

ESTATE PLANNING AND GAS LEASEHOLDERS

In the past few years, Western Pennsylvania and the nearby states have been subjected to an influx of companies interested in leasing and/or drilling for natural gas. Some of you may have been contacted or have already entered into leasing arrangements with these companies whereby the leasing companies/drillers will pay to you a royalty amount based upon the amount of oil or natural gas removed from your property.

Our office has been involved in negotiating a great many leases since the gas companies have moved into our area. Many people have allowed wells to be placed upon their property for the extraction of gas, while others have entered into subsurface arrangements whereby no wells appear on the surface of their property, but the gas underneath their property is accessed by a subsurface horizontal well originating from a nearby property. In either case, if you own a gas lease your right to receive royalty payments has created an additional asset in your estate that did not exist prior to the production of oil or gas on your property.

In effect, your real estate has now been divided into two separate interests in property. The first interest is the more traditional interest in real estate that we are all familiar with; the ability to reside upon the surface of the land. This right includes the right to build a home

and use and enjoy the surface of the property as we all have traditionally become accustomed.

The second interest in the real estate is the interest created by your right to receive income from your property based upon the amount of gas taken from your property by the driller pursuant to the lease agreement. Your rights to payment under this lease depend to a large extent on how much gas is taken from the property and how long it takes to remove the gas. The payments from the gas lease may extend for a number of years until the gas is exhausted. This stream of income can be separately passed to your estate beneficiaries, just as the surface of the real estate can also be passed to your estate beneficiaries. You now have, in essence, two assets that you need to address in your estate plan where traditionally only one (the surface real estate) existed before.

It is possible to transfer in your will the right to own the surface of the property to one beneficiary, while transferring the right to receive the income from the gas lease to a separate beneficiary or group of beneficiaries. When planning for an estate with a gas lease it is necessary to take into account how the gas lease will be valued upon the owner's death. It is difficult to value the right to receive a stream of income over a period of years—particularly from an asset that may produce sporadically, may be exhausted at any time and whose value is reliant upon the market value of natural gas as it is produced. Since the gas lease, would be a taxable asset in the estate of the deceased, proper planning beforehand is critical to ensure that the estate does not end up generating estate or inheritance tax that it is unable to pay. Valuation of the gas lease is an important component of the estate planning.

In some instances, it may be advisable to have the gas lease owned by either a limited liability company or a family limited partnership. This can make it easier to transfer interests in the gas lease to family members during the owner's lifetime (if desired), as well as provide an easier transition at death, while at the same time providing a business entity to administer the lease during the owner's lifetime.

Finally, an owner of gas leases in other states (as well as owners of Pennsylvania gas leases who are not Pennsylvania residents) may want to consider creating a revocable living trust in order to hold those leases and avoid an ancillary probate administration in those states where the gas leases are located. This technique will serve to streamline the estate administration and avoid having to deal with another state's probate process. Anybody who owns a gas lease as part of their estate should consult with an experienced estate planning attorney to ensure that this unique asset is properly administered.

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