HALLIBURTON

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April 15, 2013

The Honorable Kevin Brady
Chair, Energy Tax Working Group
The Committee on Ways & Means
United States House of Representatives
Washington, DC 20515

The Honorable Mike Thompson
Vice - Chair, Energy Tax Working Group
The Committee on Ways & Means
United States House of Representatives
Washington, DC 20515

Dear Representatives Brady and Thompson:

I am writing on behalf of Halliburton Company to provide written recommendations for the Energy Tax Working Group regarding the Ways & Means Committee's comprehensive tax reform initiative. Halliburton's competitive position and commercial success are determined in large part by the U.S. tax code. Because we operate worldwide, our tax liabilities are impacted by the laws of about 80 countries. But ultimately the international tax and energy tax laws of the U.S., and the underlying U.S. corporate tax rate are the factors that play a dominant role in determining our profitability and our ability to continue making domestic investments.

Halliburton is an energy services company formed under Delaware law with headquarters in Houston, Texas, and Dubai, United Arab Emirates. Halliburton's worldwide revenue was in excess of $28 billion in 2012, with operating income of about $4 billion. About 58% of this revenue was in the United States, with the remaining 42% from abroad. With more than 72,000 employees, Halliburton serves the upstream oil and gas industry throughout the life-cycle of the reservoir—from locating hydrocarbons and managing geological data to drilling and evaluating formations, constructing and completing wells, and optimizing production from the reservoir. In other words, Halliburton assists exploration and production companies find and produce the resources we need to defend our nation, fuel our economy, gain energy independence and enhance our lives, and it is a key supplier of the oil and natural gas industry, which supports 9.2 million American jobs and contributes over $1 trillion to the U.S. gross domestic product annually.[1]

Like energy, revenue is needed to run our nation. Tax reform can make revenue collection more efficient by reducing transaction costs. It can also enhance our competitive position worldwide and increase economic growth by removing burdens and complexity that steer business to our competitors from foreign nations. Successful tax reform will achieve both efficiency and growth, thus improving our economy and enhancing our national security.

[1] American Petroleum Institute, *The State of American Energy* (2013), pp. 4-5.

Successful tax reform may also reduce tax expenditures to broaden the tax base, while lowering statutory rates. As the Ways and Means Committee is well aware, the top U.S. tax rate for corporations is the highest among OECD nations. For Halliburton and our U.S.-based oil and gas customers, the effect of this high rate structure is disproportionate relative to its effect on other industries. In 2011, income tax expenses as a share of pre-tax net income (i.e., the effective tax rate) averaged 40.6% for U.S. oil and gas companies but only 25.1% for other S&P industrial companies.[2] Reducing the top corporate rate to 25%, for example, would help to reduce the effective tax rates in our industry to levels more comparable to those borne by major foreign competitors. Yet we urge you to be judicious in this process, to evaluate tax items that are true expenditures—subsidies designed to incentivize certain behavior—from tax items that are designed to measure income or expenses, or impose a tax rate.

For example, the Administration has repeatedly proposed repealing current deductions for intangible drilling costs (IDCs), calling it an energy subsidy. IDCs include the labor, fuel, repairs, materials, and transportation that are used to drill an oil or gas well. For an exploration and production company, these costs are the ordinary and necessary, day to day expenses of looking for oil. Oil and gas wells have no salvage value, and do not create a capital asset. Like a scientist researching new technology, the new well may or may not produce results. But the roughnecks' wages have to be paid nevertheless and are as much a business expense as the scientist's deductible salary. Quite simply, denying a current deduction for IDCs would not eliminate a subsidy of any kind; it would instead eliminate a deduction allowed to virtually every other business.

Further, eliminating the current deduction for IDCs will discourage new domestic oil and gas exploration. According to the Energy Information Administration, domestic oil and gas companies spend more than twice as much to explore for and produce each barrel of oil in the U.S. offshore than they do to explore for and produce each barrel of oil abroad.[3] Eliminating the deduction for IDCs would only increase domestic exploration and production costs, making domestic production far less attractive than foreign exploration and production. Such an increase in costs would force the oil and gas industry to abandon, or simply refuse to invest in, many marginal domestic projects as high-potential but costly domestic production prospects that would no longer be economically feasible.[4]

One might argue that section 199's manufacturing deduction is another subsidy, because it encourages manufacturing in the U.S. But it is neutral as to what is being manufactured; it does not prefer one sector over another or one product over another, thereby distorting investment. Instead section 199 prefers manufacturing within our borders by imposing a lower tax rate.

The section 199 deduction was enacted to help create and maintain well-paying U.S. jobs in the manufacturing and production industries. Although the inclusion of oil and gas extraction and refining income had widespread support when the section 199 deduction was adopted, recent legislation limited the deduction for the oil and gas industry.[5] The call now for denying the section 199 deduction for the oil

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[2] American Petroleum Institute, *The State of American Energy* (2013), p. 5.

[3] *See* U.S. Energy Information Administration, *How much does it cost to produce crude oil and natural Gas*, Frequently Asked Questions, *available at* http://www.eia.gov/tools/faqs/faq.cfm?id=367&t=8.

[4] *See* Wood Mackenzie, *Evaluation of Proposed Tax Changes on the Oil and Gas Industry*, (August 2010) ("In the scenario where gas prices remain low and the industry loses both the IDC and Section 199 deduction, Wood Mackenzie expects that almost all additional productive potential in the US would be eliminated.").

[5] *See* Joseph R. Mason, *Budget Impasse Hinges on Confusion among Deficit Reduction, Tax Increase, and Tax Reform: An Economic Analysis of Dual Capacity and Section 199 Proposals for the U.S. Oil and Gas Industry*, July 12, 2011, p.8, *available at* http://www.americanenergyalliance.org/wp-content/uploads/2011/07/2011-07-12-Mason-Sec-199-DC-Tax-Paper.pdf (describing the history of section 199).

and gas industry specifically singles out our industry for discriminatory treatment from all other U.S. manufacturers and producers.[6]

While the selective repeal of the section 199 deduction is intended to decrease the federal deficit and increase federal revenues, such a repeal would have precisely the opposite effect. Although the selective repeal is expected to raise approximately $30 billion in federal revenues over the next ten years, the industry cutbacks that may be reasonably expected will cost the economy approximately $341 billion in economic output, 155,000 jobs, $68 billion in wages, and $83.5 billion in reduced tax revenues.[7]

Halliburton builds oil and gas wells—we manufacture them from components for use at sea and on land, at home and abroad. Imposing a lower tax rate on this activity when done in the United States keeps more of our manufacturing work and jobs in the U.S. As a tax rate imposition provision, section 199 should be retained, or all rates lowered to retain its economic effect.

The most significant source of complexity for Halliburton, with significant risk of double taxation, is the U.S. tax code's international provisions. As you know, unlike most of the world, which uses territorial taxation so that foreign subsidiaries' earnings are exempt from home country taxation when those earnings are repatriated, the U.S. taxes income world-wide and then permits tax credits for foreign taxes paid. Over the decades the foreign tax credit provisions grew more complex as Congress sought revenue and discriminated against the energy sector by limiting its credits. Much of this complexity and market distortion could be eliminated by harmonizing the U.S. tax code with the world norm of territorial taxation.

Moving to a true territorial system may therefore reduce tax compliance costs in the long-term, as such a system could obviate or reduce the need for determinations under many of the current technical rules (e.g., the foreign tax credit income basket rules). While we understand that any territorial system must include anti-abuse and transition rules, we urge Congress to seize this opportunity to replace the existing scheme with one that is less onerous from a compliance standpoint.

But the greatest benefit of territorial taxation for the energy sector would be putting our energy businesses on par with our international competitors. Whenever we bid for a project, our costs include not only the local country's taxes, but also our taxes in the U.S. **Our foreign competitors do not have this home country tax burden.**

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[6] *See* Harold Ford, Jr., *Washington vs. Energy Security*, WALL STREET J., May 11, 2011 ("Why, when gas prices are climbing, would any elected official call for new taxes on energy? And characterizing legitimate tax credits as 'subsidies' or 'loopholes' only distracts from substantive treatment of these issues. Lawmakers misrepresent the facts when they call the manufacturing deduction known as Section 199—passed by Congress in 2004 to spur domestic job growth—a 'subsidy' for oil and gas firms. The truth is that all U.S. manufacturers, from software producers to filmmakers and coffee roasters, are eligible for this deduction.").

[7] *See* Mason, *supra* note 5 (noting that the "net fiscal effect [of the elimination of the section 199 deduction and changes to the dual capacity rules resulting in] a loss of $53.5 billion in tax revenues, suggests that the policy proposals exacerbate, rather than alleviate, the federal deficit."); Salvatore Lazzari, Energy Tax Policy: History and Current Issues, CRS Report for Congress, Congressional Research Service, June 10, 2008, CRS-25, available at http://www.fas.org/sgp/crs/misc/RL33578.pdf ("In the long run, eliminating the [section 199] deduction for the domestic oil and gas industry will raise average production costs, adversely affecting the economics of domestic oil and gas projects as compared to domestic non-oil and gas projects. Generally, rates of return to investments in oil and gas would decline, causing a decline in capital flows to this industry, and an increase in capital flowing to other industries, including foreign industries. This would tend to adversely affect domestic production and increase imports: Domestic oil and gas output would be lower, and imports would be higher than they otherwise would be without the tax increase.").

The current US international tax system handicaps American businesses in the global marketplace and cost jobs abroad and at home. For example, we are forced to avoid repatriation to minimize taxes and to manage our capital projects and operations without the free transferability of corporate funds enjoyed by our foreign competition. As of January 1, 2012, we had accumulated unrepatriated foreign earnings of $4.4 billion and $470 million of cash and equivalents held by our foreign subsidiaries that would be subject to tax if repatriated. Further, the inability to access foreign resources for domestic investments requires finding alternative sources of funding capital projects, such as costly debt and equity issuances.

The high effective tax rate on repatriated earnings, the costs of planning tax-efficient strategies under the existing rules, and the costs of accessing alternative sources of capital place Halliburton and our many U.S.-based customers at a significant disadvantage relative to foreign competitors. These disadvantages have a pronounced and compounding effect on Halliburton and our U.S.-based customers because the oil and gas industry is capital-intensive, and our success depends directly on the level of capital investment in the industry. And these disadvantages are only increasing as more countries move to territorial systems.

Caution should be used in drafting a territorial system that does not take away the competitive benefit it could create. Repatriation of foreign profits should be permitted without a toll charge that diminishes the benefit of a territorial system. For example, "base erosion" provisions that make U.S. costs for supporting international businesses non-deductible will shift jobs overseas.

Finally, we strongly believe that tax rules should be non-discriminatory among industries and should provide a level playing field for taxpayers engaged in similar activities. Thus, we urge Congress to include all types of active operating and related income in any exemption from worldwide taxation and to avoid any industry-specific restrictions.

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Halliburton would be pleased to assist the Committee throughout the legislative process in understanding the impact of the U.S. tax code on the energy services business. We would like to thank the Committee and commend it for undertaking the difficult and lengthy process of tax reform. Please let me know if we can answer any questions you may have.

Sincerely,

Myrtle L. Jones

Senior Vice President, Tax