GENERALIZED TAX ADVANTAGES OF OIL & GAS DRILLING VENTURES

Source: Research Institute of America Tax Guide

With the passage of the Tax Reform Act of 1986, oil and gas ventures are now one of the ***<u>most tax advantaged investments</u>****. The Act specifically* ***<u>exempts</u>*** *oil and gas Working interest from being classified as "passive income". Thus, all deductions can be Used to offset* ***"active"*** *or* ***"ordinary"*** *income.*

<u>Intangible Drilling and Development Costs (IDC'S):</u>

IDC's are the costs of labor, fuel, repair, geology and engineering work, roadways, rock, geophysical logging, testing, hauling, supplies, etc., incidental and necessary for the drilling and preparation of wells for the production of oil and gas, including work done by contractors under and form of contract, including the drilling of a well be turnkey contract. The IDC does not include the pipe and equipment that becomes part of the well; the IDC'S Generally run in the range of **<u>90%</u>**, of the total investment. A total investment in a well of $100,000 could result in a tax write-off approximation **$90,000** ($100,000 X 90%). For an individual in the 39.6% Federal and 9% State tax bracket this would be savings of **$43,740** ($90,000 X 48.6%) in accordance to the IDC's tax savings.

<u>Tangible Drilling and Development Costs (TDC'S):</u>

Tangible drilling costs (well equipment: including, but not limited to, well casing, surface and subsurface equipment, and well flow / sales lines) attributed to the venture is reported as depreciation on the tax return as an expense. In "Example A" the difference between $100,000 and $90,000 (i.e. $10,000) would be the amount subject to depreciation. For simplicity assume a straight-line depreciation on all tangible equipment for five years – a deduction of $2,000 per year. Again assuming a 48.6% Federal and State tax bracket, this would equate to additional savings of $972 per year raising the total tax savings in the first year to **<u>$44,712</u>**. The investor would also realize additional tax savings of $3,888 ($972 X 4 years) over the next four years, making the investment **100% deductible**.

<u>Percentage Depletion:</u>

Percentage depletion allows the owner of a producing oil and/or gas well to recover his Investment through tax deductions over the period in which oil and/or gas is produced. The rate for percentage depletion is 15%. The deduction in any tax year may not exceed 65% of the taxpayer's taxable income from all sources.

Encore Energy does not provide tax advice for any jurisdiction. This example is for illustration purposes only. Some investors do not file a state income tax. Please consult your tax advisor regarding the potential tax deductions and how they affect your tax liability.