Don't Miss Out on the Gross Production Tax Rebate for Economically At-Risk Oil and Gas Wells

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A little used gross production tax rebate may now be available to help cushion the blow of low oil and natural gas prices. This gross production tax rebate is available to owners of economically at-risk wells. The rebate was designed to extend production from wells that otherwise would likely be shut in during difficult times in the oil and gas industry (such as these) and has been in the law since 2005. With the steep drop in oil and natural gas prices in the last two years, many more oil and gas wells now qualify as economically at-risk than ever before. In fact, the Oklahoma Tax Commission estimates that the claims for the economically at-risk rebate for the 2015 year will total $132.9 million compared to total rebates of just $11 million in 2013 when prices were much higher.

An “economically at-risk oil or gas lease” eligible for the rebate is any oil or gas lease operated at a net loss or at a net profit which is less than the total gross production tax remitted for the lease during the previous calendar year. *See* 68 O.S. §1001.3 (a). A “lease” for this purpose is defined as “a spaced unit, a separately metered formation within the spaced unit, or each tract within a Corporation Commission approved unitization, or a lease which, for tax reporting purposes, has been assigned a production unit number”. *See* 68 O.S. §1001.2 (b).

To determine whether a lease is economically at-risk, an operator starts with the gross production from the lease and then subtracts severance taxes, royalty, operating expenses of the lease including workover and recompletion costs for the previous calendar year, and overhead costs up to the maximum overhead percentage allowed by the Council of Petroleum Accountants Societies (COPAS) guidelines. No deduction is allowed for depreciation, depletion, or intangible drilling costs in determining whether the well is economically at-risk.

Using that methodology, if the lease is operating at a net loss, then it will be economically at-risk and eligible for the rebate. The amount of the rebate for economically at-risk wells subject to the standard 7-percent rate is 6/7ths of oil and gas production taxes collected, while the amount of the rebate for wells subject to the 4-percent rate is 3/4ths of oil and gas production taxes collected. To simplify, the impact of the rebate reduces the effective gross production tax rate on qualified economically at-risk oil or gas wells to 1 percent.

The operator cannot claim the rebate until after July 1 of the year subsequent to the year of the production. So, for example, the claim for rebate for 2015 production cannot be made until after July 1, 2016. The rebate claim must be made within eighteen months after the date the refund is first available or the claim will be barred. The rebate claim is to be made on Form 329 "Gross Production Application for Certification – Economically At-Risk Oil Lease".

To complete the Form 329, the operator needs to provide the following:

- Operator's FEI/SSN number.
- Operator's OCC assigned company number.
- Operator's name and mailing address information.
- Lease name as found on record at the Oklahoma Tax Commission.
- Lease description.
- Oklahoma Tax Commission assigned production unit number.
- Calendar year for request.
- Total gross revenue earned for the calendar year including both oil and gas production.
- Lease royalty.
- Operating expenses for the lease to include expendable workover and recompletion costs for the previous year.

- Gross production tax deducted by the tax remitter, which shall not include petroleum excise tax or any fee collected for another agency.
- Actual overhead cost, but do not exceed the maximum overhead percentage allowed by COPAS guidelines.

The Oklahoma Tax Commission has the authority to determine if an oil or gas lease qualifies for certification as an economically at-risk oil or gas lease. Within sixty (60) days after an application is filed for economically at-risk oil or gas lease status, the Oklahoma Tax Commission shall make its determination and shall issue either an approval letter or a denial letter to the lease operator. Upon certification by the Oklahoma Tax Commission, a refund of the gross production taxes paid in the previous calendar year for the lease shall be issued to the well operator or its designee after July 1 of the subsequent year.

Although Oklahoma oil and gas producers could use this tax incentive now more than ever, the economically at-risk lease rebate is itself at-risk as the Oklahoma Legislature explores options to reduce Oklahoma's budget shortfall. Earlier this year, a bill was introduced to suspend the rebate for economically at-risk wells. While the bill did not advance, an amendment to the statute suspending, reducing or eliminating the rebate could be proposed at any time prior to the end of the legislative session. Hopefully, this much needed rebate will be left alone to do what it was designed to do – enable producers to maintain production from their wells that are operating at a loss during this period of low prices.

Absent a statutory change this session to the gross production tax rebate for economically at risk leases, operators should be evaluating whether they may be eligible for the rebate and should be ready to submit claims attributable to 2015 production to the Oklahoma Tax Commission on or after July 1, 2016. Don't miss out!

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