the development

1 of oil or gas within the United States (as defined in  
 2 section 638) as payments which are not chargeable  
 3 to capital account. Any payments so treated shall be  
 4 allowed as a deduction in the taxable year in which  
 5 paid or incurred.

6 “(2) DELAY RENTAL PAYMENTS.—For purposes  
 7 of paragraph (1), the term ‘delay rental payment’  
 8 means an amount paid for the privilege of deferring  
 9 the drilling of an oil or gas well under an oil or gas  
 10 lease.”.

11 (2) CONFORMING AMENDMENT.—Section  
 12 263A(c)(3) of such Code, as amended by subsection  
 13 (b)(2), is amended by inserting “263(k),” after  
 14 “263(j),”.

15 (3) EFFECTIVE DATE.—

16 (A) IN GENERAL.—The amendments made  
 17 by this subsection shall apply to payments made  
 18 or incurred after the date of the enactment of  
 19 this Act.

20 (B) TRANSITION RULE.—In the case of  
 21 any expenses described in section 263(k) of the  
 22 Internal Revenue Code of 1986, as added by  
 23 this subsection, which were paid or incurred on  
 24 or before the date of the enactment of this Act,  
 25 the taxpayer may elect, at such time and in

1           such manner as the Secretary of the Treasury  
2           may prescribe, to amortize the suspended por-  
3           tion of such expenses over the 36-month period  
4           beginning with the month in which the date of  
5           the enactment of this Act occurs. For purposes  
6           of this subparagraph, the suspended portion of  
7           any expense is that portion of such expense  
8           which, as of the first day of the 36-month pe-  
9           riod, has not been included in the cost of a  
10          property or otherwise deducted.

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