Oil and Gas Investment Vehicles Revisited

Denney Wright – University of Houston Law Center
Robert Jacobson – Willkie Farr & Gallagher LLP
Maria Collman – PwC
Clifford Warren – Internal Revenue Service

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Current Environment

Continued low price environment

Reduced cash flows

Reduced capacity for borrowing

Bankruptcies

Divestment activity for non-core assets

Foreign investment less prevalent

Continued investment focus by private equity

New investment opportunities with non-traditional investors

Changing political environment

Tax reform

Key Items from the pending House and Senate Bills

Corporate tax rate of 20%

Special pass-through rates – House 25% (special rules apply), Senate 17.4% deduction

Corporate AMT repealed

NOL carryback and carryforward changes

Immediate expensing of capital spending (temporary time frame)

EOR credit and Marginal Well Credit repealed (R&D credit retained)

Sec. 199 deduction repealed

Limitation on interest deduction

Like-kind exchanges repealed (real property exception)

International – many changes and special rules to achieve the 100% DRD on foreign dividends

Many other changes

Typical Investors and Investment Vehicles

Investors	Investment Vehicles
Domestic companies	Working interest
Domestic individuals	Royalty
Foreign investors	NPI
Private equity	Production payment
Banks	Partnership joint venture
Tax exempt organizations	MLP
	Debt with equity kicker
	Resource funds
	Other

What are the relevant tax considerations when structuring oil and gas investment vehicles for these different types of investors?

Tax and Economic Matters Relevant to Structuring the Investment

Single versus Double Taxation

Timing for Recognition of Items of Income, Deduction, Gain or Loss

Character of gain/loss on disposition

Effectively Connected Income (ECI)

Foreign Investment in Real Property Tax Act (FIRPTA)

Unrelated Business Income Tax (UBIT)

Passive Activity Losses (PALs)

Flexibility

Complexity

Tax and Economic Matters Relevant to Structuring the Investment

Corporation	Pass Through
Current law approximately 50%	Current law typically 39.6%
Reform approximately 39%	House bill provides for a 25% rate for passive income and a portion of active income with regular graduated tax rates applying to the remaining active income. Senate different approach with 17.4% deduction.
State tax additional cost	State tax typically only at investor level
Income recognized upon distribution	Inability to control timing of income recognition
Potential ability to control timing	Potential for “phantom” income
No allocation of deductions or losses to investors	Investors may receive a disproportionately large amount of deductions compared to income in early years of investment.
Capital gain treatment	Capital gain but subject to recapture
Form 1099 reporting	Schedule K-1 reporting; partnership audit rules

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