



# Certain tax considerations

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# Speaker and disclosure

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- ▶ This presentation is for instructional purposes only and is intend solely to facilitate a discussion of the issues addressed herein. Nothing contained herein can, or should, be used for purposes of federal, state or local tax planning.
- ▶ The views expressed herein are the views of the presenter (Greg Matlock) and are not necessarily those of Ernst & Young LLP.

# New (old) investment structures

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- ▶ The change in the commodity price environment has resurrected prior structures that may have not been commercially viable a couple of years ago
  - ▶ Payout provisions – complete payouts (If a payout provision is included in a carried interest arrangement, the carried party would not share in revenue from property until the amount paid by carrying party is recovered (the payout period))
- ▶ New credit funds supplementing a potentially limited debt market for development
  - ▶ Equity-like features
  - ▶ Different returns than historical norms
- ▶ Arrangements such as production payments, net profits interests, and other interests are attracting more attention from the investment community

# Common types of ownership

Type	Characteristics
Working interest	<ul style="list-style-type: none"><li>• Granted by owner of mineral interest</li><li>• Entitles holder to share of production</li><li>• Bears all development and operating costs</li><li>• Intangible drilling cost &amp; depletion deductions</li></ul>
Royalty	<ul style="list-style-type: none"><li>• Retained by owner of mineral or fee interest when leasing operating rights to another party</li><li>• Entitles holder to receive share of gross income or production from mineral interest (net of production / severance tax)</li><li>• Does not bear development or operating costs</li><li>• Depletion deductions</li></ul>
Overriding royalty	<ul style="list-style-type: none"><li>• Carved out of operating interest</li><li>• Otherwise, similar characteristics as royalty</li></ul>
Production payment	<ul style="list-style-type: none"><li>• Right to receive a specified share of gross production from a mineral property</li><li>• Limited in quantum, (e.g., dollar, time or volume)</li><li>• Commonly treated as debt for tax purposes (with certain exceptions)</li><li>• If treated as debt, not entitled to depletion</li></ul>
Net profits interest	<ul style="list-style-type: none"><li>• Entitled to share of gross production, net of operating (and sometimes development) costs (net profits)</li><li>• Not directly liable for payment of costs</li><li>• Depletion deductions</li></ul>

# Accommodating new (foreign) capital

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- ▶ With competition for global capital, non-US investors have a wide variety of choices as to where they deploy capital
- ▶ As a result, net, after-tax IRR becomes important, placing more emphasis on investor-friendly tax structures
  - ▶ Blocker set up and maintenance
  - ▶ Intercompany debt (leveraged blockers)
  - ▶ Accommodating sovereign wealth funds (Section 892 investors)
  - ▶ Managing FIRPTA

# Planning up front with the end in mind...

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- ▶ Despite current market uncertainty, understanding potential public exit structures (and planning accordingly) is critical to ensure the ability to proceed in a tax-deferred manner
  - ▶ Questions → qualification for certain structures, which assets fit strategically into the structure, value proposition and comparison to base case, timing, liquidity and growth
  - ▶ Vehicles
    - ▶ MLP (including Royalty Trust variations)
    - ▶ Traditional C-Corp IPO (and “Up-C” variant)
    - ▶ YieldCo
- ▶ Funding capex → debt (intercompany or third-party) versus equity? Differences and benefits/detriments