How to invest successfully in Oil & Gas drilling programs

With everyone's attention focused on the crisis in the financial markets, many are overlooking the fact that there are still good investment avenues open if you know where to find them and how to evaluate them. One such avenue is oil and gas and this article will show you why it is still a good investment, and how you can evaluate the ones you find.

Let me clarify that I am specifically talking about investing in oil & gas drilling programs. There are other vehicles to invest in the energy industry but they are currently not doing well so I am focusing only on drilling ventures. So what is a drilling venture?

The entire oil and gas industry depends upon the ability of companies to locate and produce oil and gas from pockets hidden under the earth's surface. Drilling programs do this both for public and private companies. The limitation with public companies is that the only way you can invest with them is via their stock. While this can be a good long term investment, it does not provide the many benefits of investing directly in an oil and gas drilling program with a private company. Here is why.

Investing in a sound drilling program offers the investor the opportunity for substantial returns, plus it offers tax benefits that are only found by investing in these programs. By substantial returns I mean that returns from 50 to 100% per year are attainable, plus these returns can last for 10 to 20 years. I must point out that these returns decrease over time at an average rate of 10% per year, so the returns do decrease as the reserves are depleted. Still these types of returns are hard to find elsewhere, if you can find them at all.

The tax benefits include three distinct mechanisms which when combined make this the most lucrative investment vehicle available. The tax code was revised in 1986 to allow for the following:

* 100% write-off of intangible drilling costs (IDCs)
* 100% depreciation write-off of capital equipment over 7 years
* 15% of income from the production is tax free (not a deduction)

IDC's are those costs which are essentially services consumed to drill the well. They include hauling, drilling fluids, core samples, electric logs, the actual drilling of the well, and many other services. Since they are not capital goods like tanks and pump jacks, they can be written off immediately regardless of the outcome of the well. What this means is that the risk capital invested in a program is reduced by the amount of the tax bracket for each investor. Essentially the investor is using $0.60 dollars (varying with the tax bracket) to invest in the program. I know of no other investment vehicle that offers this and this alone is one reason it is popular with those who have done it.

Depreciation is well understood though it is worthy to note that equipment is 100% depreciated in 7 years.

Finally for every dollar the investor earns, 15% is tax free meaning only 85% of the income can be taxed.

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Source: http://www.nuwireinvestor.com/opportunities/how-to-invest-successfully-in-oil--gas-drilling-programs-52150.aspx