ANADARKO PETROLEUM CORPORATION
1201 LAKE ROBBINS DRIVE • HOUSTON, TEXAS 77380
P.O. BOX 1330 • HOUSTON, TEXAS 77251-1300

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Re: **Comments: Intangible Drilling Costs and the Small Business Tax Initiative**

Anadarko Petroleum Corporation ("Anadarko") appreciates the opportunity to submit our thoughts on tax reform as it relates to America's oil and natural gas exploration and production industry ("E&P industry"). Anadarko supports and applauds efforts to simplify our tax system. We believe such efforts should be implemented fairly, and in a way that encourages investment and growth for a thriving U.S. economy.

Anadarko is among the largest independent oil and natural gas exploration and production companies in the world. The company's portfolio of assets encompasses premier positions in the U.S. onshore shales and resource plays as well as premier deepwater positions in the Gulf of Mexico. Anadarko is committed to safely producing the energy we all need in a manner that protects the environment and public health, and supports our communities. Our comments are submitted to share the practical impact that certain proposals on both Anadarko and the E&P industry in which it participates.

Intangible Drilling Costs

According to the American Petroleum Institute ("API") the U.S. oil and natural gas industry supports 9.2 million jobs in the economy, and accounts for 7.8 percent of the national Gross Domestic Product ("GDP"). Because oil and natural gas are depleting resources, the exploration and production of such resources involves large investment on a continuous basis to maintain and continue to grow production. Due to the large amount of investment required, and the inherent risk in the exploration and production of oil and natural gas, costs incurred must be recovered quickly in order to continue the cycle of investment at a rate that keeps energy costs stable for the consumer.

One of the most important tools for cost recovery in the E&P industry is the ability to elect to expense intangible drilling costs ("IDC"), pursuant to Internal Revenue Code ("IRC") §263(c). IDC include charges for non-salvageable items, with no inherent ongoing value in and of themselves, such as wages, fuel, repairs, hauling, and other expenses incident to and necessary for the drilling or preparation of wells for the production of oil and gas. Currently, independent producers are able to elect to expense such costs in the year incurred, aligning treatment of such expenses with those of all other businesses' operating costs. The current expense of such items does not represent a "subsidy", nor a special credit to the E&P industry, as it does not reduce the actual tax liability over the life of any given project.

Current deduction of IDC expenses promotes sound domestic energy policy and is necessary to maintain and ensure America's energy security. The timing of the deductions has played a crucial role in making investment funds available to advance technology, similar to the role played by the deduction of research and experimental ("R&E") expenses in other industries. The deduction for R&E expenses (IRC §174) shares the same policy goal as the deduction for IDC to promote innovation, foster development of new products and resources, and promote economic growth. The current deduction of IDC expenses facilitates reinvestment in the next breakthrough technology or the hiring of additional employees.

Enhanced technologies developed by the E&P industry have moved the U.S. closer to realizing energy independence in the coming years. Such technology is dependent on the availability of adequate cash flow to sustain such investment and discovery. Current deduction of IDC expenses goes a long way toward making these advances possible.

Disallowing the current deductibility of IDC expenses decreases cash flow, thereby reducing funds available to invest in new wells, technologies, and employees. Even if the overall tax rate was reduced, the rate reductions currently under consideration would not offset the immediate increase in taxes due to the loss of the IDC deduction. This net tax increase would result in far fewer dollars available for Anadarko to invest in U.S. oil and gas assets. The impact of this proposal would be to increase the attractiveness of foreign projects, while decreasing the attractiveness of U.S. projects, resulting in less domestic energy available to consumers. This resulting supply constraint would raise costs to the end-users, as well as constrict economic growth due to the availability of fewer well-paying jobs in the energy sector. In short, disallowing a current deduction of IDC expenses results in less oil and natural gas production and supplies, and fewer American jobs – it is not sound economic or energy policy.

House Ways and Means Small Business Tax Initiative

Due to the inherent risks and significant investment needs of the E&P industry, it is common for companies to enter into Joint Operating Agreements ("JOAs") to jointly invest in, develop, and operate oil and natural gas properties in an effort to share such risks and ensure the availability of sufficient investment funds. Current partnership rules under Subchapter K of the Internal Revenue Code of 1986, as amended, and the associated regulations thereunder ("the Code"), allow JOA participants to allocate the costs and expenses of such operations in a manner that reflects each party's obligation to fund such expenses. In a common transaction in the oil and gas industry, one party will fund 100% of the exploration and/or development expenses related to an oil and gas property to earn an interest in the property. In these transactions, it is typical to allocate the deductions related to the exploration and development expenses to the party which has funded the expenditure.

As a part of a House ways and means small business tax initiative, two options were presented for reforming tax rules that would affect partnerships. Option 2 presented in the discussion draft seeks to replace the current rules and replace both Subchapter K and Subchapter S of the Code with a single pass-through entity regime which would apply to both current tax partnerships and S corporations. The proposed rules, as currently drafted, appear to preclude the ability to specifically allocate IDC expenses to the party which funds the expense. Such approach ignores the true economics of the underlying arrangement, and would be detrimental to the E&P industry's ability to share risk and properly allocate expenses for tax purposes, while ensuring adequate investment.

As discussed above, Option 2 of the small business tax initiative as currently drafted will significantly impair the E&P industry's ability to continue to invest in oil and natural gas operations at a rate required to provide affordable domestic energy to the nation. If Option 2 were to be pursued, Anadarko would recommend that:

- current rules are maintained which allow for costs borne by a particular party, e.g. IDC, to be allocated to that contributing party for tax purposes
- current exceptions to disguised sale rules are maintained
- the proposed entity level withholding tax be dropped
- rules under current IRC §§721(b) and 351(e) be aligned to reduce complexity
- rules under current IRC §7704 are maintained
- the effective date be deferred so that adequate time is allowed for implementation.

In summary, Anadarko supports tax reform that will simplify the tax code and maintain fairness, while encouraging investment to grow the US economy. We believe the points discussed above further this goal.