

An Alternative Investment Solution For Real Estate Owners Seeking 1031 Exchange Options:

Energy

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About the Author:



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DIRECT INVESTING in oil and natural gas may provide cash flow, tax benefits, and portfolio diversification. Typically, energy investments qualify as real estate investment alternatives, and oil and gas royalty programs fulfill IRC Sec. 1031 exchange requirements. Investments in natural resources may provide inflation adjusted returns to investors. With the world's need for energy growing, this may be a good time to make direct investments in energy.

Ownership Rights

It's important to become familiar with the levels of ownership rights. Here is a quick recap:

Surface Land Owners: Surface rights are conveyed in the title to the land and will allow the owner to build surface structures, farm the land, etc.

Mineral Interest Owners: Mineral interests (located beneath the soil surface) may be separate from drilling rights and allow the owner to authorize drilling on the acreage.

Royalty Interest Owners: Mineral interests change to royalty interest once drilling begins and a well produces oil or natural gas.

Working Interest Owners: The proportion of interest in the project owned by a drilling company or operator.

Reasons To Invest in Oil and Gas Royalties

Replacement properties. In most cases, real estate investors and property owners may use oil, gas and mineral properties as replacement properties to identify in 1031 exchanges. Generally, the exchange process may allow real estate investors to defer capital gains taxes and trade into properties with no intensive management issues. Furthermore, owners can sell their deeded interest just as any other real estate without consulting limited partners. Note: Energy interests generally are eligible for 1031 exchange into another energy program or back into traditional real estate.

They may provide diversification. Energy investments not only help provide potential diversification, but they also may provide regular income streams.

Diversification is also a factor in the location of clients' investments since fields may be located in many states. Structured royalty portfolios provide ownership in real property and a potential stream of income from production of oil and gas. However, there are no assurances that diversification will guarantee against loss.

They may provide monthly income. Energy investors receive regular monthly checks for their share of production on their properties.

They provide participation: Energy programs typically offer much lower investment requirements than many 1031 Exchange investment properties. Royalty programs with experienced sponsors can allow your clients to complete a transaction in the exact dollar amount needed, when needed.

Land brokers may bring energy-based exchange properties into their real estate businesses by contacting a registered representative in securities.

When you become a land broker of choice, you may receive a desperate call from a client. "I'm on my last day to find a replacement property. I can't find anything on the market, and I don't want to back into something that ties me down."

You can have the solution. A call to your registered representative may help your client be placed into a suitable oil and gas royalty fund, potentially receive monthly income, offset gains, and experience hassle-free ownership while diversifying their portfolio.

While this article is focused on the royalty (cash flow) funds, there are other direct investments in oil and gas programs that have potential tax advantages. Some of these would be Developmental Drilling programs (which do not qualify for 1031 exchanges); "IDCs" or Intangible Drilling Costs; "TDCs" or Tangible Drilling Costs; and "Gross Depletion" Programs specifically suited for clients needing ownership in tax advantage programs to offset taxes in high net worth situations.