

Estate Planning and Marcellus Shale

By J. Corey Reeder

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It seems as though scarcely a day goes by without some commentary surrounding the Marcellus Shale formation and the extraction of the natural gas contained therein. However, in most of the articles, blogs, and postings, very little time is spent discussing the impact that drilling wells will have on a landowner's estate plan. It has always been good practice to review one's estate plan in light of either significant changes in the law and/or significant changes in one's personal life in order to make sure that the estate plan properly provides for the distribution of assets and minimizes any death attributable to the estate. Owning real property that contains desirable Marcellus Shale would certainly qualify as a significant change in a person's life given the potential increase in wealth both presently and in the future. From an estate planning perspective, one of the first items to determine is whether the ownership of the gas rights is properly structured to most efficiently distribute the real property and accompanying gas rights upon death and take advantage of estate and inheritance tax planning techniques. In Pennsylvania, gas rights are completely severable and thus can be separated from the rest of the real property. In many situations, it makes sense to form a limited liability company ("LLC") or a limited partnership ("LP") to own these rights with the landowner as the initial member or partner.

By utilizing either an LLC or LP as the owner of the gas rights, the transferor can control many facets of the ownership of the gas rights now and in the future. First, the transferor can determine the initial number of partners or members. Generally speaking, it makes sense for the property owners to be the sole member(s) or partner(s) in the LLC or LP that holds the gas rights. By utilizing the LLC or LP structure, the gas rights themselves remain fully intact within the LLC or LP rather than being divided among heirs, and the management of the gas rights is centered in the LLC or LP and governed according to the operating agreement (for the LLC) or the partnership agreement (for the LP). In addition to managing the rights, the use of an LLC or LP allows one to control how members or partners can transfer their membership interests or partnership interests to third parties. In addition, the operating or partnership agreements can limit the extent to which a member or partner can assign or pledge his or her interest in the LLC or LP, and whether or not said interest is devisable pursuant to the member or partner's Last Will and Testament. Finally, language can be included that allows the LLC or LP the right to buy back the membership or partnership interest upon a multitude of events. This last point is very important because it can often be used to restrict the rights of non-family members to acquire interests in the LLC or LP.

In conjunction with the control of ownership and management that an LLC or LP structure provides, membership or partnership interests are great assets to fund trusts for family members because the trusts can contain provisions controlling how the assets are distributed to family members and at what time. In situations where one is survived by minor children or young adult children, the passing of substantial assets outright upon the death may not be suitable given the age and/or maturity of the children. The transfer of membership or partnership interests into trusts is a perfect vehicle to provide limits, not only on the receipt by the beneficiary of both net income and principal generated from the membership or partnership interests, but also at what time frame the beneficiary may receive them.

In addition to the above benefits the LLC or LP structure provides in terms of funding trusts, membership and partnership interests are also efficient assets to pass outright or into certain trusts for the purpose of removing them from one's estate and thus avoiding paying Federal estate tax. At the most basic level, the transferor can utilize his or her annual gift exclusion and transfer membership interests in the LLC or partnership interests in the LP to family members either outright

or in trust via gifts of membership or partnership interests equal to the annual gift tax exclusion (currently \$13K per person or \$26K with spousal consent). In addition, the transferor can make gifts of membership and partnership interests either outright or into trusts by utilizing his or her lifetime gift tax exclusion (currently \$1M).

If you are fortunate enough to have real property containing Marcellus Shale formations, you are encouraged to contact a member of the McNees Asset Planning and Federal Taxation Group so you can be given specific guidance on how best to address this opportunity as it relates to your estate plan.

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