



Exchange Real Estate for Producing Oil and Gas Royalties

Real Estate is "Like-Kind" to Oil and Gas Royalty Properties

In 1968, the IRS published the Revenue Ruling 68-331 clarifying Section 1031 of the 1954 Act. The ruling established that real estate ownership interests, whether above or below the ground, met the definition of "like kind" for an exchange.

Oil and gas royalty investment began in the early 1900's. Owners of royalty assets receive monthly "mailbox money" from oil and gas companies who drill and operate wells on their property.

Unlike oil and gas drilling investments, royalty owners do NOT invest in capital equipment or field operations. Royalty interest holders do NOT get billed for exploration, drilling, or operating wells, nor do they share in any of the risks or liabilities associated with that side of the industry.

Over the past four decades, court rulings have re-affirmed that oil and gas royalty interests qualify as "like-kind" to all other forms of real property. In addition, several Revenue Rulings and Private Letter Rulings have further established the "like-kind" nature of royalties when exchanging out of traditional real estate.

Revenue Rule 55-526
Revenue Rule 73-248
Revenue Rule 73-2117
Private Letter Ruling 8135048
Crichton v. Commissioner, 122 F. 2d 181
Palmer v. Bender. 287 U.S. 551



Royalty Advantages

Transaction Size Flexibility: Royalty ownership is a 1031-Exchange alternative that allows you to customize your investment level. Whether you need \$100,000 or \$5,000,000 worth of replacement property, we can carve out the exact interest that fits your exchange.

Superior Cash Flow Potential: Royalty properties can generate annual returns over 2X what is available in today's comparable real estate market.

No Capital Calls: Royalty owners do not have the risk of having to make capital calls. Investors in oil and gas drilling programs or tenant-in-common real estate do have the risk of having to make capital calls.

Investor Independence: Owners of undivided interests in royalty properties are not locked into an ownership structure that links them to other investors in the same property. Each owner is free to exercise control over holding period and exit strategy to suit individual investment objectives.

Tax Savings: 15% of royalty income is shielded from tax regardless of the carry-over basis from the previous property.

Portfolio Diversification: Cash flow from multiple producing wells and undeveloped acreage for potential future production can alleviate the risk of owning a single property or being over-concentrated in traditional real estate



FAQs

What exactly are oil and gas royalties?

“Lucky Landowners” have been receiving a share of revenue from oil and gas wells drilled on their property since the 1850’s. This share of revenue is called a royalty and is commonly referred to within the industry as “mailbox money.” Royalty owners do NOT drill or operate wells nor do they share in any of the risks or expenses associated with that aspect of the industry

How is ownership held in royalty properties?

Royalty owners receive direct deed and title to their asset the same way they would for a traditional real estate property. That title is recorded and held on a county level.

What do I receive as a royalty owner?

Royalty owners receive 12 checks (or direct deposits) each year and 1099 tax documents directly from the operators

What are the biggest risks?

Pricing and production variability are the biggest risks to owning oil and gas royalties. A royalty owner’s monthly income moves up and down as commodity prices and production levels fluctuate.

What are the liquidity options?

Although royalties are designed as a generational buy-and-hold asset, there is always a healthy demand for cash flowing energy properties and owners can generally get liquid in 90-120 days

What are the closing, title, and management costs?

There are no closing or management costs associated with royalty ownership. Title verification costs vary but are generally nominal.

How are royalties taxed?

Royalty income is taxed as portfolio (ordinary) income. Some states assess property taxes on royalty interests the same as they would for real estate, although the amounts are usually much lower for royalties.