ENERGY NEWS

DENNIS, GARTLAND & NIERGARTH
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Energy Industry Clients & Friends

As 2017 comes to a close, it certainly has been another year of uncertainty in the Michigan oil and gas industry. Our hope for all of our industry friends is a cold winter and increased prices! We at Dennis, Gartland & Niergarth are pleased to share our latest annual edition of the DGN Energy News. The DGN team is committed to providing our clients and colleagues in the oil and gas industry with the most current and comprehensive expertise as your trusted advisors. As with our previous energy newsletters, we hope you find something in the articles below that will help you to improve the profitability of your business or your ability to plan for the future. We look forward to working together in the year ahead.

Tax Reform on the Horizon

By Shelly A. Ashmore, CPA, MST

The Conference Committee recently reconciled the House and Senate versions of the tax reform bill, and President Trump signed the Tax Cuts and Jobs Act (TCJA) into law December 22, 2017. The law provides significant changes for both businesses and individuals. A cornerstone is targeted reductions in business taxes, with the intent to spur on capital investments and job growth. It also aims to provide tax benefits for individuals and families. Most provisions are effective beginning January 1, 2018 and some of the highlights are discussed below.

The law reduces the corporate tax rate to a flat 21% rate and also provides a reduction in tax on pass through income. This includes Sole Proprietors, S Corporations, Partnerships and LLCs. There are various complexities in the new pass through deduction. In general, the law provides for a 20% deduction of Qualified Business Income (QBI) for certain taxpayers. Service providers (other than engineers and architects) will generally be limited on benefits from these provisions unless taxable income is less than $315,000 (married) or $157,500 (single).

The law provides for a temporary increase in bonus depreciation to 100% on eligible property in service after Sep 27, 2017. The law also now allows bonus depreciation to be taken on both new and used assets in service. Previously bonus depreciation was allowed at 50% on new property only. The Section 179 deduction has also been increased to $1 Million on eligible property with the phase out at $2.5Million.

The law reduces the corporate tax rate to a flat 21% rate and also provides a reduction in tax on pass through income.

The corporate AMT was eliminated while individual AMT remains now with higher income thresholds. Like-kind exchanges are now limited to real property only. Deductions

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for business entertainment and DPAD were both eliminated. Business interest expense will be limited to 30% of EBITDA for entities with average gross receipts in excess of $25 Million.

The prior tax law included 7 individual rates from 10% - 39.6%. The new law provides the same 7 brackets now ranging from 10% - 37%, with the top bracket reduced and 4 of the middle brackets each getting a 3% - 4% rate reduction through 2025.

The preferential tax on long term capital gains and qualified dividends of 0%, 15% and 20% remain unchanged. However, short term capital gains which are taxed at ordinary income rates could be lower for many taxpayers under the new law.

TCJA eliminates personal exemptions and many of the itemized deductions. However, the law raises the standard deductions to $12,000 (Single) and $24,000 (Married). Medical deductions are retained in excess of 7.5% of AGI. Charitable deductions remain and the limit is increased to 60% of AGI for cash contributions.

State, local and real estate tax deductions on a combined basis are now limited to $10,000. Mortgage interest on a qualifying residence is an allowable deduction on acquisition indebtedness but now limited to $750,000 (previously $1Million). However, these reduced limitations will not apply to debt incurred on or before December 15, 2017. Additionally, refinancing will not affect the limits to the extent it doesn't exceed the original debt. Home equity interest will no longer be an allowable deduction.

Surprisingly, the exclusion of gain on the sale of a principal residence remained the same for homes used for 2 of the last 5 years. Both the House and Senate bills had proposed to increase the usage requirement to 5 of 8 years. However, the final bill left the law unchanged…an unexpected win for taxpayers.

The individual mandate penalty under the Affordable Care Act will be repealed starting in 2019. The law also expands the child tax credit and eliminates the Pease limitation on itemized deductions, both taxpayer favorable. However, it also repeals deductions for moving expenses, unreimbursed employee expenses, and miscellaneous itemized deductions. Personal casualty losses will now be limited to only those in federally declared disaster areas.

The estate tax exclusion has been doubled which means each taxpayer will have an exemption of $11.2 Million in 2018 indexed for inflation. However, this provision will sunset and return to current levels in 2026 unless made permanent. Both the step-up-in-basis and portability provisions remain unchanged under the new law.

Both the Marginal Well Credit (MWC) and the Enhanced Oil Recovery Credit (EOR) remain unchanged although the House version of the bill had proposed repealing both credits.

There are numerous provisions and complexities not addressed here and forthcoming regulations will continue to clarify the application of the law. Please contact our office if we can assist with further questions related to your particular situation.

DGN's Energy Industry Team – Expertise & Experience

DGN's Energy Industry Team brings multidisciplinary expertise in tax, audit and accounting, as well as significant experience with the many complex facets of the oil and gas industry. Services include:

- Entity Selection
- Tax Planning Strategies
- Tax Return Preparation
- Alternative Minimum Tax Planning
- Form 1099 Assistance
- Personal Property Tax Returns
- Multistate Tax Planning
- Audited and Reviewed Financial Statements
- Periodic Financial Statement Compilation
- Bookkeeping Services
- Custom Investor Brochures
- Investor Education
- Mergers & Acquisitions
- Due Diligence on Acquisitions
- IT Services

For more information or to discuss industry issues, please contact the DGN Energy Industry Team.

DRILL BITS

By Liz Hedden, CPA

As we informed you in previous years, effective January 1, 2012, the subtraction allowed for gross oil and gas revenues from Michigan taxable income changed dramatically. The new law still permits taxpayers to subtract their gross income, but now requires them to add back all of the expenses incurred on the production of this income. This new tax treatment has left us with a lot of unanswered questions about which expenses the state considers "production costs". Adding to the confusion is the Michigan Department of Treasury, which has not been consistent on which addbacks they are requiring – some of our responses to these notices have been rejected with a Department of Treasury letter asserting all oil and gas costs should be added back, including intangible drilling costs and dry hole costs. Be aware that the State of Michigan has been issuing notices for the majority of taxpayers with adjustments for oil and gas on their returns. The notices require additional information

Depreciation Update

By Jonathan Benjamin, CPA

The Protecting Americans from Tax Hikes Act of 2015 (the PATH Act) enacted several depreciation provisions for the 2015 tax year and beyond. These provisions permanently extended Section 179 expensing while indexing it for inflation, and extended bonus depreciation through 2019. Recently passed legislation, the Tax Cuts and Jobs Act, further modifies and expands these and other provisions to further accelerate cost recovery.

For 2017 $510,000 of qualified purchases may be expensed, with a phase-out of the deduction beginning at $2,030,000 of purchases. Section 179 may be claimed against either new or used purchases, but requires taxable income to offset the deduction claimed. For 2017 bonus depreciation of 50% is available for qualified new asset purchases purchased prior to September 28, 2017. Unlike Section 179, the bonus depreciation deduction is not subject to the taxpayer's taxable income limitation.

The PATH act also created opportunities to accelerate depreciation on a new category of property. Qualified Improvement Property (QIP) includes any improvement to an interior portion of a building that is nonresidential real property if the improvement is placed in service after the date the building was first placed in service. Exclusions from QIP include expenditures to enlarge a building, elevators and escalators, and additions to the internal structural framework of the building. QIP qualifies for 50% bonus depreciation, significantly accelerating depreciation from prior methods.

Section 179 expensing has been modified and increased to $1 million, with the phase-out amount increased to $2.5 million, effective for tax years beginning after 2017.

Under the recently passed Tax Cuts and Jobs Act, several new provisions are slated to take effect with eligible asset purchases after September 27, 2017. The most significant of these revises bonus depreciation rules to allow 100% expensing of qualified property placed in service prior to January 1, 2023, with gradual phase-outs from 2022 through 2026. Additionally, bonus depreciation now applies to previously used property, as long as it is the taxpayer's first use of the property. Section 179 expensing has been modified and increased to $1 million, with the phase-out amount increased to $2.5 million, effective for tax years beginning after 2017. Further, Section 179 expense now applies to improvements to nonresidential property placed in service after the date the property was first placed in service. Additional provisions include increased depreciation allowed on passenger automobiles, shortened recovery periods for residential real property, and new limits on like-kind exchanges to apply to real property only.

Over the past several years Congress has been modifying depreciation provisions that have generally been favorable to businesses in accelerating cost recovery on certain assets. Recently passed legislation will have a significant impact in 2017 and beyond in the ability to accelerate depreciation and reduce taxable income.

in order to process the returns and issue any refunds due. Unfortunately, this has become routine now for the State since the 2012 law change. This summer, the State of Michigan issued a DRAFT Revenue Administrative Bulletin (RAB) that attempts to define oil and gas income and expenses. Obviously, these definitions are in the State's favor and require addbacks of expenses such as overhead, intangible drilling costs and depletion to name a few. The Michigan Oil & Gas Association (MOGA) has been allowed to comment and has done so with the assistance of the Michigan Chamber of Commerce. MOGA and the Michigan Chamber are working hard on the industry's behalf to fight the DRAFT RAB and help them define "production costs" for the industry. Despite the inconsistency from the Department of Treasury, we at DGN have been successful in obtaining many client refunds. However, we have seen a more aggressive approach by the State with this new DRAFT RAB, even though it is only in DRAFT form. The DGN Energy team will continue to follow up with the State and MOGA for additional guidance.

Due to low oil prices, the federal Section 43 Enhanced Oil Recovery (EOR) credit is available for 2017 and most likely 2018. The credit is equal to 15% of the taxpayer's qualified enhanced oil recovery costs (QEORC). QEORC are incurred on any U. S. project that involves one or more tertiary recovery methods that under sound engineering principles can reasonably be expected to result in a more than insignificant increase in the amount of crude oil which will be ultimately recovered. A project shall not be treated as a qualified enhanced oil recovery project unless the operator timely submits to the Secretary a certification from a petroleum engineer that the project meets the engineering and recovery requirements. The EOR credit qualifies as a general business credit and therefore any unused current year portion can be carried back one year and forward 20 years.

We are currently updating our Form 1099 Oil & Gas Compliance Guide for 2017. If you received a 2016 Guide, you will automatically receive the 2017 package. If anyone else is interested in receiving this popular industry resource please contact Dennis, Gartland & Niergarth at (231) 946-1722 or dgn@dgncpa.com for a complimentary copy.

UPCOMING CHANGES FOR REVENUE RECOGNITION

By Julie A. Burks, CPA

Many businesses, as well as investors, rely on revenue as an important measure of performance and a crucial component in valuation.

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09 (ASU 2014-09), Revenue from Contracts with Customers, which sets out a single and comprehensive framework for revenue recognition. For many companies, the timing and pattern of revenue recognition will change from earlier guidance. For some industries, the changes will be very significant and will require careful planning.

Prior to ASU 2014-09, under current generally accepted accounting principles, revenue is recognized when it is earned and realizable. Commonly used criteria includes: persuasive evidence that an arrangement exists; delivery has occurred or a service has been rendered; price is fixed or determinable; and, collectability is reasonably assured. Current guidance, including industry specific guidance such as that for oil and gas entities in ASC 932-605, will be superseded by ASU 2014-09.

In the new guidance, the core principle of revenue recognition is to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The FASB provides the following five steps to apply to achieve this core principle:

1) Identify the contract with a customer
2) Identify the performance obligations (promises) in the contract
3) Determine the transaction price
4) Allocated the transaction price to the performance obligations in the contract; and
5) Recognize revenue when (or as) the reporting organization satisfies a performance obligation.

The effective date for adopting ASU 2014-09 is the annual reporting period beginning after December 15, 2017, for public companies, and December 15, 2018, for non-public companies, including interim reporting periods. Both public and non-public companies may adopt the new standard early, but not before annual reporting periods beginning after December 15, 2016.

How might this new standard affect you? Certain arrangements such as sales of mineral interests and production payments, take-or-pay arrangements, and/or drilling contracts are a few areas requiring consideration of these changes in revenue recognition.

Some areas of the industry will be greatly impacted and careful planning prior to adoption will be key in a seamless implementation. Our DGN Energy Industry team is here to provide you with the tools and resources your company needs.

Thank You

At Dennis, Gartland & Niergarth, we continue to value the confidence you have shown in our firm and look forward to working with you in the future. We always welcome your comments on this newsletter, our services and energy issues that are impacting you and your business. We also invite you to visit our website at www.dgncpa.com. As always, ***Our Clients' Success Is Our Business.***

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