



Mineral Rights: Planning Considerations

Here is a simplified look at the kinds of mineral rights people typically own and the charitable gift opportunities available:

Nancy owns land in Oklahoma, including all the subsurface minerals. She enters into a lease agreement with Benson, giving him the right to develop any gas and oil that may be found on the property (*a working interest or operating interest*). Nancy receives a lease bonus and a royalty interest amounting to 10% of any gas or oil found by Benson, who will pay all drilling and operating costs. Under the IRS partial interest rule, Nancy could not contribute and deduct her royalty interest, unless the royalty interest were all that she owned (however, if she later sells the land and retains only her royalty interest, she can then give and deduct her remaining royalty interest). A possible gift option for Nancy would be to give the Church a percentage of all her current ownership rights in her land (15%, for example), which would include 15% of her royalty interest.

Benson, to raise funds for exploration and development, may carve up his working interest into different pieces that he sells to investors, either separately or in combination. One such piece could be an overriding royalty interest that provides the buyer with a percentage of gross oil or gas production, without liability to pay any production costs. The overriding royalty interest will last until Benson's working interest expires. The owner of the overriding royalty interest can give it to the Church – or give half, or some other fraction – and take a charitable deduction.

Benson also might sell investors a net profits interest, which gives the buyer a share in the net (not the gross) production from the wells, also with no liability for paying operational expenses. This interest will continue for the duration of Benson's working interest. Charitable gifts of part or all of a net profits interest also will be tax deductible.

A third way for Benson to raise capital for his oil and gas operation is to sell the right to production payments – a share of the gas and oil produced that generally is capped at a certain dollar amount or percentage of production that will terminate before the end of Benson's working interest.

Charitable contributions by investors who are not in the gas and oil business can be deducted at the current fair market value of their royalty or net profits interests, not just their original cost, if they have held their interests more than one year. Deductions over \$5,000 must be substantiated through a qualified appraisal. An independent appraiser will provide an estimate of future cash flow from the contributed interest, which must be discounted to its present value, for minority status if any, and other factors.



The IRS has ruled that donors of production payments will continue to be taxable on income as it is earned, even after ownership has passed to a charity, under the assignment of income doctrine. But donors will be entitled to charitable deductions as income is received by charity.

Charitable Gifts by Operators

Benson, in our example, can contribute all of his working interest, or an undivided fraction of his interest, to a qualified organization and receive a charitable deduction. Benson cannot, however, carve out an overriding royalty interest, net profits interest or production payments interest, give it to the Church, and receive a charitable deduction. If Benson wants to give the Church part of his working interest, he must contribute an undivided fractional interest (10%, for example) in all of his ownership rights, under an IRS ruling.

Operators who contribute oil and gas interests can deduct any long-term capital gains (on interests owned more than one year), if the interest can be treated for tax purposes as real estate used in a trade or business. Otherwise, deductions will be limited to the operator's cost basis. Donors who have taken deductions for intangible drilling costs will be required to reduce contribution deductions by any amounts that would have been treated as ordinary income upon a sale. Gifts of oil and gas leases from which production payments have been "carved out" will be treated as gifts of property subject to indebtedness, with the result that donors' deductions will be reduced under the bargain sale rules. Furthermore, donors will be required to report some capital gain.

Gifts in Trust

Both charitable lead trusts and charitable remainder trusts can be funded with interests in oil and gas, but careful planning will be needed. Unrelated business taxable income (UBTI) may be an issue for both lead trusts and remainder trusts, although recent changes in the law mean that charitable remainder trusts will not lose their tax-exempt status as a result of receiving UBTI.

How to Proceed

If you are interested in making a gift of mineral rights, such as oil and gas interests, to the Church, please e-mail, call or write our office.

We are pleased to advise you:

1. Our correct legal name, for use by your attorney in drafting deeds or other transfer documents



2. The approximate income tax and capital gains tax savings available from your gift
3. Appraisal issues for gifts of your interest
4. Details of the transfer and gift acceptance process

You will need to share with us:

1. The type of interest you propose to contribute and an estimate of its current value
2. Any other interests you may own in the property on which the interest is located
3. Your basis in the interest
4. How the interest is owned (in partnership, for example)
5. Whether a sale of your interest is currently pending
6. Whether you wish to reserve lifetime income or other benefits from your gift for a family member

You can contact our office at philanthropy@cspcs.com, by phone at 1-800-288-7155, extension 3288, or write to us at the address below. We look forward to hearing from you.

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