HOW TAX REFORM WILL IMPACT OIL & GAS

On December 22, just a few weeks following the passage of the Senate's Tax Cuts and Jobs Act, the conference version of the bill was signed into law, marking the largest change to U.S. tax policy in decades.

Most of the provisions are set to go into effect this year, and it's important that the oil and gas industry review the changes that occurred during the conference process to understand the impact to their companies.

To help executives navigate the key provisions affecting the energy industry, we've summarized top considerations and implications below.

PROVISION	SUMMARY OF CHANGES	IMPLICATIONS FOR PRIVATE EQUITY
REDUCE THE CORPORATE TAX RATE	Reduces the top corporate tax rate from 35 to 21 percent. **Effective date:** Taxable years after December 31, 2017	**Industry View:** Positive **What's at stake:** A reduction in the corporate tax rate is a huge win for oil and gas companies overall—especially since the major tax benefits the industry enjoys under the current tax regime have been left largely intact.
LOWER TAXES ON PASS-THROUGH BUSINESS INCOME	Raises the deduction available to pass-through filers to 20 percent. **Effective date:** Taxable years after December 31, 2017	**Industry View:** Positive **What's at stake:** Major tax savings for oil and gas companies structured as partnerships-including Master Limited Partnerships (MLPs)-and reduced tax liability for joint ventures.
REPEAL THE CORPORATE ALTERNATIVE MINIMUM TAX (AMT)	Conforming to the repeal of the corporate AMT, the bill also repeals the election to accelerate AMT credits in lieu of bonus depreciation. **Effective date:** Taxable years after December 31, 2017	**Industry View:** Positive **What's at stake:** Keeping the corporate AMT would have made it difficult for businesses to reduce their effective corporate tax rate lower than 21 percent.

PROVISION	SUMMARY OF CHANGES	IMPLICATIONS FOR PRIVATE EQUITY
ELIMINATE ABILITY TO CARRYBACK NET OPERATING LOSSES (NOL)	Eliminates taxpayers' abilities to carryback NOL, and will limit the use of NOLs to 80 percent of taxable income. NOLs will no longer have an expiration period. **Effective date:** The elimination of carrybacks is effective in taxable years after December 31, 2017. The current 100-percent allowance is phased down by 20 percent per year beginning in 2023.	**Industry View:** Negative **What's at stake:** This is potentially the most damaging aspect of the bill to the oil and gas industry. Costs incurred in one year will not be able to offset 100 percent of taxable income in the next year. This will require additional planning around intangible drilling costs (IDC) deductions versus capitalization over longer horizon.
LIMIT 1031 "LIKE KIND" EXCHANGES TO REAL PROPERTY	Eliminates the exemption for like-kind exchanges except for real property. **Effective date:** December 31, 2017. An exception is provided if the property in the exchange is disposed of or received by the taxpayer on or before December 31, 2017.	**Industry View:** Negative **What's at stake:** While the IRS treats oil and gas properties as "real property," the tax break no longer applies to other assets like machinery and equipment.
LIMITATIONS ON INTEREST DEDUCTIBILITY	Revises Section 163(j) and expands its applicability to every business, including partnerships. Generally, caps deduction of interest expense to interest income plus 30 percent of adjusted taxable income, which is computed without regard to deductions allowable for depreciation, amortization, or depletion. Disallowed interest is carried forward indefinitely. Contains a small business exception. **Effective date:** Taxable years after December 31, 2017.	**Industry View:** Negative **What's at stake:** Interest expense ceiling could be problematic to the highly leveraged E&P sector.
REPEAL SECTION 199	Repeals the section 199 domestic production deduction available for qualified production activities in the U.S. **Effective date:** Taxable years after December 31, 2018.	**Industry View:** Negative **What's at stake:** Oil and gas companies that previously claimed the section 199 deduction will no longer be able to reduce their tax rate by the benefit; however, this impact will likely be offset by the significant reduction in overall tax rates.

PROVISION	SUMMARY OF CHANGES	IMPLICATIONS FOR PRIVATE EQUITY
PARTICIPATION EXEMPTION SYSTEM	The participation exemption system generally provides a 100% dividends received deduction for the foreign source portion of dividends received by U.S. shareholders that are C corporations (other than a RIC or REIT) from certain foreign subsidiaries. **Effective date:** Applicable to distributions made after December 31, 2017	**Industry View:** Positive **What's at stake:** Significant tax savings for multinational companies over the long-term, but short-term "transition" taxes could be painful (see below). Domestic oil and gas companies will be largely unaffected.
TAX EXISTING OVERSEAS PROFITS	U.S. shareholders of certain foreign corporations are required to include the foreign corporation's deferred foreign earnings into taxable income. Earnings held in cash and cash equivalents subject to a 15.5% rate and an 8% rate applies to all other earnings. **Effective date:** Effective for the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to U.S. shareholders, for the taxable years in which or with which such taxable years of the foreign corporation's end.	**Industry View:** Neutral **What's at stake:** The one-time repatriation tax rate is relatively low, but may still come as an unexpected expenditure for companies with significant cash overseas.
BASE EROSION ANTI-ABUSE TAX (BEAT)	Introduces a new base erosion minimum tax that applies to certain multinational groups that make certain types of cross-border payments to related foreign persons. **Effective date:** Taxable years after December 31, 2017	**Industry View:** Negative **What's at stake:** Functioning like a global minimum tax, oil and gas companies owned by foreign entities or with significant foreign operations may be forced to pay the BEAT instead of the base rate less credits and deductions.
MODIFY CONTROLLED FOREIGN CORPORATION (CFC) SUBPART F RULES	Eliminates the inclusion of foreign base company oil-related income (FBCORI). **Effective date:** December 31, 2017	**Industry View:** Positive **What's at stake:** Oil and gas companies will no longer need to track FBCORI.

TACKLING TAX REFORM: 5 INITIAL STEPS OIL AND GAS COMPANIES CAN TAKE NOW

1. Assess impact. Tax professionals will likely need to review the law manually, measure their company's specific circumstances against it to assess the impact of each provision, as well as the holistic effect on their company's bottom line.
2. Assemble a team. While the heaviest burden may fall on accountants, companies and their finance teams will have an important role to play to gather all the necessary data.
3. Dig into the data. Assessing the impact of tax reform requires a substantial amount of data to be readily available. Companies need to move from modeling the impact of tax reform to focus on data collection and computations as soon as possible.
4. Establish priorities. Focus on the areas that could have the greatest impact on your company. For multinational oil and gas companies, landmark provisions include: international tax changes, changes that could influence entity choice (reduced corporate tax rates and lower taxes on pass-through business income), and the elimination of net operating loss (NOL) carrybacks.
5. Initiate tax reform conversations with your tax advisor. Tax reform of this magnitude is the biggest change we've seen in a generation, and will require intense focus to understand not only how the changes apply at a federal level, but also to navigate the ripple effect this is likely to have on state taxation as well.

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