

**Chapter 14****Federal Taxation of Investors  
in Oil and Gas Drilling Programs**

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**§ 14.01. Introduction.**

Investors in oil and gas drilling programs seek a return on their investment through revenues produced by the wells drilled and through tax benefits associated with such drilling and production. The nature of the investors, their tax attributes and their economic goals should drive the structure of the legal framework through which the drilling and production is carried out. Unfortunately, this is frequently not the case. Investors regularly invest in drilling programs that are not structured to take into account their particular tax attributes and frequently subject themselves to unnecessary tax liabilities.

The majority of oil and gas wells in Appalachia are drilled and operated through unincorporated joint venture arrangements. Some of these joint ventures elect not to file partnership tax returns but others report income or losses for federal income tax purposes as partnerships. Some of the “partnerships” are actual legal entities structured as general partnerships, limited partnerships and limited liability companies. Some are “tax only” partnerships. “Tax only” partnerships are unincorporated joint ventures that are recognized for income tax purposes only and have no legal status as a separate entity. In addition, each state allows formation of limited liability companies which may qualify as partnerships for tax purposes or which may be taxed as associations taxable as corporations.

This chapter discusses the tax rules applicable to investors in oil and gas drilling programs and the different forms through which such programs may be conducted. Depending upon the investors involved, such programs may be conducted through operating agreements (the Operating Agreement Structure), limited partnerships (the Limited Partnership Structure) or