

Reference Price for Section 45I Credit for Production of Natural Gas from Marginal Wells During Taxable Years Beginning in Calendar Year 2016

Notice 2017-51

SECTION 1. PURPOSE

This notice provides the applicable reference price for qualified natural gas production from qualified marginal wells during taxable years beginning in calendar year 2016 for the purpose of determining the marginal well production credit (MWC) under § 45I of the Internal Revenue Code. The applicable reference price for taxable years beginning in calendar year 2016 is \$2.38 per 1,000 cubic feet (mcf).

This notice also provides the credit amount used for the purpose of determining the MWC for taxable years beginning in calendar year 2016. The credit amount is determined using the 2016 inflation adjustment factor of 1.2332 and the applicable reference price of \$2.38 per mcf. The credit amount for taxable years beginning in calendar year 2016 is \$0.14 per mcf.

SECTION 2. BACKGROUND

Section 45I(a), as it relates to qualified natural gas production, provides that, for purposes of § 38, the MWC for any taxable year is an amount equal to the product of

(1) the credit amount and (2) the qualified natural gas production that is attributable to the taxpayer.

Section 45I(c)(1) provides that “qualified natural gas production” means domestic natural gas produced from a qualified marginal well. Section 45I(c)(3)(A) provides that a qualified marginal well is a domestic well (i) the production from which during the taxable year is treated as marginal production under § 613A(c)(6), or (ii) which during the taxable year (I) has average production of not more than 25 barrel-of-oil equivalents per day, and (II) produces water at a rate of not less than 95 percent of total well effluent.

Section 613A(c)(6)(D) and (E) provide that “marginal production” means domestic natural gas produced during any taxable year from a property that is a stripper well property for the calendar year in which the taxable year begins. A “stripper well property” is, with respect to any calendar year, any property producing not more than 15 barrel equivalents per day, determined by dividing the average daily production of domestic crude oil and domestic natural gas from producing wells on the property for such calendar year by the number of such wells on the property.

Section 45I(c)(2)(A) provides that generally only the first 1,095 barrels or barrel-of-oil-equivalents (as defined in § 45K(d)(5)) produced during the taxable year qualify for the MWC. This limitation is proportionately reduced in the case of a short taxable year or in the case of a well that is not capable of production each day of a taxable year.

See § 45I(c)(2)(B). The number of wells on which a taxpayer can claim the MWC is not limited.

Section 45I(d)(2) provides that to claim the credit a taxpayer must hold an operating interest in the qualified marginal well producing the natural gas to which the credit relates. Under § 45I(d)(1) if a well is owned by more than one owner and the natural gas production exceeds the limitation under § 45I(c)(2), the qualifying natural gas production attributable to the taxpayer is determined on the basis of the ratio the taxpayer's revenue interest in the production bears to the aggregate of the revenue interests of all operating interest owners in the production. Finally, § 45I(d)(3) provides that the MWC is not allowable if the taxpayer is also eligible to claim the § 45K nonconventional sources credit for the taxable year, unless the taxpayer elects not to claim the credit under § 45K for the well.

For purposes of § 45I(a)(1), the credit amount is 50 cents (adjusted for inflation) per mcf of qualified natural gas production (tentative credit amount). See § 45I(b)(1)(B) and (b)(2)(B).

Section 45I(b)(2)(A) and (B) provide that the tentative credit amount (adjusted for inflation) is reduced (but not below zero) to the extent that the applicable reference price exceeds \$1.67 (adjusted for inflation). More specifically, § 45I(b)(2)(A) provides that the tentative credit amount (adjusted for inflation) is reduced by an amount that bears the same ratio to such amount as the excess (if any) of the applicable reference price over \$1.67 (adjusted for inflation), bears to \$0.33 (adjusted for inflation). As a result, the MWC is not available if the applicable reference price for qualified natural gas production exceeds \$2 (adjusted for inflation).

Section 45I(b)(2)(A) also provides that the applicable reference price for a taxable year is the reference price for the calendar year preceding the calendar year in which the taxable year begins. Section 45I(b)(2)(C)(ii) provides the term “reference price” means, with respect to any calendar year, in the case of qualified natural gas production, the Secretary’s estimate of the annual average wellhead price per mcf for all domestic natural gas.

Section 45I(b)(2)(B) provides that in the case of any taxable year beginning in a calendar year after 2005, each of the dollar amounts contained in § 45I(b)(2)(A) will be increased to an amount equal to such dollar amount multiplied by the inflation adjustment factor for such calendar year (determined under § 43(b)(3)(B) by substituting “2004” for “1990”).

SECTION 3. INFLATION ADJUSTMENT FACTOR AND REFERENCE PRICE

.01 Inflation Adjustment. The inflation adjustment factor under § 45I(b)(2)(B) for calendar year 2016 is 1.2332.

.02 Reference Price. The Secretary generally obtains data on energy prices from the Energy Information Administration (EIA), an independent agency within the Department of Energy. In the past, the EIA published estimates of monthly and annual average wellhead prices for natural gas, but the EIA has not published those estimates since December 2012. Consequently, the Secretary’s estimate of the calendar year 2015 annual average wellhead price per mcf for all domestic natural gas under § 45I(b)(2)(C)(ii) was calculated by applying the Producer Price Index commodity index

for “Natural Gas” (WPU05310105)¹ published by the Bureau of Labor Statistics (BLS) as part of its Producer Price Index program, to update to 2015 pricing the “national average wellhead price of natural gas” published by the EIA for 2012. For years after 2015, the Secretary intends to calculate the reference price by application of the Producer Price Index commodity index for “Natural Gas from the Wellhead” (WPU053101051) published by the BLS to the previous year’s reference price.

The EIA’s reported national average wellhead price for 2012 was \$2.66 per mcf.² The annual price index for natural gas published by the BLS fell from 149.5 in 2012 to 133.5 in 2015, which implies the ratio of 2015 to 2012 average wellhead prices was 0.89 (133.5/149.5). Therefore, the Secretary’s estimate of the calendar year 2015 annual average wellhead price per mcf for all domestic natural gas is \$2.38 per mcf (0.89 x \$2.66 per mcf).

SECTION 4. CALCULATION OF CREDIT AMOUNT

Under § 45l(b)(1)(B) and(2)(B), the tentative credit amount used to calculate the MWC for taxable years beginning in calendar year 2016 is 62 cents per mcf (\$0.50 x 1.2332 inflation adjustment factor). However, in order to determine the credit amount for purposes of § 45l(a)(1), the tentative credit amount must be reduced as provided by § 45l(b)(2)(A).

Pursuant to § 45l(b)(2)(A), the tentative credit amount for taxable years beginning in calendar year 2016 is reduced (but not below zero) by an amount (§ 45l(b)(2) Reduction Amount) which bears the same ratio to such amount as (i) the excess (if any) of the

¹ <https://data.bls.gov/cgi-bin/srgate>. BLS publishes indexes and not actual or average prices.

² https://www.eia.gov/dnav/ng/ng_pri_sum_a_epg0_fwa_dmcf_a.htm.

applicable reference price over \$2.06 (\$1.67 x 1.2332 inflation adjustment factor), bears to (ii) \$0.41 (\$0.33 x 1.2332 inflation adjustment factor). Accordingly, the § 45I(b)(2) Reduction Amount (as adjusted for inflation) is computed as follows:

$$\frac{\$ 45I(b)(2) \text{ Red. Amount}}{0.62} = \frac{\text{App. Ref. Price} - 2.06}{0.41}$$

Solving for the § 45I(b)(2) Reduction Amount yields the following formula:

$$\$ 45I(b)(2) \text{ Red. Amount} = \frac{0.62 \times (\text{App. Ref. Price} - 2.06)}{0.41}$$

Using the applicable reference price of \$2.38, the § 45I(b)(2) Reduction Amount is \$0.48. Therefore, the credit amount used to calculate the MWC for taxable years beginning in calendar year 2016 is \$0.14 per mcf (\$0.62 - \$0.48).

SECTION 5. EFFECTIVE DATE

This notice is effective for qualified natural gas production during taxable years beginning in calendar year 2016. The Internal Revenue Service (IRS) will provide information on how to claim the credit on IRS.gov, tax forms or instructions, or through other published guidance.

SECTION 6. ADDITIONAL CONSIDERATIONS

A taxpayer who filed a 2016 return on or before October 2, 2017 and either did not claim the credit or claimed the credit in an amount that differs from the amount determined using the applicable reference price stated in this notice may file an amended return using the applicable reference price stated in this notice.

Generally, a taxpayer has up to three years from the date it filed a return, or two years from the date the tax is paid, whichever is later, to file an amended

return. Taxpayers should consider consulting with a tax advisor to determine if they want to file an amended return. More information about filing an amended return is available on IRS.gov.

SECTION 7. COMMENTS

.01 The Treasury Department and the IRS request written comments on this notice, including the methodology for determining the reference price.

.02 Date for comments.

Comments in response to this notice should be received by the IRS before November 16, 2017.

.03 Address to send comments:

Internal Revenue Service
CC:PA:LPD:PR (Notice 2017- 51)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Please include "Notice 2017- 51 " on the cover page.

.04 Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Internal Revenue Service
Courier's Desk
1111 Constitution Ave., N.W.
Washington, DC 20224
Attn: CC:PA:LPD:PR
(Notice 2017-51)

.05 Submissions may also be sent electronically to the following e-mail address:

Notice.Comments@irsounsel.treas.gov

Please include "Notice 2017-51" in the subject line.

All comments will be available for public inspection and copying.

SECTION 8. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Philip Tiegerman of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Philip Tiegerman at (202) 317-6853 (not a toll-free call).