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Qualified Business Income and Percentage Depletion Interaction

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The Tax Cuts and Jobs Act (TCJA) of 2017 brought about many changes in the tax code, including the introduction of new provisions. Luckily, deductions available to taxpayers in the oil and gas industry have survived tax reform and will continue to make oil and gas a favorable investment from a tax perspective. One of the new provisions, the qualified business income deduction under IRC section 199A, has raised questions regarding the interaction between the new potential 20% deduction and the percentage depletion deduction familiar to oil and gas investors.

In its simplest form, section 199A allows for a deduction up to 20% of a taxpayer's qualified business income (QBI) from a trade or business operated as a non-C-corporation entity. The deduction is claimed as a reduction to taxable income on the taxpayer's return.

Percentage depletion allows a taxpayer to deduct 15% of the gross income (less royalties) derived in a trade or business from an oil and gas property. For non-C-corporation taxpayers, the depletion deduction is claimed on the partner or shareholder's return, where limitations may apply. One limitation is that the taxpayer's percentage depletion deduction may not exceed 65% of his/her taxable income.

P.L. 115-97, issued on December 22, 2017, amended IRC Section 613A to clarify that the 65% of taxable income limitation should be computed without regard to qualified business income deduction. This proves to be very favorable to taxpayers, as it does not reduce the potential depletion deduction and taxpayers can enjoy a potential deduction of up to 20% on qualified business income. For more information on either deduction, please contact a Schneider Downs Tax Advisor.

You've heard our thoughts… We'd like to hear yours

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