

# Dependable Solutions for Royalty Owners



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## The Landscape



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## Considerations

- Pre-Leasing issues
- Post-Leasing issues
  - Pre-Royalty
  - Post-Royalty

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## Considerations

- Legal
- Tax
- Investment
- Estate Planning

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## Much Confusion and Misinformation

Leased gas rights

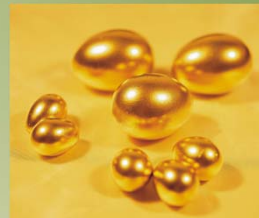
Versus

Selling gas rights

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## Considerations

- **Gas Income**
  - Lease income
  - Royalty income
- **Gas Rights** (Mineral Interests, Mineral Estate, Subsurface Rights, etc.)
  - Has a value of its own
  - Can be transferred or sold
  - Value based on proximity to development
  - Value can be taxed at death



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**Income Issues**  
**Lease Bonus vs. Royalty Planning**

Differing issues

<p><b><u>Lease Bonus</u></b></p> <ul style="list-style-type: none"><li>•One time</li><li>•Well-defined</li><li>•Can be very large</li><li>•Applies to entire parcel</li></ul>	<p><b><u>Royalty Income</u></b></p> <ul style="list-style-type: none"><li>•Recurring</li><li>•Varied in amount</li><li>•Can be very large or small</li><li>•Applies only to production unit</li></ul>
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**Income Issues**  
**Lease Bonus vs. Royalty Planning**

Differing strategies

<p><b><u>Lease Bonus</u></b></p> <ul style="list-style-type: none"><li>•Consider tax deferral<ul style="list-style-type: none"><li>•Ret. Plans, etc.</li></ul></li><li>•Suitable for Individual Contracts/Investments</li></ul>	<p><b><u>Royalty Income</u></b></p> <ul style="list-style-type: none"><li>•Consider Tax Free Options</li><li>•Needs Investments that are flexible and scalable</li></ul>
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**Bottom Line:**

**One Size Does NOT Fit All**

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## INCOME TAX IMPLICATIONS OF NATURAL GAS LEASING CONTRACTS

### I. Fundamentals of the Taxation of Natural Gas Related Income

- A. Under Section 613A of the Internal Revenue Code, this is Ordinary Income, not Capital Gain Income
- B. Rental and Royalty Portions are Treated—and Reported— Differently
- C. 22% or 15% Depletion Expense Deduction is Allowed for Royalty Income Only
- D. Royalty Income Depletion Deduction may subject taxpayer to AMT

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### II. Strategies to Reduce Taxable Income

#### A. Strategies Directly Related to Natural Gas Related Income

- 1. 22% or 15% Depletion Expense Deduction (applies to Royalty Income Only)
- 2. Allocation of Real Estate Taxes
- 3. Allocation of Property Insurance
- 4. Direct Expenses – Legal Fees, Accounting Fees, Etc.
- 5. Don't Give Up an Income Stream Just to Reduce Taxes!!!

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## II. Strategies to Reduce Taxable Income, cont.

### B. Strategies Beyond Natural Gas Leasing Income

#### 1. Bundling of Itemized Deductions (such as Charitable Contributions, Medical Expenses, Employee Business Expenses, Etc.)

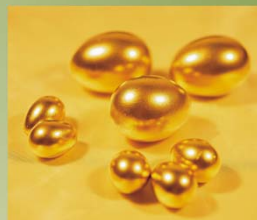
- Pay state income tax in the year lease is received

#### 2. Immediate Funding of Long-Term Charitable Intentions

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## Gas Rights

- Legal Issue – \*Disclaimer\*
- Real Estate
  - Surface Rights
  - Subsurface Rights

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## “New” Asset – New Estate Planning Considerations

- Death Taxes
  - New York State Estate Tax
    - Exemption Amount
    - Maximum Rate is 12%
  - Pennsylvania Inheritance Tax
    - Rate depends on who inherits
    - Rates: 4.5% - 15%
  - Federal Estate Tax ?

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## Strategies to Reduce Death Tax

- Gifting
  - Gift Taxes
    - U.S. Citizen Spouse: unlimited, but...
    - Annual Exclusion: \$13,000 per donor per donee per year
    - Lifetime Exemption Equivalent: \$1,000,000 per donor
  - Charitable Gifts
    - Not taxed
    - Possible income tax deduction if taxpayer itemizes

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## Strategies to Reduce Death Tax

- Gifting Real Estate and/or Mineral Interests can be complicated
- Consider use of a business entity
  - Family Limited Partnership (FLP)
  - Limited Liability Company (LLC)

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## What If I Don't Want to Make Gifts?

- Consider Life Insurance
- Important Details:
  - Who owns the policy matters!
  - What type of policy (or policies) matters!
  - Choice of insurance company matters!
  - Your agent should be knowledgeable in both insurance and this type of planning!

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We Own Mineral Interests. What Can the Bank Do for Me?

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## Fiduciary Services

- Power of Attorney / Attorney-in-Fact / Agent
- Trustee
  - Testamentary
  - Revocable Living Trust
  - Irrevocable Trusts
  - Grantor Trusts
  - Charitable Trusts
  - Special Needs Trusts
  - Life Insurance Trusts (ILIT's)
- Executor
- Investment Agent
- Custody Services

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## Why Might My Lawyer Recommend a Trust(s)?

- May Avoid Probate
- May produce Gift/Estate Tax Savings
- Ability to make a gift “for a while”
  - Benefit Spouse first then kids
  - Charities
- Ability to protect assets from “irresponsibility”
  - Minors
  - Beneficiaries whose views do not align with yours
- Avoid disqualifying a beneficiary from benefits

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## Why Use a Professional Fiduciary (Trustee or Executor)

- Experience
- Expertise
- Endurance
- Impartial



### Co-Trustee / Co-Executor Option

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## Why Use C&N as Your Fiduciary?

- Experience
  - Over 50 years in trust business
- Expertise
  - Multiple staff with professional credentials (CPA, CTFA, CFP®)
- Endurance
  - Presence in Bradford County for over 100 years
- Impartial
  - Deep understanding of statutes governing duties



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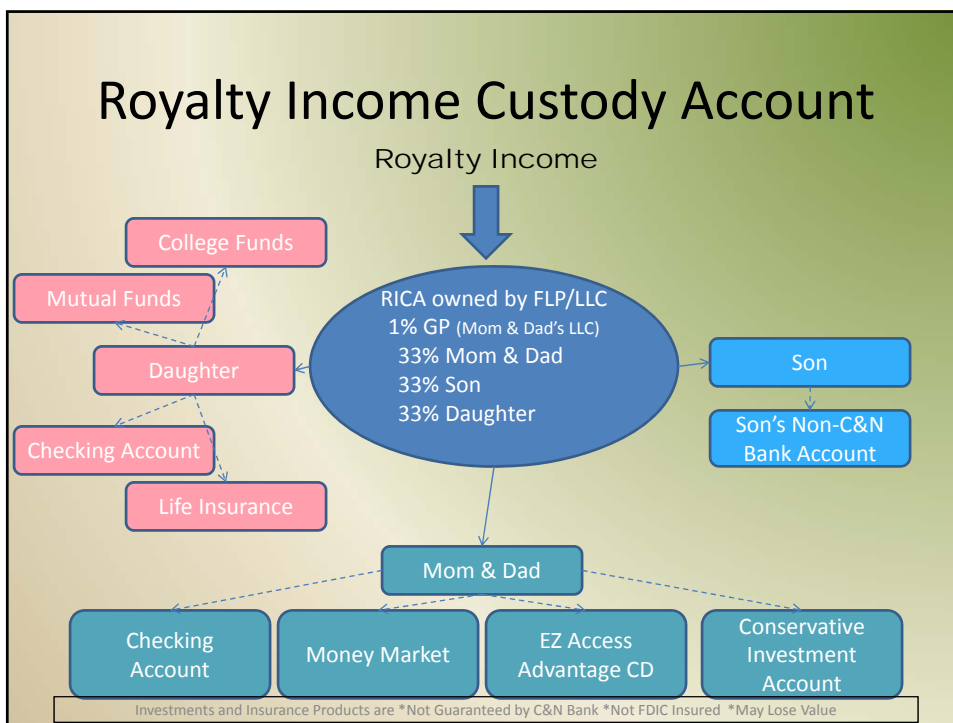
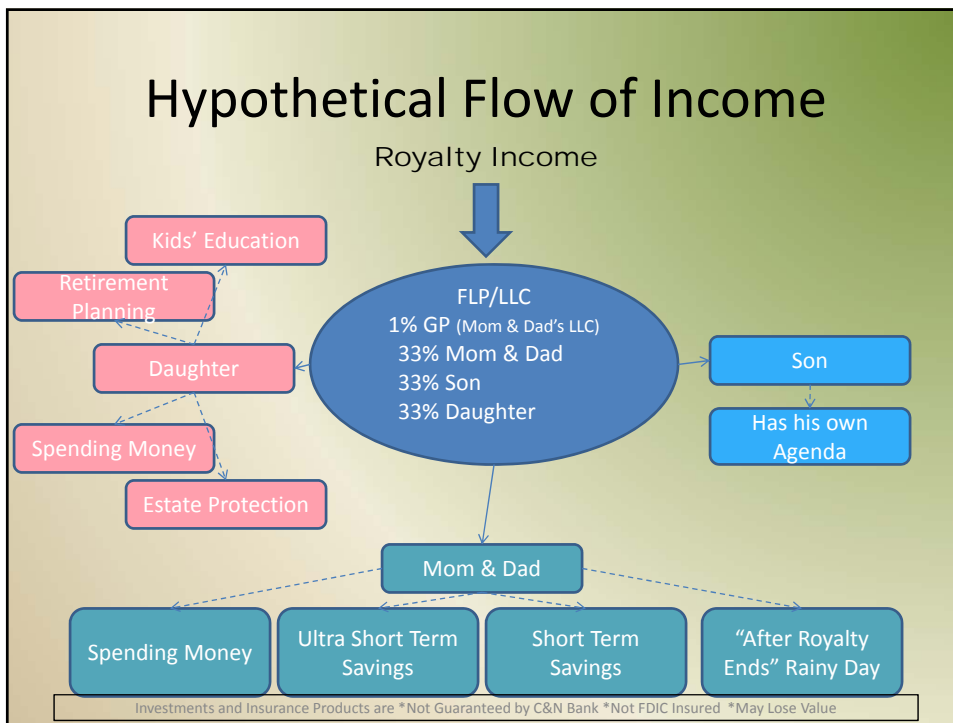
## What about Our Current Royalty Income?

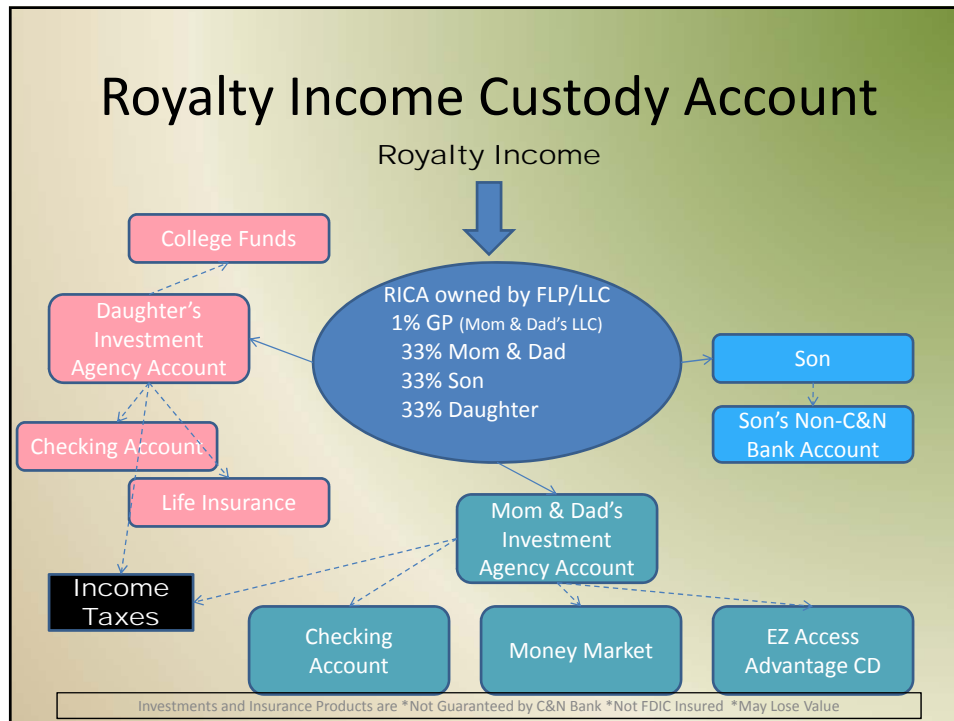
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## Common Scenario

- **Generation 1 - Mom & Dad**
  - Goals: Retain some royalty income, give some to children, spend some, save some, protect property
- **Generation 2 – Children**
  - Goals: Reduce debt, spend some, save for retirement, kids' college, protect property

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## Action Items

- Get a good team
  - Attorney
  - Accountant
  - Financial Planner
- Start planning early
- Procrastination can be costly
- Don't be penny wise and pound foolish (don't be afraid to pay for competent counsel)

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*Professionals dedicated to meeting  
your lifetime financial needs, with  
a personal touch.*



*Thank You for Attending*

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