

Gifts and Marcellus Shale

by J. Corey Reeder

When estate planning lawyers discuss gifting as an estate planning strategy with clients, there are a few very important components to this discussion that must be reviewed in order to most effectively leverage gifting as an estate planning strategy. Pursuant to the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the “Act”) that President Obama signed into law last December, each person has a five million dollar exemption for lifetime gifting over the thirteen thousand dollar per person annual exclusion. What this means is that under the Act a person may make gifts over the annual exclusion of up to five million dollars without incurring gift tax. That being said, the Act is only in effect for 2011 and 2012 and with 2011 almost over, there is not a lot of time for a person to take advantage of this exemption.

The most important part of the gifting discussion centers on what type of asset is most suitable for gifting. In many situations, this discussion will focus on assets that are expected to appreciate in value after the gift is made such that the growth of the asset gifted will be outside of the person’s estate who made the gift. In the case of a gas lease, an interest in natural gas may be a very attractive asset to consider gifting. This analysis focuses on the timeline of the gas lease because the value of a natural gas interest is usually lower the earlier one is in the timeline.

This makes sense because determining the value of a natural gas interest will take into account (among other factors) the “bonus payment” that the owner of the interest would receive for the right of a gas company to drill for natural gas and as well as the “royalty” payment once the well is put into production and natural gas is being extracted. Consequently, if a gift of a natural gas interest is made prior to these two factors (in addition to many others) the value of the natural gas interest will not be realized until after the gift is made and thus may be removed from the estate of the person making the gift.

Another important factor to consider is if there are any “discounts” that can be taken against the value of the asset being gifted so as to reduce its value and the ultimate amount of annual or lifetime gift exclusion that a person must utilize. In the case of a natural gas interest, there are many discounts that can be applied to the value of the asset, however, these discounts are based on many factors and many of those factors are time sensitive. A few examples of discounts related to natural gas interests would be the percentage ownership of the natural gas interest; the classification of the natural gas reserve pursuant to IRS regulations; location of the property to active producing wells; location of the property to mid-stream pipelines; and how many wells can the acreage support. Clearly the aforementioned list is not exhaustive and is very generic in nature, but it should highlight that there are many factors that should be considered when doing a valuation, and given that the valuation will have to pass IRS scrutiny, it is imperative that a client engage a valuation firm that utilizes techniques and methods that are in line with the IRS regulations and Tax Court holdings.

Further, it should be noted that a valuation is a time sensitive study which means that one should not engage a firm to do a valuation unless the client is prepared to make gifts of the natural gas interest so as to not spend funds for the valuation only to have it become worthless because of the passage of time.

In conclusion, with the current gift tax environment, the gift of a natural gas interest at the proper time could allow a client to pass significant wealth to the next generations free of any estate or gift tax provided an appropriate and well documented valuation is obtained.

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