

## **Marginal Well Credit for 2016 Natural Gas Production Announced**

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The Internal Revenue Service announced September 12, 2017, in Notice 2017-51 that the Marginal Well Production Credit (MWC) for natural gas production from qualifying wells in calendar year 2016 is \$.14 per mcf for the first 18 mcf of daily production. Our Firm is committed to staying up to date on issues that will benefit the oil and natural gas industry and those who serve its members. The following is a summary of this credit and its source and application.

Marginal well working interest owners have not experienced much in their favor in the past several years with lower production, lower gas sales prices, and increased operating, transportation, and regulatory costs. Surprisingly, a very positive current item for marginal well working interest owners may be found in the federal income tax area with a federal income tax credit for 2016 natural gas production. Internal Revenue Code Section 45I was passed by Congress as part of the American Jobs Creation Act of 2004. This MWC was based on production from qualified marginal wells. Qualified marginal oil wells are those with an average production of not more than 15 barrels per day, those wells producing heavy oil, or wells producing not less than 95% water with average production of not more than 25 barrels per day of oil. Qualified marginal natural gas wells are those producing not more than 90 mcf per day. The first step in determining wells that qualify for this credit is making certain they qualify as marginal wells, combining oil and natural gas equivalent units to determine marginal well status.

This tax provision allows a \$3 per barrel tax credit for the first three barrels of daily oil production from an existing marginal well and a \$.50 per mcf tax credit for the first 18 mcf of daily natural gas production from a marginal well. The second step is determining the actual average daily production from the qualified wells and limiting that production to a daily combined three barrels of oil and 18 mcf of natural gas in equivalent units of production. If oil produced from qualifying wells is not allowed in a year due to oil's reference price being too high, which was the case for 2016 production, it should be appropriate to include only natural gas in your 18 mcf of qualifying production calculation. The qualified average daily production under this limitation would then be applied to the number of days that the working interest owner actually owned that well interest.

The third step in determining the dollar amount of federal tax credit available is to apply the qualifying production in a year to the approved dollar amount per unit of production. For oil production, the original \$3 credit per barrel was to be proportionately eliminated as the inflation adjusted average price of oil increased from \$15 to \$18 per barrel. For 2016 oil production, the inflation adjusted maximum credit of \$3.70 per barrel was eliminated as the average allowable sales price of oil in 2015 increased from \$18.50 to \$22.20 per barrel and the 2015 reference price for oil was above \$22.20 per barrel.

For 2016 natural gas production, there is a MWC for the first 18 mcf of daily production from qualifying wells of \$.14 per mcf. The original maximum MWC of \$.50 per mcf has now increased due to inflation to a maximum of \$.6166 per mcf. The original \$.50 per mcf credit was reduced as the average price of natural gas in the year prior to the production year increased from \$1.67 to \$2.00. With inflation, the 2016 natural gas maximum credit of \$.6166 per mcf is reduced as the reference price of natural gas in 2015 increases from \$2.06 to \$2.47 per mcf. In other words, if the reference price for natural gas production is less than \$2.47 per mcf in 2015, there will be a MWC for 2016 natural gas production.

The Internal Revenue Service is the agency that is to calculate and publish the 2015 natural gas reference price. This average natural gas price will determine the amount of credit per mcf of qualifying production no matter what producers actually sell their natural gas for in 2016. The Internal Revenue Service issued Notice 2017-51 listing the 2016 inflation adjustment factor of 1.2332 and the 2015 applicable reference price of \$2.38 per mcf. Based on these factors, the MWC for 2016 natural gas production from "stripper wells" is \$.14 per mcf.

This natural gas federal income tax credit for 2016 qualifying production is definitely good news. One additional limitation on use of this credit is that it may only offset regular income tax in excess of Alternative Minimum Tax (AMT). An offsetting benefit to this AMT limit is that any MWC not used in a year due to total tax or AMT limits may be carried back 5 years and over up to 20 years. This extended number of years to utilize this credit hopefully ensures a significant amount of Section 45I credit for 2016 natural gas production will be realized by those with qualifying marginal well production.

We will continue to monitor and update information about this credit as its specific application become better defined. If you have any questions concerning the above information or how this credit may be applied to benefit you, please contact the following Arnett Carbis Toothman LLP associates at 800-924-0729 or email at: [don.nestor@actcpas.com](mailto:don.nestor@actcpas.com); [marlin.witt@actcpas.com](mailto:marlin.witt@actcpas.com), [bill.phillips@actcpas.com](mailto:bill.phillips@actcpas.com); [ryan.nestor@actcpas.com](mailto:ryan.nestor@actcpas.com); or [wanda.bailey@actcpas.com](mailto:wanda.bailey@actcpas.com). You may also contact any of our Arnett Carbis Toothman LLP offices and we will respond to your requests concerning this valuable credit or other planning needs you may have.