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Energy Practice

April 15, 2016

Found Money? Potential Overlooked Texas Tax Credits for Oil and Gas Producers

By: Geoffrey Polma and Martin Gibson

Cash-strapped E&P companies may be leaving a portion of their severance taxes on the table. Among other production incentives found in the Texas Tax Code are (1) a tax credit for qualifying low-producing oil leases and (2) a tax credit for qualifying low-producing gas wells. It is only recently that the oil credit has applied whereas the gas credit has applied for several years. Informal surveys indicate that many eligible companies are not claiming credits available under these provisions.

Tax Credit for Low Producing Gas Wells

This is a two-step test found in Texas Tax Code §202.059 and is on a well-by-well basis.

First, the credit is available only to "qualifying low-producing wells," defined as gas wells whose production during a three month period is no more than 90 Mcf/day, determined by computing the average daily production from the well using the monthly well production report made to the Railroad Commission.

Second, the credit is available only when the taxable price of gas falls below certain thresholds. The price is based not on what a particular producer receives, but rather on the average taxable price of gas adjusted to 2005 dollars during the previous three months as reported on certain indices, all as computed by the Texas Comptroller. Each month, the Comptroller analyzes the three preceding months' data to determine what percentage credit, if any, applies. Every qualifying low-producing well in Texas becomes entitled to claim the credit for that month. The relevant indices are Henry Hub, Houston Ship Channel, Mississippi Barge, New York Mercantile Exchange, "or other spot prices, as applicable." The producer receives a 25% credit when the average price is between $3/Mcf and $3.50/Mcf; a 50% credit between $2.50 and $3; and a 100% credit if the price is not more than $2.50. The credit is applied "on the tax otherwise due on gas produced and saved from that well during a month."

A producer must file Form AP-217 with the Texas Comptroller to establish that a specific well is a qualifying low-producing well entitled to the credit. Thereafter, any person remitting tax on production from the well simply claims the credit as a reduction of taxes due for qualifying months when the return is filed (other than in future months in which the production exceeds qualifying levels). The credit does not apply to casinghead gas or condensate. The credit, if overlooked, can be claimed retroactively within the limitations period of Texas Tax Code §111.104, which is four years from the date a report is due. The reference price has been low enough to trigger a partial or full credit for all but 5 months since September, 2011. Therefore, persons who historically remitted tax on production from qualifying low-producing wells without claiming credits may be entitled to a tax refund.

Tax Credit for Qualifying Low Producing Oil Leases

Like the gas credit, the oil lease credit is a two-step test, found in Texas Tax Code §202.058.

First, an oil lease must be a "qualifying low-producing oil lease," which requires that the well must be classified as an oil well and must, during a 90 day period, produce less than 15 barrel of oil per day or 5% recoverable oil per barrel of produced water. Per day production is calculated by dividing the sum of the lease production by the sum of the number of "well-days," where a

well-day is one well producing for one day and the volume is based on the operator's monthly lease production report.

Second, for qualifying leases, the availability of the credit for any month is determined by whether the oil price is below a certain price for the previous three months. As with the gas credit, the relevant price is not what a qualifying well actually receives, but instead an average price computed by the Comptroller based on spot price indices. Once the Comptroller determines that the credit applies for a particular month, all qualifying leases in Texas are entitled to claim the credit. The oil price is also adjusted to 2005 dollars; this means, for example, the June, 2014 WTI price was $106 but the Comptroller's adjusted price was $75.21. Since the calculated price adjusted to 2005 dollars must be less than $30 for any credit ($25-$30 = 25% credit; $22-$25=50% credit; $22 or less = 100% credit), it was only when the calculated price dropped below $30 in February of 2016 that the oil credit first became available for any month.

The credit does not apply to casinghead gas. Like the gas credit, a producer files a Form AP-216 with the Texas Comptroller to establish that a specific lease is a qualifying low-producing oil lease entitled to the credit, and thereafter the credit is claimed on returns filed for qualifying months to reduce the taxes payable. Refunds are available for overlooked oil credits, but oil credit refunds are less of an opportunity than gas credit refunds because the oil credit has only very recently become available.

More Information

For more and for the appropriate forms, please visit here and here.

Members of the Texas Alliance of Energy Producers may listen to a podcast on this subject on April 14 and thereafter. www.texasalliance.org.

Caution

While we are aware of no current instances, we are aware of claims having been made against a well operator by royalty owners and working interest owner for refunds or credits that could have been taken but were not.

Geoffrey Polma | 214-740-8644 | gpolma@lockelord.com
Martin Gibson | 512-305-4743 | mgibson@lockelord.com