1

AGENDA

1. Types of Property Interests
2. Mineral Interests 101
3. Real Estate 101
4. Facilitating Gifts
5. Valuation & Taxation
6. Choosing a Gift Vehicle

2


TYPES OF PROPERTY INTERESTS

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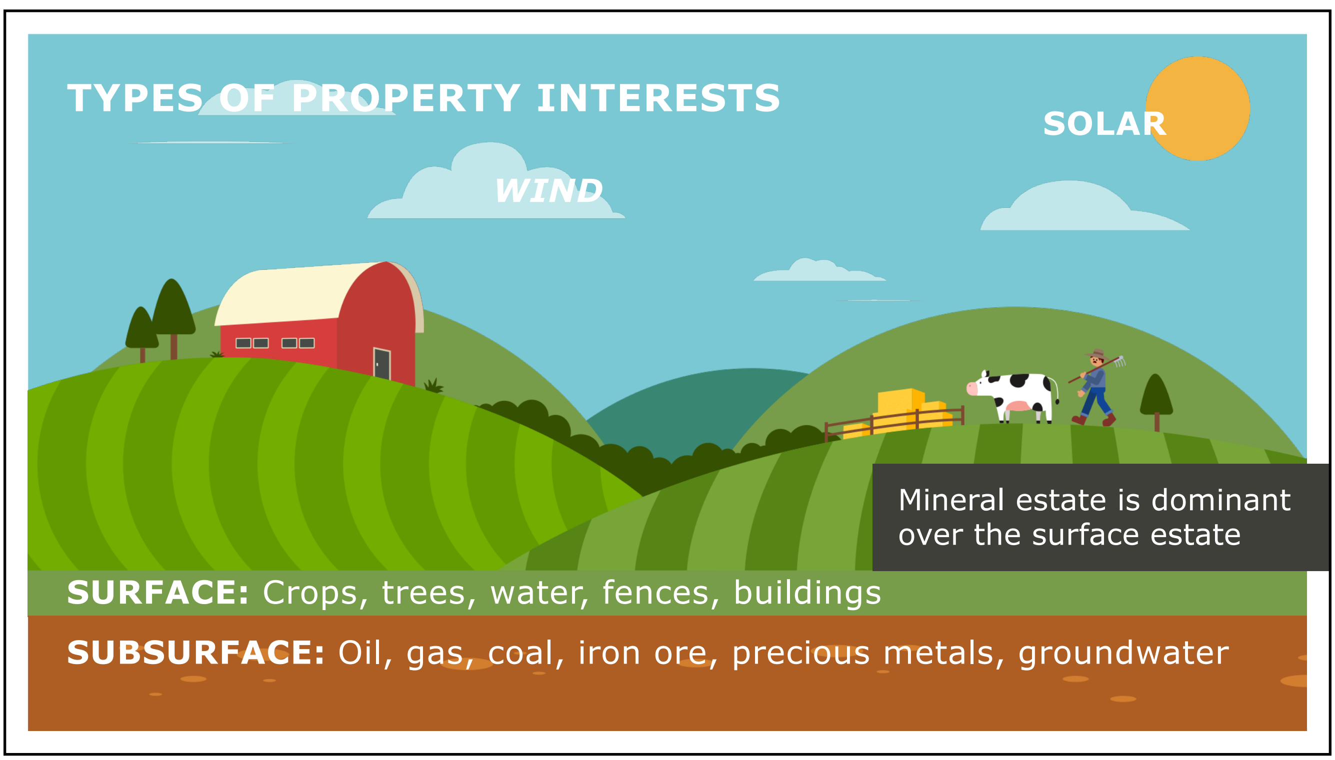
TYPES OF PROPERTY INTERESTS
SOLAR
WIND
Mineral estate is dominant over the surface estate
SURFACE: Crops, trees, water, fences, buildings
SUBSURFACE: Oil, gas, coal, iron ore, precious metals, groundwater

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MINERAL INTERESTS 101

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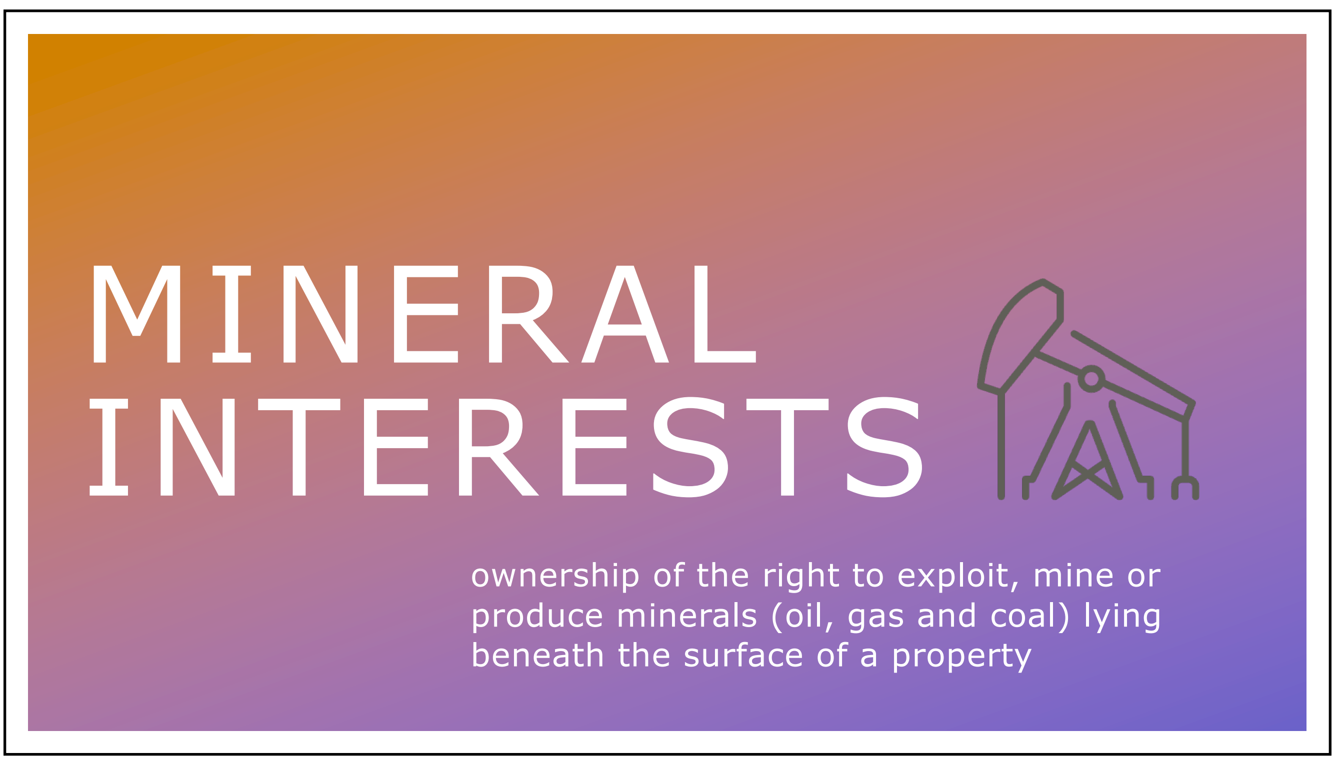
MINERAL INTERESTS
ownership of the right to exploit, mine or produce minerals (oil, gas and coal) lying beneath the surface of a property

6

EXECUTIVE RIGHTS

allows the owner of the interest to lease the interest to others

7

BONUS

a one-time payment to lessor to acquire a lease

8

ROYALTY PAYMENT

regular payments, usually based on the volume or price of oil, gas or minerals extracted

9

SHUT-IN

a non-producing well

10

DIVISION ORDER

schedule of owners and their respective share of revenues

11

LANDMAN

negotiates leases, ensures proper title, monitors ongoing well production and payments

12

OPERATOR

conducts drilling
operations for a well

13

ROYALTY INTEREST

shares in production but is not liable
for expenses – *a 25% royalty is common*

14

WORKING INTEREST

allowed to use surface for exploration and production and is liable for expenses – *retains profits*

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NON-PARTICIPATING ROYALTY

“carved out” of a prior interest without regard to the terms of the lease

16

OVERRIDING ROYALTY

"carved out" of working interest to compensate landmen, geologists, attorneys, etc.

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UBTI

Unrelated Business Taxable Income is gross income from an unrelated trade or business *(not substantially related to charitable purpose)* that is regularly carried on

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TYPES OF OWNERSHIP INTERESTS

WORKING INTERESTS
are discouraged:
- Liability exposure
- Unrelated business income (UBI) generated
- Charitable deduction limited to basis

ROYALTY INTERESTS
are encouraged:
- No risk liability
- Do not generate UBI
- May be deducted at full FMV

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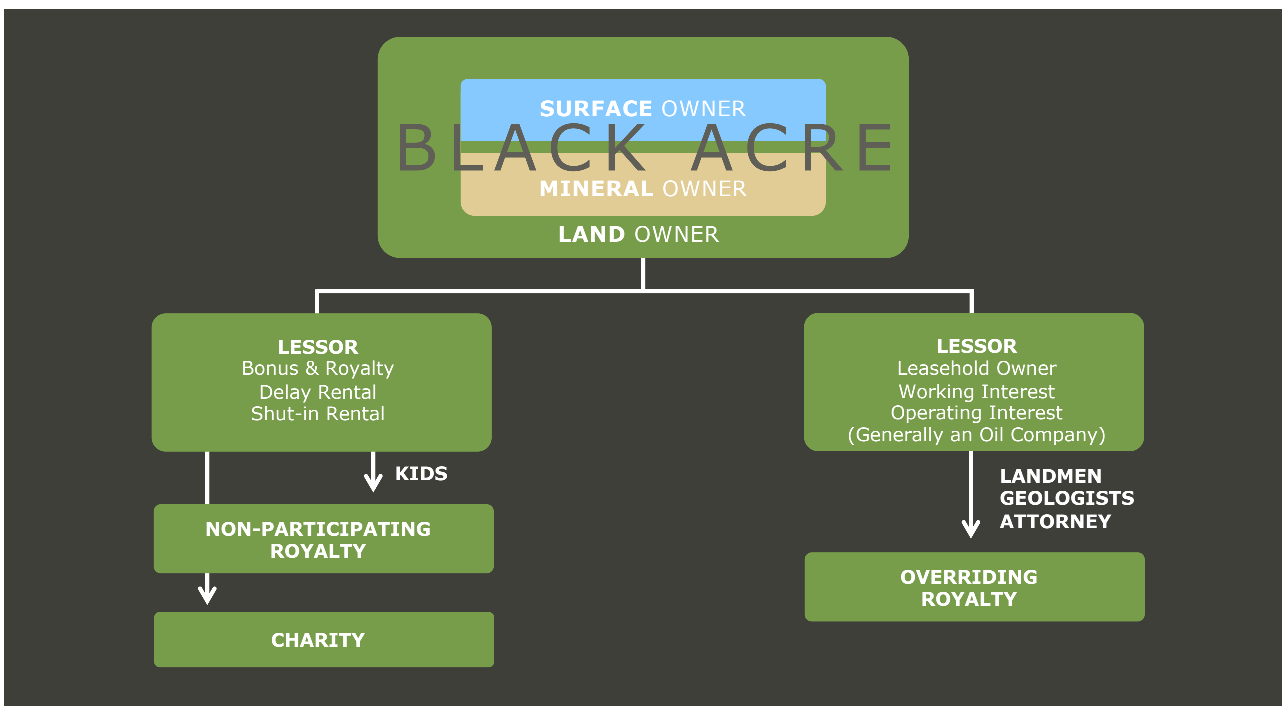

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MINERALS MANAGEMENT OPTIONS

1. Sell the interest:
   - Typical purchase price is 5 to 7.5 times annual production
2. Hire minerals management group
   - Larger banking organization
   - Investment management group
   - Financial services firm

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MINERALS MANAGEMENT OPTIONS

Active management for **producing** interests
- Review division orders
- Monthly review of revenues and payment status
- Monitor actual production
- Obtain releases when necessary

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MINERALS MANAGEMENT OPTIONS

Active management for **non-producing** interests

- Negotiate maximum bonus and royalty for new leases
- Update and maintain undeveloped acreage records and shut-in well requirements
- Coordinate easements or permits for surface owners
- Monitor existing leases and secure timely releases

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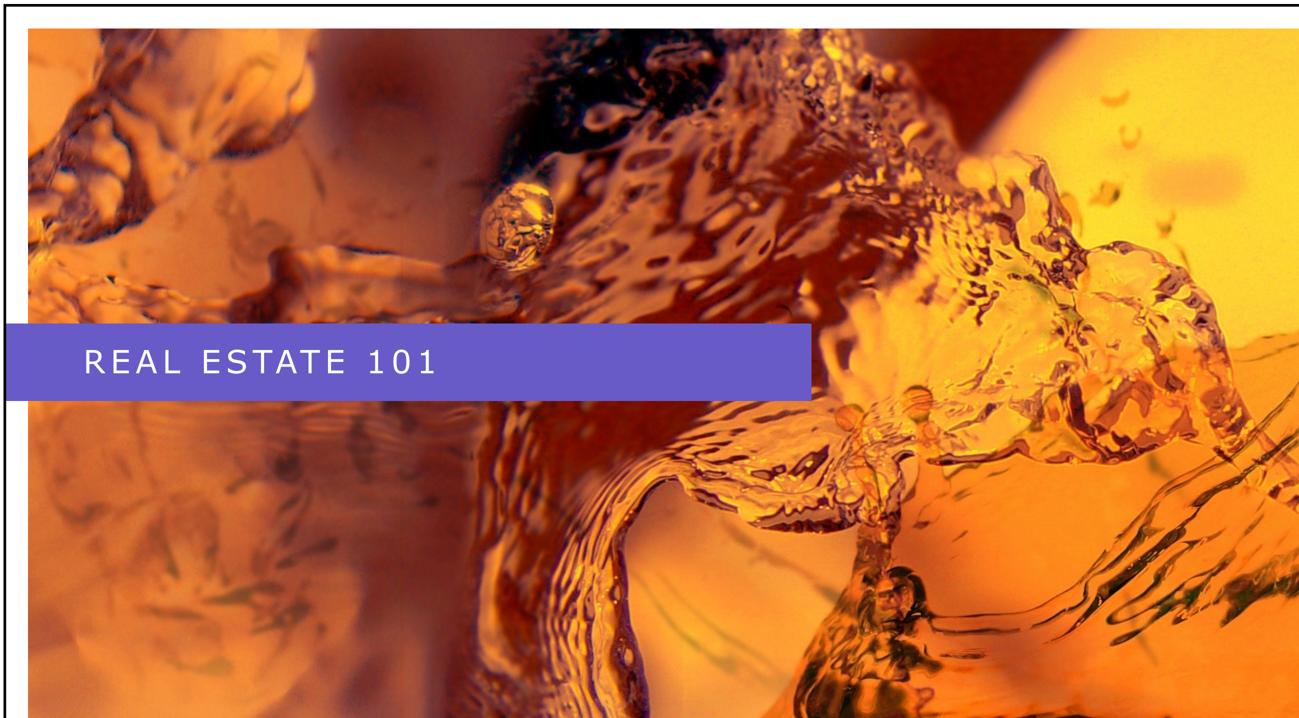

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TYPES OF REAL ESTATE TO DONATE

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CHECKLIST FOR REAL ESTATE

- Location of property
- Legal description
- Existing leases, liens, easements, etc.
- Currently or previously listed for sale
- Donor’s basis (if funding a trust)
- Donor’s estimation of value
- Current and previous uses
- Market conditions

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PROPERTY INSPECTION CONSIDERATIONS

1. Donor questionnaires
2. Site visit
3. Ownership history
4. Environmental issues
5. Additional third-party testing
6. Valuation issues
7. Marketability issues
8. Current or potential liabilities
9. Carrying costs (HOA fees, debt, insurance, etc.)

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WHAT TO DO WITH REAL ESTATE

HOLD IT

USE IT AS INCOME-PRODUCING PROPERTY

USE IT FOR NONPROFIT NEEDS

SELL IT

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FACILITATING GIFTS

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FACILITATING GIFTS
MINERALS

- Oil and gas interests are conveyed by:
  - Mineral deed
  - Lease
  - Assignment
- Conveyance may or may not be recorded
- May receive interest by testamentary transfer
- Probate process will evidence conveyance and ownership

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GIFT ACCEPTANCE POLICIES
MINERALS

MAY INCLUDE:

- Minimum values for surface rights
- Minimum per year royalty amounts
- Liability review procedures
- Provision prohibiting working interests
- Environmental review procedures
- Ongoing management considerations

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RED FLAGS
MINERALS

- Type of interest
  - Operating or working interests
    - Liable for environmental or surface-related problems
    - May want to form a separate legal entity
  - Royalty interests
    - Do not participate in production
    - Not responsible for expenses
    - Not liable
- Litigation or dispute

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WORKING WITH DONORS
MINERALS

QUESTIONS TO ASK:

1. What is the ownership interest?
   - Prior or existing leases
   - Prior division orders
   - Prior transfer orders
   - Check stubs from royalty payments
2. How was the interest acquired?
3. Is the interest under lease?
4. What do you want to gift?

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FACILITATING GIFTS
REAL ESTATE

- Real estate interests are conveyed by:
  - Deed
    - Inter vivos
    - Will or trust
    - Transfer on Death or Ladybird Deed
- Conveyance should be recorded
- May receive an undivided interest in real property

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GIFT ACCEPTANCE POLICIES
REAL ESTATE

MAY INCLUDE:

- Mortgaged property restrictions
- Liability review procedures
- Environmental review procedures
  - Site visit
  - Property inspection and testing
  - Donor questionnaires
  - Ownership history
- Ongoing management considerations

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RED FLAGS
REAL ESTATE

- Valuation and marketability
- Carrying costs
  (HOA fees, debt, insurance, etc.)
- Timeshares
- Environmental issues
- Property disputes or litigation
- Avoid pre-arranged sales
  - Anticipatory assignment of income could subject donor to capital gains taxes

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TITLE REVIEW

Title commitment may reveal a cloud in title, such as:

- Ownership
  - Not titled in donor's name
  - More than one owner
  - Do not own part of the land in question
- Mechanic's lien
- Federal tax lien
- Pending legal action
- Easement
- Covenant or condition

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SURVEY REVIEW

Survey may reveal the following:

- Discrepancy in acreage
- Encroachments
  (your property onto your neighbor's property or your neighbor's property onto your property)
- Location of easements
- Structures, driveways, cemeteries

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POTENTIAL ISSUES BEFORE CLOSING

- Appraised value
- Feasibility period
  - Environmental inspection
  - Soil test
- Zoning
- Extensions
- Closing document review

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WORKING WITH DONORS
REAL ESTATE

QUESTIONS TO ASK:

1. What is the ownership interest?
2. How long have you owned the property?
3. How was the property acquired?
4. Is the property under lease?
5. How much of the property do you want to gift?
6. Do you need to retain use of the property?

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VALUATION OF MINERAL INTEREST

- General Rule of Thumb:
  Value = annual income x 5
- Formal appraisal will determine the expected future cash flows:
  - Production history
  - Number of producing wells
  - Discounted to present value

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VALUATION OF INTEREST

FAIR MARKET VALUE (FMV):

The price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts

Reg. § 1.170A-1(c)(2)

Rev. Rul. 68-69, 1968-1 CB80

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VALUATION OF INTEREST

- The FMV is to be determined in the market which the item is most commonly sold to the public
  Rev. Rul. 80-69, 1980-1 CB55
- For interests valued in excess of $5,000, a qualified appraisal is required
  Reg. § 1.170A-13(c)(1)(i)

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VALUATION OF REAL ESTATE & MINERALS

QUALIFIED APPRAISAL:

- Prepared no sooner than 60 days before gift date
- Prepared by a "qualified appraiser"
  - Pension Protection Act of 2006 requires:
    - Appraisal designation or minimum education and experience
    - Regularly perform appraisals for pay
    - In good standing
- Donor's responsibility

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VALUATION OF REAL ESTATE & MINERALS

MINERAL INTERESTS:

- Gift of royalty interest or non-participating royalty interest
  - May deduct FMV if held more than 1 year
- Operators
  - Deduction limited to basis

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CHARITABLE DEDUCTION

GENERAL RULE:

– Charitable deduction for non-cash assets held more than a year is limited to 30% of adjusted gross income (AGI)
– Carry over deduction for up to 5 years

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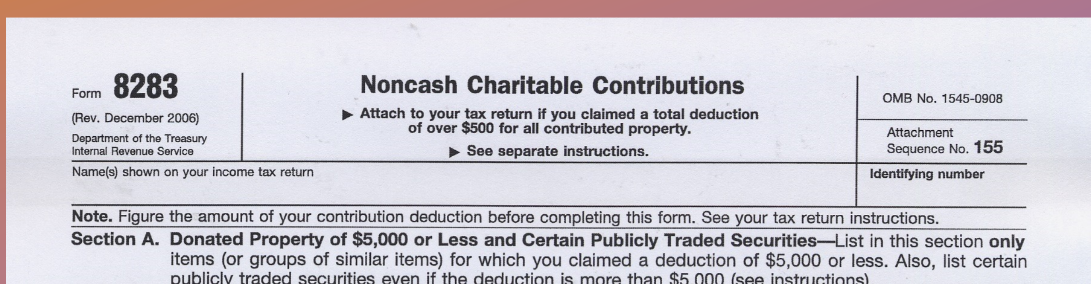
CHARITABLE DEDUCTION
IRS FORM 8283: NON-CASH CONTRIBUTIONS

THE "APPRAISAL SUMMARY":

– Signed by appraiser
– Signed by donee charity to acknowledge receipt


Form 8283
(Rev. December 2006)
Department of the Treasury
Internal Revenue Service

Noncash Charitable Contributions
▶ Attach to your tax return if you claimed a total deduction of over $500 for all contributed property.
▶ See separate instructions.

OMB No. 1545-0908
Attachment Sequence No. 155

Name(s) shown on your income tax return | Identifying number

Note. Figure the amount of your contribution deduction before completing this form. See your tax return instructions.

Section A. Donated Property of $5,000 or Less and Certain Publicly Traded Securities—List in this section **only** items (or groups of similar items) for which you claimed a deduction of $5,000 or less. Also, list certain publicly traded securities even if the deduction is more than $5,000 (see instructions).

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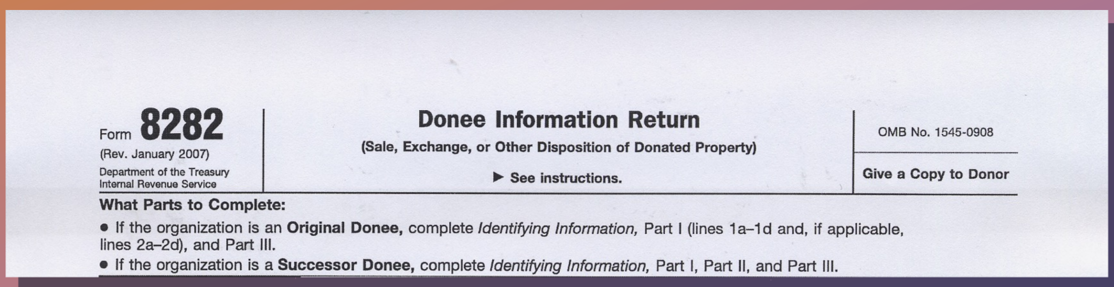
CHARITABLE DEDUCTION
IRS FORM 8282: DONEE INFORMATION RETURN

- If charity sells property within 3 years of gift
- Disclose amount received upon sale
- Penalties to charity for failure to file


Form **8282** (Rev. January 2007) Department of the Treasury Internal Revenue Service

Donee Information Return
(Sale, Exchange, or Other Disposition of Donated Property)
▶ **See instructions.**

OMB No. 1545-0908
Give a Copy to Donor

What Parts to Complete:
- If the organization is an **Original Donee,** complete *Identifying Information,* Part I (lines 1a–1d and, if applicable, lines 2a–2d), and Part III.
- If the organization is a **Successor Donee,** complete *Identifying Information,* Part I, Part II, and Part III.

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PARTIAL INTEREST RULE

GENERAL RULE:
- Contribution of less than a donor's entire interest in a property precludes a deduction

KEY EXCEPTION: *an undivided portion of the donor's entire interest must*
- Be a fraction or percentage of every substantial right
- Extend over the entire term of the donor's interest

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PARTIAL INTEREST RULE

UNDIVIDED INTEREST:
- Many mineral interests are fractional shares of a larger whole
- Gift of fractional interest may be entire interest
- May gift a "sub-fraction" as an undivided interest

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PARTIAL INTEREST RULE

EXAMPLE #1:
- Donor owns surface and minerals
- Wants to gift surface and retain minerals
- **No deduction**

Charity may want to restrict surface use if minerals are retained

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PARTIAL INTEREST RULE

EXAMPLE #2:

— Donor owns surface and minerals

— Donor partitions surface interest from mineral interest

— Donor gifts surface interest

— **No deduction**

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PARTIAL INTEREST RULE

EXAMPLE #3:

—Standard royalty owner "carves out" a non-participating royalty interest for charity

—**No deduction**

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UNRELATED BUSINESS TAXABLE INCOME

- Income from working interest is UBI
- To avoid UBI, royalty interest must be free from:
  - Development costs
  - Operating expenses
- Bonus payments are passive
  - Not "regularly carried on"
  - Only a one-time payment

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UNRELATED BUSINESS TAXABLE INCOME

PASSIVE INCOME:
- Oil and gas royalties
- Shut-in royalties
- Delay rentals
- Rents from real estate (if not debt financed)

ACTIVE INCOME:
- Running a hotel
- Managing a parking lot
- Working interest in oil and gas

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CHOOSING A GIFT VEHICLE

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CHOOSING A GIFT VEHICLE

QUESTIONS TO ASK:

1. Will annual income support payment provision of the gift arrangement?
2. Will other assets be involved?
3. Sell or retain the mineral interest?

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CHOOSING A GIFT VEHICLE
GIFT ANNUITY

- Careful consideration is necessary
- Fixed payment obligation
- Depleting asset

EXAMPLE:

- Donor, age **72**, gifts mineral interest valued at **$75,000** *(annual royalty income of $15,000)*
- ACGA rate is **5.8%**, resulting in an annual annuity obligation of **$4,350**
- Donor life expectancy is **14.5** years

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CHOOSING A GIFT VEHICLE
GIFT ANNUITY

YEAR	ROYALTY AMOUNT	ANNUITY OBLIGATION	ANNUAL RESERVE AMT	TOTAL RESERVE
1	15,000	4,350	10,650	10,650
2	13,500	4,350	9,150	19,800
3	12,000	4,350	7,650	27,450
4	10,500	4,350	6,150	33,600
5	9,000	4,350	4,650	38,250
6	7,500	4,350	3,150	41,400
7	6,000	4,350	1,650	43,050
8	4,500	4,350	150	43,200
9	3,000	4,350	0	41,850
10	1,500	4,350	0	39,000
11	0	4,350	0	34,650
12	0	4,350	0	30,300
13	0	4,350	0	25,950
14	0	4,350	0	21,600
15	0	4,350	0	17,250

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CHOOSING A GIFT VEHICLE
CHARITABLE REMAINDER TRUST

- Same considerations as with the gift annuity, but the Trustee may not rely on non-trust assets
  - 5% probability of exhaustion could also be an issue

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CHOOSING A GIFT VEHICLE
CHARITABLE REMAINDER TRUST

EXAMPLE:

- Donor receives fixed dollar or fixed percentage payments
- **Surface:** Charity sells surface property without paying capital gains tax
- **Minerals:** Annual revaluation of assets accommodates mineral interest well
  - Annual value based on production
  - Payment obligation and production “rise” and “fall” together

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CHOOSING A GIFT VEHICLE
FLIP CHARITABLE REMAINDER TRUST

FLIP CRUTs accommodate gifts of real estate

- Net income payout provision
  - Pays lesser of stated percentage of annual FMV of trust assets or actual net income earned
  - Protects against "acquisition indebtedness" prior to sale of property
- Straight payout provision
  - Pays stated percentage of FMV of trust assets, as revalued annually
  - Allows trust to be invested more advantageously

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CHOOSING A GIFT VEHICLE
FLIP CHARITABLE REMAINDER TRUST

EXAMPLE:

- Donor, age **72**, funds FLIP CRUT with both surface and mineral interests
- Surface appraised at **$250,000** and minerals appraised at **$60,000**
- CRUT flips upon sale of surface interest
- Mineral interest is retained
- Annual valuation of invested sale proceeds and retained mineral interest determines payment outcome

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CHOOSING A GIFT VEHICLE
CHARITABLE LEAD TRUSTS

- Charitable Lead Annuity Trust (CLAT): Same considerations as with a gift annuity and a charitable remainder trust
- Charitable Lead Unitrust (CLUT): Variable payments work well with fluctuations in mineral production/valuation

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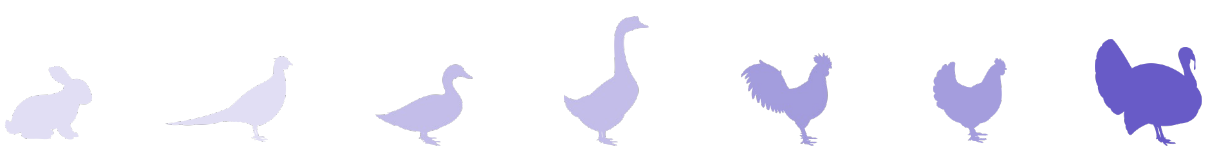
CHOOSING A GIFT VEHICLE
REMAINDER INTEREST IN RESIDENCE OR FARM

- Donor conveys both surface and mineral estates, retaining life interest
  - Maintenance issues
  - Tax issues
  - Register to receive deed activity alerts



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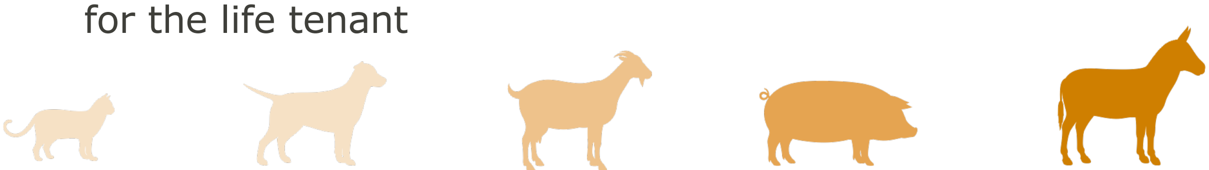
CHOOSING A GIFT VEHICLE
REMAINDER INTEREST IN RESIDENCE OR FARM

COMMON LAW RULES:

- Life tenant and remainderman must both execute leases
- Bonus money is considered corpus and paid to the remainderman
- Royalties from production are treated as consumption of corpus and are paid to the remainderman
- Income from invested payments is considered income for the life tenant



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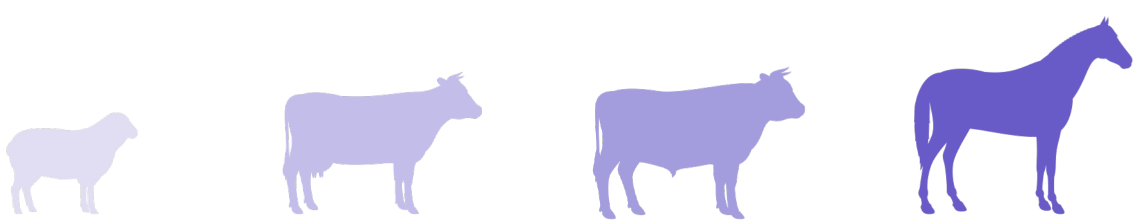
CHOOSING A GIFT VEHICLE
REMAINDER INTEREST IN RESIDENCE OR FARM

MINERAL INTERESTS:

- Open Mine Doctrine presumes that the life tenant will receive all income if production was occurring when life tenancy was established
- Contractual Life Estate trumps Common Law
  - Could raise partial interest concerns



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CHOOSING A GIFT VEHICLE
DONOR-ADVISED FUND

- Avoid capital gains tax
- Receive charitable tax deduction for FMV at the time of the gift
- Make recommendations for charitable distributions for years to come
- Appoint successor advisors

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CHOOSING A GIFT VEHICLE
BARGAIN SALE

- Sell property to a charity for less than fair market value
- Charitable tax deduction
  - Deduction= FMV-Sale Price
- Requires careful documentation and receipting

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WORKSHOP CASE STUDIES

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SCENARIO #1: OFF**BEET** CHARITABLE DONATION

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SCENARIO #2: RICH IN CHARITABLE GIVING OPPORTUNITIES

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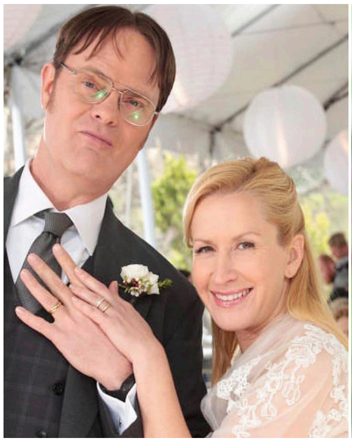


SCENARIO #1: OFFBEET CHARITABLE DONATION

Mr. and Mrs. Schrute own a beet farm in rural Texalvania, where they raise their three sons. Mr. Dwight Schrute serves as Assistant to the Regional Manager of a small paper company and spends his nights and weekends cultivating new beet varieties. Mrs. Angela Schrute runs a successful party planning business. When a well-connected politician puts in a good word for Mrs. Schrute, her party planning business lands a huge event: the gubernatorial ball. After pulling off the best ball in decades thanks to her Jazz Cats theme, Angela is inundated with lucrative party planning bookings, resulting in a windfall year.

Tapping long-dormant skills from her former career as a staff accountant, Angela tells Dwight that they should consider charitable giving opportunities to offset their hefty tax burden. Dwight, though not normally charitably inclined, perks up at the opportunity to lower his tax bill. Tired of her husband always smelling of beets and eager to help her church upgrade their musical instruments to better accompany her annual Christmas Eve performance of "Little Drummer Boy," Angela initially proposes that they deed the beet farm to her church.

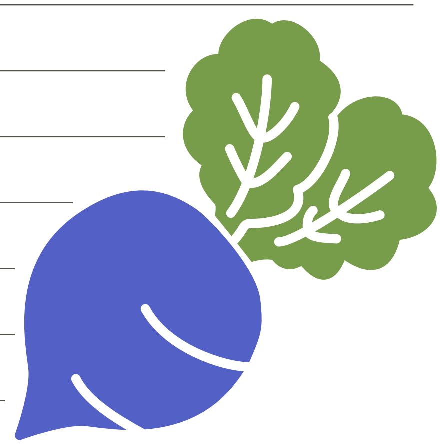
Dwight balks at the suggestion of parting with his beloved farm but offers to donate a portion of his yearly beet harvest to the local school lunch program. Angela scoffs at that idea, knowing that even their own sons refuse to touch beets, and she asks Dwight if he would be willing to donate a portion of his farm to the church. "Maybe we could even do a gift annuity for part of the donation, to give us an extra income stream in case times ever turn lean for party planning."

Dwight, remembering how his wife's business struggled during the early COVID years, is intrigued by the thought of another income stream. He seems open to the idea of selling 25% of his acreage but worries about how that will impact his beet inventory. "I have different varieties growing on every acre!" he says. "How about if you retain the rights to the first beet harvest of the year?" Angela asks, "That way you wouldn't lose all the production value off that donated land."

"I have an even better idea," Dwight says. "My cousin Mose has been wanting to get his hands on part of the beet farm for years. I could donate a portion of it to the church if they agree to sell it to Mose at a discounted price. Then we get a deduction, the church gets income, and Mose gets some land—he'll share his harvest with me, of course. Everyone wins!"

Angela suggests that the church might want to rent the property to Mose, so they get a continual stream of rental income. "That's a good thought," Dwight says, "Then Mose won't be tied to that acreage, in case the EPA ever comes knocking about the underground petroleum storage tanks." His wife rolls her eyes and throws up her hands in exasperation. "Dwight, this is too complicated. I think we need to consult a professional for guidance."

One of Angela's party planning clients refers her to you for help. Can you help Mr. and Mrs. Schrute evaluate their charitable giving options, identify potential problems, and come up with a solution that meets their goals?



"First rule in roadside beet sales, put the most attractive beets on top. The ones that make you pull the car over and go, 'Wow, I need this beet right now.' Those are the money beets."

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SCENARIO #2: RICH IN CHARITABLE GIVING OPPORTUNITIES

Mr. Jed Clampett and his family relocated to California years ago, but they kept some acreage in the Ozarks that funds their Beverly Hills lifestyle with free-flowing mineral royalties. However, when Jed's nephew, Jethro, gets a job as a paralegal at an estate planning firm, he starts filling his uncle's head with lots of confusing talk of estate taxes, trusts, and beneficiary designations.

Mr. Clampett, who has an innate distrust of lawyers, decides to figure out his estate plan for himself, with help from Jethro. He wants to provide for Jethro and for his daughter Elly May, but he also has in mind to benefit children back home in the Ozarks. He remembers with nostalgia his childhood spent running barefoot through the hills and coming home to a steaming possum dinner. While he thinks that children benefit greatly from a simple childhood such as his, Jed acknowledges that his lack of education wasn't ideal. He wants to give impoverished children world-class educational resources that they can access without moving away from home.

Jed calls his cousin Pearl, a realtor, to talk about listing his Ozarks property. "I want to sell the property and keep the minerals," Jed says. Pearl suggests that it might be easier to donate the surface of the property to a local educational foundation. "That way, the charity can do all the work of selling the property and you can claim the tax deduction while you keep the mineral royalties," Pearl explains. "And Jed, before you donate that property, make sure the charity agrees to use me as the listing agent." Jed asks how big of a tax deduction will come with the donation and Pearl says, "I bet the surface property is worth $3 million. Just use that estimate on your tax forms."

After some research, Pearl discovers that the deed to part of the parcel in question is in Granny's name, and it happens to be a parcel that contains access to the main road. "To get that $3 million price, Granny will need to sign a deed to include her property in the charitable donation," Pearl says. "Well, I'm sure she'll be happy to do that," Jed says, "To tell you the truth, Granny's mind isn't what it used to be. She doesn't know where she lives half the time, so I can't imagine she has use for the property." "Well, just catch her on a good day and get her to sign," Pearl orders.

Before Pearl has a chance to get deeds drafted for Granny and Jed to sign, she calls with another update. "Jed, I think you're gonna need to come out here and get Ole' Rogers to move his trailer from where he's been squatting on that back five acres. He was mighty obnoxious when I told him we were gettin' rid of the property—said he had been living there ten years and he aims to keep living there until the Lord takes him home. I told him he never had permission to be there in the first place, but he just laughed at me."

While Jed is mulling over how to approach Rogers, Jethro comes home with another idea, "Uncle Jed, one of the lawyers at work told me about a trust that gives money to your kinfolk and charity. I thought that sounded mighty fine." "Well doggie," Jed replied, "We best look into that for you and Elly May." A combination of Jethro's second-hand information and Jed's Google research gives him some partially informed ideas: he wants to know if a charitable gift annuity or a charitable remainder trust could provide for his daughter and nephew while benefitting the education foundation.

Feeling confused and a little exasperated at the difficulty of trying to be generous, Jed decides he should ask for guidance from a professional gift planner. His neighbor, Mr. Drysdale, introduces him to you. Can you help Mr. Clampett evaluate his charitable giving options, pinpoint problematic ideas, and find a solution that meets his goals of providing for his family and benefitting the educational foundation?