ENERGY NEWS

DENNIS, GARTLAND & NIERGARTH
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Energy Industry Clients & Friends

As 2018 has come and gone, it certainly was another year of uncertainty in the Michigan oil and gas industry. Congratulations to our industry friends on 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 Cuts and Jobs Act 2018

By Shelly A. Ashmore, CPA, MST

The Tax Cuts and Jobs Act (TCJA) signed into law December 22, 2017 is arguably one of the biggest changes in the tax code in over 30 years. The new law will have a significant impact on both businesses and individuals beginning with the 2018 filing year.

Some of the highlights and changes that **businesses** will see under TCJA include:

- Elimination of deductions for entertainment or recreation
- Meals remain deductible at 50%
- Limitation on business interest if gross receipts > $25 million
- Bonus Depreciation now deductible at 100% for both new and used property
- Section 179 deduction increased to $1 million, phase-out increased to $2.5 million
- Qualifying 179 property is expanded
- Increased depreciation limits for luxury autos
- Like Kind Exchanges now allowed only for real estate
- New tax credit for employers that pay family and medical leave to employees
- Cash method of accounting now available if average gross receipts < $25 million
- Domestic Production Activities Deduction (DPAD) was eliminated
- New 20% Section 199A deduction for passthroughs and Sole Proprietors (see article on page 3 for more information)
- For C corporations, TCJA reduces the corporate rate to a flat 21% and eliminates AMT

Some of the highlights and changes that **individuals** will see under TCJA include:

- Reduction in tax rates
- Elimination of personal exemptions
- Expanded standard deduction $12,000 (S), $18,000(HOH), $24,000 (MFJ)
- State, local, sales & property tax deduction on a combined basis is limited to $10,000
- Charitable contribution limit increased to 60% of AGI for "Cash" contributions

TAX REFORM - CONT'D ON PG. 2

TAX REFORM - CONT'D FROM COVER

- Charitable deductions are no longer allowed for athletic event "seating rights"
- Medical expense AGI threshold reduced from 10% down to 7.5%
- Mortgage interest remains deductible on loans up to $750,000 ($1M if loan originated prior to December 15, 2017)
- Interest on a home equity loan is no longer deductible
- Casualty and theft losses were eliminated unless attributable to federally declared disaster
- Overall limit on itemized deductions was suspended
- Miscellaneous itemized deductions (job related expenses, investment fees, tax prep) were eliminated
- Moving expense deduction was suspended and employers must include moving expense reimbursements as taxable wages to the employee
- Child tax credit maximum increased to $2,000 and income thresholds were increased
- Alternative Minimum Tax exemption was increased and the income thresholds increased
- Qualified Opportunity Zone investment opportunity is new and provides tax deferral on capital gains
- Alimony payments are no longer deductible or includable in income for agreements after December 31, 2018
- 529 plan distributions are now allowed for K-12 education
- Kiddie tax is now calculated based on trust and estate tax rates, and will be subject to the highest tax rate of 37% once income is over $12,500
- Recharacterizations of Roth conversions are no longer allowed
- The individual mandate penalty under the Affordable Care Act will be repealed starting in 2019
- The Estate and gift tax exemption was doubled to $11.2M, but will sunset in 2026 unless made permanent

The IRS continues to issue regulations to help further explain the application of the law. There are various complexities and planning opportunities to be considered and each situation is unique. Please contact our office if we can assist with further questions related to your individual circumstances.

INSIDE PUBLIC ACCOUNTING TOP 400 FIRMS 2018

INSIDE PUBLIC ACCOUNTING BEST OF THE BEST FIRMS 2017

DRILL BITS

Due to low oil prices, the Federal Section 43 Enhanced Oil Recovery (EOR) credit is available for 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 enhance 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.

Michigan News & H.B. 6485

Beginning in 2012, the law required adjustments to the Michigan income tax base by eliminating income and expenses of oil and gas "production subject to severance tax." Six years later in 2018, Treasury issued RAB 2018-8 providing their interpretation of the statute. The RAB expanded on the "production expenses" to also include "pre-production costs" as part of the disallowed tax deductions for the industry.

During the lame duck session, a team from MOGA along with Rep. Triston Cole introduced House Bill 6485, seeking to clarify the language of the statute and isolate "production expenses" as the only disallowed expenses. The Bill passed both the House and Senate, but unfortunately was vetoed by Governor Snyder.

There will be further developments on this issue as MOGA and those in the industry maintain their position that this was the intent of the legislature when the law was passed, and the plain language of the statute also supports this argument. The DGN Energy team will continue to follow up with the State and MOGA for additional guidance.

Tax Reform and the Qualified Business Income Deduction

By Jonathan Benjamin, CPA

The Tax Cuts and Jobs Act (TCJA), effective for 2018, enacted several favorable tax provisions for both businesses and individuals. In January 2019, the IRS released regulations that clarified ambiguities in the new law and modified the proposed regulations in several key areas. The new IRC Sec. 199A deduction available to owners of partnerships, S-corporations, sole proprietorships, and certain rental properties could provide significant tax savings.

To claim the full Section 199A deduction the taxpayer must be in a qualified trade or business.

Taxable income from these entities passes through and is taxed on Form 1040 at the owners' standard tax rates. Beginning in 2018, the TCJA established a Section 199A deduction for this type of pass through income and is subject to certain limitations, exceptions, and phase-ins and phase-outs.

The Section 199A deduction is generally 20% of Qualified Business Income(QBI). QBI is essentially net income with some exceptions. A few common items not included in QBI include capital gains, dividend income, or interest income, as well as any deduction related to these items. Further, QBI does not include W-2 compensation or guaranteed payments paid to the taxpayer for services on behalf of the trade or business.

Conversely, sole proprietorships have no adjustment to QBI for reasonable compensation paid for the value of the owner's services. However, pursuant to the final regulations, self-employed individuals must reduce QBI by 50% of self-employment tax, the self-employed health insurance deduction, and qualified retirement plan contributions.

To claim the full Section 199A deduction the taxpayer must be in a qualified trade or business. This is broadly defined as any business other than the business of performing services as an employee or a specified service trade or business (SSTB). A SSTB is generally any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners, although some exclusions apply. These restrictions prevent claiming a Section 199A deduction against wage income or personal service income.

Rental property owners are subject to ambiguity in determining whether their rental income qualifies as trade or business income. There are various requirements as well as uncertainties in this area, and each situation will need to be evaluated accordingly.

The QBI deduction is also subject to certain restrictions when taxable income exceeds various thresholds.

These thresholds are:

Married Filing Jointly:
$315,000 - $415,000

All Other Taxpayers:
$157,500 - $207,500

For taxpayers with income in excess of these thresholds, the QBI deduction is limited to:

The greater of:

1) W-2 Wages x 50%
2) W-2 Wages x 25% + 2.5% cost basis of qualified property

If these thresholds are not met, there is a reduced deduction. Further, a second limitation may reduce the deduction to 20% of the taxpayer's taxable income less the sum of net capital gains.

Taxpayers with SSTB income are subject to phase-out of the deduction based on the same thresholds above. The deduction is completely eliminated if over the upper limit.

This provision involves many complexities that have not been addressed in this article. However, the Section 199A deduction will provide a significant tax benefit to many taxpayers with qualified business income. Please contact us if we can assist with any questions you may have related to your particular situation or for planning opportunitiesto ensure you are getting the best use of this new deduction.

DGN's Energy Team – Expertise & Experience

DGN's Energy 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 team.

FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) ACCOUNTING STANDARDS UPDATE FOR LEASES

By Aaron Mansfield, CPA

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, Leases (Topic 842), which is intended to improve financial reporting for leasing transactions. The ASU affects all companies that lease assets such as real estate, airplanes and equipment.

The ASU will require companies that lease assets – referred to as "lessees" – to recognize all leases, with lease terms of more than 12 months, on the balance sheet as a right-of-use asset and lease liability for the rights and obligations created by those leases. Consistent with current Generally Accepted Accounting Principles (GAAP), the recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP – which requires only capital leases to be recognized on the balance sheet – the ASU will require both types of leases to be recognized on the balance sheet.

The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements.

The accounting by companies that own the assets leased by the lessee – also known as lessor accounting – will remain largely unchanged from current GAAP. However, the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in 2014.

The ASU could have an effect on the calculation of any debt covenants required by bank financing and may make companies out of compliance with debt covenants. It is recommended companies discuss this upcoming change with their respective bank before it is implemented.

The ASU on leases will take effect for fiscal years beginning after December 15, 2019 and for interim periods within fiscal years beginning after December 15, 2020. Please contact our office if we can assist with further questions related to your company's circumstances.

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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