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Oil and gas interests in 1031 exchanges

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As an alternative to purchasing local real estate to satisfy the Tax Deferred Exchange requirements, investors have the option to roll their relinquished sale proceeds into Tenant in Common (TIC) replacement properties. This has allowed exchangers to free up some of their management and maintenance time, as well as give them the opportunity to diversify their real estate holdings, investing in commercial, industrial, retail or residential apartment complexes. However as we have seen, whether local or national, the real estate market is not what it used to be.

Becoming prevalent as a replacement property option is an interest in oil and gas production. This is generally referred to as an oil and gas royalty interest, which qualifies as "like kind" under Section 1031 of the IRS code. Ownership is taken as a "fractional interest" similar to TIC ownership.

This ownership entitles the investor to receive a share of the production of the property or a portion of the revenue from this production. Those having a royalty interest in his type of lease share in the profits generated from production, but have no rights or obligations in daily operations. Since investors do not participate in the production itself, they do not incur development expenses.

To date, royalty interests in oil and gas leases have not been as widely used as replacement property options as compared to traditional real estate structures, but a number of national companies continue to offer these types of investments to 1031 Exchange clients. Tax laws regarding this type of investment can be complex, so as with any 1031 Exchange opportunity, consulting with experienced tax and legal counsel is prudent.

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