Investors, Uncle Sam Share Benefits of Drilling Programs

Vehicle Ideal to Address End-of-Year Tax Concerns

By Gregory Anderson, CFP®

As implausible as it seems, some of us occasionally end up with too much money. Specifically, too much at the wrong time. The untimely abundance means the government gets to share the windfall in the form of higher taxes, leaving less money available for investment that could generate even greater wealth.

This time of year, investors become even more concerned about finding tax-advantaged places to put their money. A vehicle that has received increasing attention in recent years is one that allows the investor to determine exactly how much he or she needs to establish as a write-off against the year's income. It is a natural gas drilling program, and it provides other investment advantages that I will discuss here. It is a non-indexed investment, meaning that it is not directly tied to the performance of the stock or bond markets.

Perhaps the most significant advantage -- and the one that attracts so many investors trying to deal with immediate tax issues -- is the possibility of up to100 percent first-year write-off. That is, the government assumes that your investment is allocated directly to intangible drilling costs, and in accordance with U.S. tax code, the government has established this benefit to encourage oil and gas exploration and development.

Yes, investors in natural gas drilling programs receive preferential tax-advantages on future distributions (depletion allowance). Currently, only 85 percent of the money returned is taxable. But the U.S. government benefits, too, by receiving much-needed support of an industry that is crucial to the nation's economy.

So let's say you are anticipating $250,000 in adjusted gross proceeds on this year's income tax return. It has lifted you into the 43 percent combined (both federal and state) tax bracket, and you have no significant write-offs (such as charitable donations, mortgage payments or childcare costs), meaning you face a tax bill of about $107,500. This is overly simplistic, because everyone has write-offs, but stay with me. You can invest $50,000 in a natural gas drilling program, and now your taxable income is only $200,000, and your tax bill is theoretically only $86,000, a savings of approximately $21,500.

Again, the simplicity is for illustration purposes only and you should consult your personal tax advisor.

After the first-year, 100 percent tax write-off, the benefits continue to accumulate in the form of monthly tax-advantaged distributions from the gas wells. With annual contributions of similar investments, the weighted value of the wells eventually returns to the investor after five years, whereupon the investor can use all proceeds to start anew – invest in a new natural gas drilling program. The result is a self-funding program of sorts. It works best if the investor is willing to commit to the full five years, because the longer term increases the likelihood of recapturing the original investment.

The success of any natural gas drilling program depends in part upon the continued appreciation of prices in the energy sector. Though this is a general discussion regarding natural gas drilling programs, there are risks involved in this type of investment. Drilling wells is highly speculative, and includes the risk of losing your entire investment. All risks concerning any particular offering should be reviewed in detail and can be found in the offering *memorandum or private placement memorandum. You should consult your tax advisor regarding the benefits and consequences to investing in natural gas drilling programs. Not all programs are suitable for everyone and customization is required. Natural gas drilling programs are subject to a number of risks and uncertainties, including, but not limited to, uncertainties concerning the price of natural gas and oil, the risk that the wells drilled are productive, but do not produce enough revenue to return the investment made or dry holes, general economic, market, or business conditions, and changes in laws or regulations. Some programs may require an accredited investor status.*

Gregory Anderson is CEO of Denver-based GRAnderson Wealth Management Group (www.GRAndersonWealth.com*). You can reach him at 303-388-7708 or via email at* Gregory@GRAndersonWealth.com.