Gollob Morgan Peddy
CERTIFIED PUBLIC ACCOUNTANTS

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Proposed Regulations for Section 199A Offer Great News to the Oil and Gas Industry.

The Law

The Tax Cuts and Jobs Act adds a new deduction for noncorporate taxpayers for qualified business income (also referred to as the "pass-through deduction"). The deduction is generally 20% of a taxpayer's qualified business income from a partnership, S corporation, or sole proprietorship. Taxpayers whose taxable income exceeds the threshold amount of $315,000 in the case of a joint return are also subject to limitations based on W-2 wages paid by the business and the business' unadjusted basis in acquired qualified property.

The pass-through deduction for a qualified trade or business is limited to the lesser of:

(1) 20% of the taxpayer's qualified business income from the qualified trade or business (Code Sec. 199A(b)(2)(A)) or

(2) The greater of (I) 50% of the W-2 wages relating to the qualified trade or business or (II) the sum of (i) 25% of the W-2 wages relating to the qualified trade or business and (ii) 2.5% percent of the unadjusted basis of all qualified property.

The Problem

The W-2 limitation is an issue for the oil and gas industry as most of the employees in this field are paid from a business separate from the oil and gas production company. Many feared that this mismatch of W-2 wages and net income would impose a severe limit on the deduction for the oil and gas industry.

The Solution

Proposed Regulation 1.199A-4 allows a taxpayer to aggregate their businesses when computing the 20% deduction as long as certain ownership and operational requirements are met. The election to aggregate businesses will apply to all subsequent years, so the decision to aggregate should not be taken lightly. Thoughtful analysis and estimates should be put together before making this election. Also, annual disclosures must be made. The Commissioner has reserved the right to disaggregate the businesses if the proper disclosures are not made annually.

The impact of this new election is shown on the following page.

If you have any questions or would like to discuss how this new election may affect your company, please reach out to Daniel Montgomery – Danielm@gmpcpa.com or call 903-534-0088.

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No Aggregation Election

	Operating Company	Production Company
Net Qualified Business Income	500,000	2,000,000
Multiply by 20%	x 20%	x 20%
20% Deduction Per Company	100,000	400,000
W-2 Wages Per Company	1,200,000	zero
50% W-2 Wage Limit Per Company	600,000	zero
Lesser of Wage Limit or 20% Per Company	100,000	zero

Failure to make the aggretation election results in a total pass-through deduction of only $100,000.

After Aggregation Election

	Operating Company	Production Company	Combined
Net Qualified Business Income	500,000	2,000,000	2,500,000
Multiply by 20%	x 20%	x 20%	x 20%
20% Deduction	100,000	400,000	500,000
W-2 Wages	1,200,000	zero	1,200,000
50% W-2 Wage Limit	600,000	zero	600,000
Lesser of Wage Limit or 20% - Combined	-	-	500,000

The aggregation election allows the Operating Company's W-2 wages to be combined with the Production Company's business income resulting in a $500,000 tax deduction.

The net result is an increase in total pass-through deductions of $400,000.