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Accounting methods and credit services

Tax

The return of the enhanced oil recovery tax credit

Companies engaged in enhanced oil recovery (EOR) projects may benefit from the 15% EOR tax credit for 2016. The tax credit is intended to encourage the development of expensive oil reserves when the low price of oil would make such development financially burdensome. Due to rising crude oil prices, the credit was unavailable since 2006. Now, with the recent dramatic decline in crude oil prices, the EOR credit is likely to be available for 2016.

With the high cost of EOR projects and declining crude oil prices, receiving an income tax credit for a portion of the EOR project costs can lead to permanent cash and tax savings. Yet how can companies be sure they are receiving all the benefits for which they are eligible?

What is a qualifying EOR project?

A qualified EOR project must meet all of the following:

- Be located in U.S.;
- Employ one of the tertiary recovery methods described in the Treasury Regulations or otherwise approved by the IRS that is reasonably expected to result in more than an insignificant increase in the amount of crude oil that ultimately will be recovered;
- The first injection of liquids, gases, or other matter for the project occurs after December 31, 1990, or if before 1991, was significantly expanded after 1990; and
- Be certified by an engineer at the beginning of the project and by the operator annually but if not timely submitted, the credit will be allowed only after the appropriate certifications are submitted.

What costs qualify for the EOR credit?

The EOR tax credit equals 15% of the following costs incurred during the year for qualifying EOR projects:

- Costs for any depreciable tangible asset that is integral to the project;
- Certain intangible drilling and development costs incurred for a well to be used in a tertiary recovery method; and
- Qualified tertiary injectant expenses.

Significant expansion rule for projects whose first injection occurred before 1991

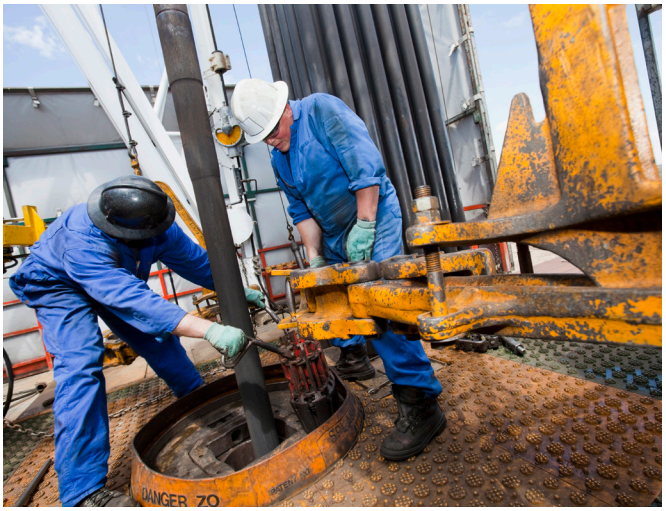
A project that began before January 1, 1991, may still qualify for the credit if the project is significantly expanded after December 31, 1990, if:

- It affects acreage that was substantially unaffected by the project's previously implemented tertiary activities (e.g., new drilling or new perforation);
- It affects a reservoir previously unaffected by a tertiary method (e.g., more intensive application of the same tertiary recovery method);
- A prior tertiary recovery method was terminated for at least 36 months; or
- It receives an IRS ruling that the project is significantly expanded.

Experienced team of professionals…

Our team of tax professionals have deep technical knowledge and practical oil and gas industry experience to help clients evaluate and comply with these complex rules while benefitting to the fullest extent from the available tax benefit. We can help you be prepared by evaluating your EOR projects from a tax perspective, identifying qualifying costs, and navigating through the complex tax rules.

Be prepared….Contact KPMG today.



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* While at her former position with the IRS, Office of Chief Counsel, Ms. Park was the principal author of Rev. Rul. 2003-82 on the definition of tertiary injectant expenses.

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