Tax Benefits

Overview

Domestic oil and natural gas production is an essential part of meeting our nation's energy demand. To encourage domestic production, the United States Congress has created tax incentives for investors in private oil and natural gas programs. Increased domestic production will reduce reliance on foreign imports, provide a stable supply of energy for domestic growth, and strengthen the position of the United States in international trade.

Tax Benefits of Oil and Gas Investing

Each Class B Unit Holder may be eligible to benefit from any available tax incentive for oil and gas drilling programs such as intangible drilling costs, depreciation and depletion allowances. Electing to be a general partner may allow partners to offset their non-passive (or active) taxable income provided from other sources with the tax deductions available from investing in oil and gas wells. This discussion is intended only to highlight potential tax benefits of an investment in the partnership and does not constitute tax advise. A discussion of tax consequences associated with an investment in the partnership is in the Private Placement Memorandum under "Certain U.S. Federal Income Tax Considerations."

Intangible Drilling Costs

Intangible Drilling Costs (IDCs) are expenditures to develop oil and gas wells which do not have salvage value. Examples of such costs are labor, chemicals, drilling fluids, engineering, equipment rental, hauling, fresh water, sand, and other consumable or non-tangible items. IDCs may typically represent 60% to 80% of the cost of a well and are eligible for the election to be deducted 100% against taxable income. To encourage oil and gas exploration and production, IRS code section 461 has a special provision that allows IDCs paid by December 31st of any given tax year to be deductible in the same tax year provided the drilling of the well commences before the close of the 90th day after the close of the taxable year.

Tangible Drilling Costs

Tangible Drilling Costs (TDCs) are expenditures to develop oil and gas wells which do have salvage value. These costs include casing, pumps, jacks, wellheads and other tangible equipment. By using bonus depreciation (IRC Section 168(k)) allowed by the 2017 Tax Cuts and Jobs Act, some of these costs may be expensed when the tangible equipment is placed into service. The tangible equipment must have a useful life of less than twenty years as specified by the MACRS guidelines.

Depletion Allowance

As oil and gas is produced by a well, the hydrocarbons contained within the well are being depleted and a depletion allowance is permitted for U.S. tax purposes. The two methods to calculate the allowable depletion deduction are the cost depletion method and the percentage depletion method, with an election to deduct the greater amount computed by each method. Cost depletion is computed on the basis of initial capitalization cost of the oil and gas minerals, commonly referred to as leasehold costs. Over the production life of the well, a portion of these costs can be recovered each year based on the ratio of the production for the year as compared to the estimated recoverable oil and gas reserves at the beginning of the year. Percentage depletion is computed on the basis of the gross production income from the property rather than capitalization costs and it allows a tax deduction equal to 15% of the gross revenue from an oil and gas producing property. The percentage depletion allowance is limited to 100% of the net income of the property and is generally only available to independent producers and royalty owners. Over the life of a well, the tax benefit provided by percentage depletion may exceed the capitalization cost of the well.

Tax Benefits Worksheet

Estimated Adjusted Gross Income	$500,000 $_______________	Line 1
Amount of Investment	$250,000 $_______________	Line 2
Multiply Line 2 by 70%		
Estimated intangible drilling cost (IDC) amount	$175,000 $_______________	Line 3
Multiply Line 2 by 5%		
Estimated tangible drilling cost amount	$12,500 $_______________	Line 4
Add Line 3 and Line 4		
Estimated 1st year tax deduction	$187,500 $_______________	Line 5
Enter the Federal Income Tax Rate plus State and Local Tax Rates		
Federal maximum tax bracket is 37% - 47%*		Line 6
Multiply Line 5 by Line 6		
Equals your potential tax savings	$88,125 $_______________	Line 7
Subtract Line 7 from Line 2		
Net investment cost due to potential tax savings	$161,875 $_______________	Line 8

Enter Line 1		
Estimated Adjusted Gross Income without investment	$500,000 $______________	Line 9
Enter Line 5		
Estimated 1st year tax deduction	$187,500 $______________	Line 10
Subtract Line 10 from Line 9		
Estimated Adjusted Gross Income with investment	$312,500 $______________	Line 11

*Includes assumed state and local tax rate of 10%.

NOTE TO POTENTIAL INVESTORS: The Tax Benefits information and Tax Benefits Worksheet are not forecasts or projections and do not constitute tax advice. They merely provide, on a hypothetical basis, potential tax savings. The tax benefits of oil and gas exploration do not eliminate the risks. Please