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April 15, 2013

The Honorable Kevin Brady
301 Cannon House Office Building
Washington, DC 20515

The Honorable Mike Thompson
231 Cannon House Office Building
Washington, DC 20515

RE: Energy Tax Reform Working Group Comments

Dear Congressmen Brady and Thompson:

Attached is ExxonMobil's submission to your Energy Tax Reform Working Group. As you consider tax reform, we urge you to embrace principles of competitiveness and neutrality. Specifically, international rules should permit American companies to compete for foreign projects on roughly equal terms with their foreign competition and prevent double taxation. Domestic rules should be neutral among taxpayers and designed to promote investment and job growth. Tax reform choices should be evaluated against these goals.

No energy source should be favored compared to others, and all taxpayers engaged in the same activities should be treated equally. We support reducing the corporate tax rate to promote domestic investment and job creation. But we also support robust cost recovery provisions, for all energy development. Capital cost recovery rules, in addition to rates, have real impacts on investment decisions.

In addition to our general comments, we have attached ExxonMobil's responses to questions from certain Senate Finance Committee members on these important tax issues. The questions stemmed from a May 19, 2011 committee hearing on oil and gas tax incentives.

Thank you for the opportunity to provide our views to your Working Group.

Very truly yours,

James Spellings

Exxon Mobil Corporation Comments to Energy Tax Reform Working Group

ExxonMobil is the world's largest publicly- traded oil and gas company. In 2012, we earned $45 billion, invested a record $40 billion in our business, and returned over $30 billion to shareholders, including individuals, pension plans and university endowments. And yet we account for only 3 percent of the world's crude oil production and 2 percent of total world energy supplies. In short, we are a large American company competing in the immense global energy marketplace, in which the wide majority of participants are nationally-owned companies.

Investments in world energy development are massive, totaling $1.6 trillion annually according to the International Energy Agency. The development of our unconventional U.S. energy resources, including newly-available shale gas and oil, is expected to require over $5 trillion in direct investment over the next two decades, presenting a transformational opportunity to enhance domestic energy security, economic growth, job creation, and new governmental revenues at federal, state and local levels.

Tax Policy Principles

As you consider tax reform, we would offer two simple, yet critical principles for you to consider. On the international side, do not double-tax U.S. energy companies. On the domestic side, embrace a neutral tax code that treats all industries and companies the same.

International

Current proposals to change "dual capacity" taxpayer rules will, in fact, double-tax foreign income earned by U.S. energy companies and make it impossible for them to compete in the global energy market for new (or even to retain existing) foreign oil and gas reserves. U.S. energy security will be weakened and American jobs will be lost.

For our industry, today's worldwide tax system and foreign tax credit rules are workable, even though most competitors are from countries with territorial tax rules. Take Qatar, for example. The income tax rate there on our liquefied natural gas projects is 35 percent, the same as in the U.S., and thus no residual U.S. tax is due. But the "dual capacity" changes proposed would arbitrarily reclassify these tax payments as royalties and disallow them as offsets to U.S. income tax costs. Our effective tax rate would increase to over 50 percent, while our non-U.S. competitors would continue to pay just the 35 percent Qatar tax. This additional tax, only applying to U.S. companies, would guarantee double taxation. Existing rules require us to prove the payments are not royalties—if we can't, we lose. But the new rules would take away our right to make such a showing and, irrespective of the facts, would deem the payments to be royalties. That is double taxation.

International Tax Reform

Looking at international tax reform, we could support a move to a competitive territorial system as long as it maintains a level-playing field between us and our non-U.S. competitors.

Domestic

As background, ExxonMobil acquired a company called XTO in 2010 for $37 billion. As soon as XTO became part of ExxonMobil, it owed more taxes on its existing business. Specifically, it lost percentage depletion, had to capitalize 30 percent of its qualified drilling costs, and had to recover its geological and geophysical costs over a 7 year period instead of the 2 year period applicable to it prior to the acquisition. Current U.S. tax rules impose a greater tax burden on 4–5 companies than every other company in the industry (even companies worth $37 billion). We are not aware of any other industry where that happens.

It is frequently asserted that there are special "big oil subsidies" of $4 billion per year. Three items make up the bulk of this claim: percentage depletion, the deduction for domestic production activity under code section 199, and the deduction for intangible costs of drilling oil and gas wells.

Percentage depletion for oil and gas production can only be claimed by independent producers and royalty owners, not by ExxonMobil, and is limited to 1000bbl/day of production. Justifying its repeal as a special provision for oil companies is misleading, since integrated companies like ExxonMobil do not even qualify for it, and producers of all other minerals do.

The deduction under section 199 applies to all taxpayers who manufacture, produce, grow, or extract property in the U.S. It includes auto makers, newspaper publishers such as the Washington Post and New York Times, Hollywood filmmakers, software companies, engineering and architectural services. Oil and gas is the only activity that is singled out, but not in a good way. The deduction for oil and gas is limited to a 6 percent deduction when all other producers and manufacturers receive a larger 9 percent deduction.

Finally, the treatment of our drilling costs deals only with the timing for deducting these costs; there is no absolute revenue loss to the government. The so called "intangible drilling cost" deduction is far from unique. All natural resource industries qualify for very similar treatment of their exploration and development costs, (largely driven by labor costs), and many other industries receive similar treatment for costs in their businesses of a similar nature.

Domestic Tax Reform

We support neutral tax treatment for all. No energy source should be favored compared to others, and all taxpayers engaged in the same activities should be treated equally. We support reducing the corporate tax rate to promote domestic investment and job creation. But we also support robust cost recovery provisions, for all energy development. Capital cost recovery rules, in addition to rates, have real impacts on investment decisions.

Summary

In making difficult tax reform choices, the Committee should be guided by neutrality and competitiveness principles. International rules should permit American companies to compete for foreign projects on roughly equal terms with their foreign competition and prevent double taxation. Domestic rules should be neutral among taxpayers and designed to promote investment and job growth. Tax reform choices should be evaluated against these goals.

Responses to Selected Senate Finance Committee Questions

On May 19, 2011, the Senate Finance Committee held a hearing on "Oil and Gas Tax Incentives and Rising Energy Prices." The hearing record is available on the Senate Finance Committee website at: http://www.finance.senate.gov/hearings/hearing/?id=974701fa-5056-a032-5227-d055ec6b20d1.

Exxon Mobil Corporation's Chairman and CEO, Rex W. Tillerson, one of the hearing witnesses, responded to a number of follow up written questions. The following questions from Senators Baucus and Snowe, and ExxonMobil's responses, are offered as additional background and information to the Energy Tax Reform Working Group.

Q: As part of Senator Baucus' question number 3, he asked: "… isn't the U.S. actually a favorable income tax environment in which to engage in production, refining, and distribution?"

A: A favorable income tax environment includes a stable, predictable and non-discriminatory set of tax rules that creates a level playing field for all competitors. As explained below, some notable exceptions to those principles exist today, and the recurring proposals for further adverse changes continue to erode confidence for U.S. energy investors. Specifically, the "S. 940" provisions ["Close Big Oil Loopholes Act of 2011," proposed by Senator Menendez] would single out three to five taxpayers for unjust, punitive and arbitrary tax treatment. A tax environment that increases tax costs on an ExxonMobil refinery in Montana but not on a foreign-owned competitor in another state is hardly a favorable one. A tax environment that purposely double taxes three U.S. companies (ExxonMobil, Chevron, and ConocoPhillips) undercuts their ability to compete in the global market and can never be considered a favorable income tax environment.

While one would not know it from the incorrect descriptions used, current tax rules already single out integrated oil and gas companies for discriminatory tax treatment versus their competitors in the same business (e.g., the IDC and G&G rules in the existing code). Within the broader energy industry, on a unit of energy produced basis, renewable and alternative energy producers receive enormous tax credits and cash grants that are not available to oil and gas producers. Further, all other domestic producers and manufacturers receive a 9% deduction under section 199, while the oil and gas companies are limited to a 6% deduction. That hardly seems a special preference to the oil and gas industry.

In the international arena, most of ExxonMobil's non-U.S. competitors are residents of countries that impose a territorial system of taxation on foreign income. The U.S., on the other hand, taxes its resident companies on their worldwide income. The negative impact of the worldwide system of taxation is mitigated by the availability of the foreign tax credit, but since Congress continues to make and propose changes to longstanding rules, this is hardly a "favorable tax environment". Proposals like the "dual capacity" changes in S. 940 would impose double taxation solely on three American-based oil and gas companies.

The United States is unusual in that its oil and gas resources under exploration, development, and production are widely dispersed, and generally smaller, more discrete resources, than those found in many countries. A rational economic environment that promotes the development of such resources can be expected to be different from foreign countries with more concentrated resources.

Finally, the quality of investment opportunity in any country is also a function of its regulatory structure. For example, the scale of development opportunities that result from specific leasing systems (or discretionary offerings) among countries competing to attract investment capital can be an extremely important factor. Variables include the geographical size of lease offerings and their location, their timeframes, their payment structures (e.g., bonuses, rentals, royalties), and development phases or benchmarks.

Q: Senator Baucus, in his question number 4, asked:

"Current tax rules arguably allow foreign tax credits for payments that are economically equivalent to royalties.

The proposal under consideration would limit creditable foreign taxes to generally applicable foreign taxes.

The three largest U.S. oil companies are on pace to earn 80 billion dollars in aggregate profit in 2011. Making the proposed changes to the foreign tax credit rules would cost your companies less than one percent of that profit.

Is it a serious problem for your company to pay less than 1% of your profits for the proposed modification?"

A: This statement is a gross mischaracterization of current law. Current tax rules today do not "arguably" or otherwise permit foreign tax credits for payments that are economically equivalent to royalties. Just the opposite is the case. Regulations in place today impose a burden on U.S. oil companies to prove that foreign income tax payments are in fact not royalties. The proposal under consideration would take away a company's right to prove its entitlement to foreign tax credits for legitimate income tax payments, resulting in guaranteed double taxation.

This proposal puts at risk the ability to effectively compete against non-U.S. companies in acquiring access to global reserves.

a. ***Cambridge Energy Research Associates Study***: A major study of changes in the competitive balance for access to critical oil and gas resources throughout the world, co-authored by Daniel Yergin and David Hobbs of Cambridge Energy Research Associates (CERA), revealed the following:

1. U.S.-based Investor-Owned Companies (or IOCs) were by far the largest international players in terms of production volume, acreage, and exploration activity at the start of the 1970s, but they have fared less well than the non-U.S.-based IOCs in recent decades. From a position of dominance, U.S.-based IOCs have been losing the race for access during the past three decades.

2. The competitive environment has changed dramatically with the widespread emergence of national oil companies in their home countries in the 1970s and

the acceleration of competition from these companies as they began operating outside their home territories in the mid-1990s.

3. While the growth of National Oil Companies (NOCs) and International NOCs (INOCs) has been at the expense of IOCs as a class, the U.S.-based IOCs have been affected to a greater extent than those from Europe, Canada, Eurasia, and Asia.

4. Two factors emerged as most responsible for this difference: (a) the interaction between the fiscal arrangements in the home countries of the IOCs and the host countries in which they operate, and (b) home country policy objectives. The fiscal factors alone could account for differences in what a company can afford to bid for mineral rights, sometimes by as much as 100%.

5. U.S. companies have been losing out under current U.S. fiscal conditions, but proposals like the "dual capacity" changes will actually make matters worse still, putting American companies at a further and distinct competitive disadvantage to their major competitors studied, including those based in the UK, Netherlands, Russia, Canada, Norway, France, Italy, and China.

6. Why is this important? Here's what CERA says:

> "....home countries believe that it is worth winning the competition for access because the success of their oil companies brings benefits, including stable supply and greater confidence in energy security; direct (and indirect) employment by successful oil companies; promotion of home country services and equipment supply (e.g., steelwork, compressors, pumps etc.); securing research and development investment at home; the status of major oil companies as diplomatic flag bearers; and, not least, the repatriated dividends and taxes thereon that home countries expect to receive."

But as CERA notes, these potential benefits can only be realized if home companies win the access race. Said differently:

> "The acquisition of mineral rights is the paramount point of competition between oil and gas companies irrespective of their origin. Win it, and a company will have the "fuel" in its portfolio to deliver superior growth and returns. Lose it, and performance (and in the long term, survival) become an uphill struggle."

b. ***Wood Mackenzie Study***: The international consulting firm of Wood Mackenzie conducted a similar study of the impacts that the proposed changes to the dual capacity taxpayer rules would have on the ability of U.S.-based oil companies to obtain global oil and gas resources.

The Wood Mackenzie report notes the increased competition U.S.-based oil companies face from non-U.S. based companies, including INOCs. The report points specifically to the rise of the Asian INOCs, which have spent over $55 billion on international acquisitions over the 2009–2010 period, acquiring over 5 billion barrels of oil equivalent. The Chinese INOC, CNPC, now holds commercial interests in 17 countries outside of China.

In its report, Wood Mackenzie evaluates the economics of a typical upstream development in 14 countries. Access to reserves is typically awarded to the investor able to pay the most to the reserve owner or invest the most through exploration activity (assuming the operational, safety, geopolitical and technological risks are addressed satisfactorily). To determine how much to pay, an investor calculates the expected returns and the net present value of the proposed investment. The higher the net present value and expected returns, the more an investor is able to bid for the access rights. Taxes are costs that decrease the expected returns and net present value of the investment opportunity, and therefore, decrease the amount an investor is willing to pay.

If the dual capacity taxpayer proposal were enacted, the Wood Mackenzie analysis shows that non-U.S. based oil companies could outbid U.S.-based companies in all 14 countries examined. Some situations, such as Qatar, show that a non-U.S. based investor could offer twice as much as a U.S. investor for new reserves. The internal rate of return that a non-U.S. based investor could earn in a new project in Iraq is some five times higher than what a U.S.-based investor would be able to earn. The result is that U.S.-based oil and gas companies could not compete effectively against non-U.S. based investors for access to global oil and gas reserves. The report concludes:

> "Under the proposed changes to the dual capacity taxpayer rules, U.S. based oil and gas companies would face an additional or residual U.S. tax burden that they do not currently face. This additional U.S. tax will reduce the after-tax value and returns from overseas projects. This could make U.S. investors less able to acquire or develop overseas opportunities economically, compared to competitors who do not face a similar additional domestic tax burden."

As a result, non-U.S. based investors (and workers) would gain further competitive advantage over U.S.-based investors in the race to acquire new reserves and grow. This competitive advantage could result in a reduction in global reserves available to U.S. investors because a non-U.S. investor would be able to earn a higher internal rate of return on these investments relative to U.S. investors. Non-U.S. investors could outbid U.S. investors for new reserves, whilst still generating adequate economic returns.

Furthermore, this proposal is likely to affect the value and rate of return of existing operations. Increased U.S. taxes on ongoing projects could force U.S.-based companies to consider selling these assets, as these projects may be more valuable to other investors. The higher value of the assets to other companies could result in the sale of overseas assets by U.S. investors to maximize shareholder value.[3]

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[3] See also the paper submitted to U.S. Department of Treasury on July 21, 2010, entitled, **Economic and Foreign Policy Implications of the Administration's "Dual Capacity Taxpayer" Proposals (July 2010),** by Pamela F. Olson and Brian H. Jenn of Skadden, Arps, Slate, Meagher & Flom, LLP and Grant D. Aldonas Split Rock International, Inc.

Q: Senator Snowe, in her question number 3 asked:

"We have to ensure the competitiveness of American companies and cutting the tax rate is one goal where we already have some consensus. We just need to agree on how to get there. Do you agree that reducing tax rates would justify the elimination of the oil and gas tax provisions we are discussing today? Do you think that rather than stop with these oil and gas provisions, we should also eliminate other energy subsidies in order to provide the broadest possible rate reductions?"

A: Please see our [prior] responses for a description of the three major tax provisions under consideration in S. 940. Two of those three provisions — the section 199 deduction and expensing of intangible drilling costs — apply to domestic production only. With respect to these provisions, we support comprehensive tax reform that looks at all provisions of the tax code, is neutral across industries, promotes growth, and brings the rates down as low as possible. With respect to the tax treatment of energy sources, we do not believe that Congress should single out one type of energy from others for substantially different tax treatment. We need all forms of domestic energy production and our tax code should be as neutral and even handed as possible. We would support the elimination of tax credits that relate solely to oil and gas, such as the enhanced oil recovery and marginal well credits, provided that similar items for other energy sources are also eliminated. This is what neutrality requires — i.e., if energy specific incentives are to be eliminated for some, they should be eliminated for all.

Unbiased tax provisions that apply irrespective of the type or scope of business should not be mischaracterized as energy specific "tax subsidies." There are several items frequently misidentified as special "subsidies for oil and gas companies" which are not in fact unique to the industry (such as the section 199 provisions and the treatment of intangible drilling and development costs). We do take exception to eliminating these provisions unless they, or their analogous provisions, are eliminated for all companies and all industries.

The third major proposal in S. 940 — the dual capacity taxpayer provision — would result in double taxation of foreign earned income, and therefore, has no place in a discussion of comprehensive tax reform that is designed to "ensure the competitiveness of American companies." It would have exactly the opposite effect.