Scary tax time ahead for energy trusts

Andrew Willis, today at 2:16 PM EDT

In the past, investors took a pounding when energy trusts cut distributions. That pain pales compared to what's coming in 2011.

With a new tax regime on the way, CIBC World Markets recently published an exhaustive study on just who will be paying out what in the oil patch in two years' time, where energy trusts will still make up a big chunk of the market.

From an investor's point of view, the report makes for scary reading, and explains why many oil executives continue to lobby against the Conservatives' decision to impose new taxes on trusts.

Here is the headline number from a team of five energy analysts, who modelled what's coming at 22 of the largest oil and gas trusts: “Our estimates imply that the average trust would reduce its monthly payout by 23 per cent in 2011 relative to the current distribution, and a further 3 per cent in 2012, followed by a period of modest increases.”

Such cuts would come in the wake of distribution suspensions or reductions that have already been announced at 19 of 48 publicly traded energy trusts, according to statistics compiled by investor advocate and former analyst Diane Urquhart.

The regime that arrives in just over two years is about more than just taxes. Come 2011, CIBC World Markets points out that strategic mandates will shift, as trusts convert to common stock companies and trust executives begin running conventional oil and gas plays. The analysts said: “Post-2010, the introduction of tax provides a reduced incentive to pay out cash, and a greater incentive to reinvest. As such, a reduction in payouts for most trusts should be expected.”

CIBC World Markets looked at 18 conventional oil and gas trusts, along with four unconventional plays, including Canadian Oil Sands. In all, the study covered energy trusts with a combined market capitalization of $85-billion. It found all trusts are not created equal when it comes to tax.

Using assumptions that included $125 (U.S.) oil and $9.75 natural gas prices, the analysts concluded most energy trusts will begin paying tax in 2011, as soon as the rules change. Canadian Oilsands becomes taxable by 2013. At the far end of the spectrum, True Energy Trust's financial position and mix of properties mean it likely won't be cutting Ottawa a cheque until 2016.

According to CIBC World Markets, the trusts that are in the “strongest position” to cope with the new tax laws include Advantage Energy Income Fund, Daylight Resources Trust, Progress Energy Trust, True Energy and Vermillion Energy Trust.

Tax alone is not a reason to own an energy trust. CIBC World Markets' team said once other factors such as quality of management, property base and exploration abilities are factored in, the top picks in this sector include Vermillion, which may not pay tax for another seven years, along with three trusts that probably will pay tax in 2011: Baytex Energy Trust, Bonterra Energy Income Fund and Crescent Point Energy Trust.

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