

# Do My Oil and Gas Rights Require Special Estate Planning?

With the boom locally in new exploration, I have been retained to prepare estate plans that deal with oil and gas rights and leases. Before proceeding any further, I want to emphasize that in the same way as no man is created equal, there is no "one size fits all" estate plan. Each client's needs and desires are different and the estate plan must be created to address an individual's situation. As a result, the estate planning I do for one client will not necessarily be the correct estate planning strategy for another.

When meeting with my clients, they voice three main concerns: how to protect their oil and gas rights, including royalties, from estate tax, income tax, and the expenses of a nursing home. These issues are addressed as follows:

1. With respect to estate taxes, on January 2, 2013, the President signed a new law permanently extending the Federal Estate Tax limit to \$5 million per person and \$10 million for a married couple. In addition, this amount will be adjusted annually for inflation. Consequently, Federal Estate Taxes do not need to be paid until an individual's estate or a couple's assets exceed this Federal Estate Tax limit.
2. With respect to income taxes, the front end bonus an individual receives when signing an oil and gas lease, as well as any royalties received under the lease, are taxable as ordinary income.
3. With respect to the nursing home, the money received from oil and gas leases will be considered either an asset or income to the client depending on the interest received from the lease. As a result, if the proper type of long term care planning is not undertaken, then the benefits the individual receives as a landowner with an oil and gas lease would be required to be paid to the nursing home.

There are several estate planning strategies to employ with respect to protecting a client's oil and gas rights. The more common estate planning strategies include the following:

- *Transfer ownership of the land and rights to heirs.* While the concept of gifting assets or real estate sounds simple, there are advantages and disadvantages to consider with this option. One advantage is the client avoids probate. However, disadvantages include the risk involved if an heir files for bankruptcy, as well as the Medicaid five year look back period. In addition, the timing of the gift is critical. When should the transfer be made? If it is made before there is actually a producing well on the leased property, then the value of the transfer will realize the greatest potential for shifting the maximum amount of wealth at the minimal tax cost. However, if the property is transferred after a well is drilled, this reduces the tax savings but is still beneficial.
- *Transfer ownership to a Trust.* When the landowner wants to transfer ownership, but retain some measure of control over the oil and gas interests, a Trust may be the appropriate vehicle. The Trust could be revocable or irrevocable. The individual creating the Trust, who is called the Settlor, can set forth the heirs of the Trust, how and when the heirs receive a distribution from the Trust, as well as designate a Trustee who will manage the Trust. This option avoids the cost and delay of the probate process and can provide continuity in the management of the oil and gas rights upon the Settlor's death.
- *Create a Family Limited Partnership.* With this entity, a landowner can maintain control of the Family Limited Partnership by being a general partner, who can determine the rules of how the partnership will operate and can determine what distributions, if any, will be made to the partners. In addition, the ownership and control of the limited partnership can be shifted to the heirs of the landowner by assigning limited partnership interests to said heirs. Unfortunately, if the real estate is transferred to a

Family Limited Partnership, then it is generally subject to realty transfer tax in Pennsylvania.

- *Create a Limited Liability Company.* A Limited Liability Company operates much like the Family Limited Partnership except that it provides greater protection of the assets of the Company. If a client is concerned with the liability of the oil and gas operations taking place on their property, then this could be an attractive feature.

If you find yourself affected by the new oil and gas industry, you should be aware of the options available. To get a better explanation of these options and which best suits your needs, you should consult a local and experienced attorney whose practice concentrates on estate planning and elder law.

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