

WHAT A LANDOWNER NEEDS TO KNOW ABOUT SALES OF MINERAL RIGHTS?

Sandusky, MI
Sanilac County
1-30-14

Curtis Talley Jr.
Farm Management Educator
MSU Extension, Hart, MI
231-873-2129
talleycu@anr.msu.edu

MICHIGAN STATE
UNIVERSITY
EXTENSION

MSU is an affirmative-action, equal-opportunity employer. Michigan State University Extension programs and materials are open to all without regard to race, color, national origin, gender, gender identity, religion, age, height, weight, disability, political beliefs, sexual orientation, marital status, family status or veteran status.



**“AND
JUSTICE
FOR ALL”**

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Persons with disabilities who require alternative means for communication of program information (Braille, large print, audiotape, etc.) should contact USDA's TARGET Center at (202) 720-2600 (voice and TDD).

To file a complaint of discrimination, write USDA, Director, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call (202) 720-5964 (voice and TDD). USDA is an equal opportunity provider and employer.

El Departamento de Agricultura de los EE. UU. (USDA, siglas en inglés) prohíbe la discriminación en todos sus programas y actividades a base de raza, color, origen nacional, género, religión, edad, impedimentos, credo político, orientación sexual, estado civil o familiar. (No todas las bases de prohibición aplican a todos los programas.) Personas con impedimentos que requieran medios alternativos de comunicación para obtener información acerca de los programas (Braille, tipografía agrandada, cintas de audio, etc.) deben ponerse en contacto con el Centro TARGET de USDA, llamando al (202) 720-2600 (voz y TDD).

Para presentar una queja sobre discriminación, escriba a USDA, Director, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410, o llame al (202) 720-5964 (voz y TDD). USDA es un proveedor y empleador que ofrece oportunidad igual a todos.

Definition of Mineral Property

- Mineral property is real property – can be severed from surface
- “Mineral” no universal definition
- Generally includes: Fossil fuels – oil, natural gas, and coal; Metals and metal-bearing ores such as gold, copper, and iron; Non-metallic minerals and mineable rock products such as limestone, gypsum, building stones and salt; May also include sand and gravel, peat, marl, etc.
- Can also include potassium, gases such as helium
"mineral" can vary from state to state and even change over time

Characteristics of Mineral Sale

- Sale is generally forever
- Owner's goals very important
 - Cash now vs. potential future cash from lease bonus or royalty
 - Financial need may be a factor
 - Young vs. Older; goals may differ
 - Older may want to live better now
- Can sell all or a portion
 - Example 50% divided interest (tenant in common) of the hydrocarbons
 - Done by mineral deed

Characteristics of Mineral Sale Continued

- If no royalties, difficult to establish value
 - What are non-producing minerals worth?
 - Consult oil and gas appraiser
- Seller loses control and leverage with eventual mineral developer
- If cash flows exist several valuation methods
 - One Rule of thumb: Sales price = 4 years of royalties
 - Example: If royalties the past 4 years averaged \$5,000 per year; sale value = \$20,000

Characteristics of Mineral Sale Continued

- Analysis of previous cash flows to project future cash flows and Net Present Value
 - Allocates very little or no value to non-producing minerals
 - Does not consider future improvements in new technology impact on cash flows

Characteristics of Mineral Sale

Continued

- Current cash flows can sell by mineral auction
 - If there is competition can significantly increase income
- Surface owner loses control of reducing impacts to surface
- New mineral owner no incentive to protect surface
- Get references on potential buyer
- Understand sales contract! qualified legal advice

Magnitude of the Royalty

- Situation: 40 acres, one oil well @25 barrels/day for 200 days @ \$90/barrel
- $25 \times 200 \times \$90 = \$450,000/\text{year}$
- $1/8 \text{ royalty} = \$56,250/\text{yr} = \$1,406/\text{acre}/\text{yr}$
- $1/6 \text{ royalty} = \$75,150/\text{yr} = \$1,878/\text{acre}/\text{yr}$
- $3/16 \text{ royalty} = \$84,375/\text{yr} = \$2,109/\text{acre}/\text{yr}$
- $.20 \text{ royalty} = \$90,000/\text{yr} = \$2,250/\text{acre}/\text{yr}$

Characteristics of Mineral Sale Continued

- Know what “Partnering Together” means in the sales contract
- Example: Sell 50 % undivided interest for \$250/acre grants buyer 50% of future mineral income to 100% of property—see Magnitude of Royalty
- Buyer may “flip” the land just as can be done with the sale of an oil and gas lease

Mineral Retention Considerations

- Oil and gas companies prefer same owner of surface and minerals
 - Less people to please (1 vs.2)
 - Surface owner more clout with company when mineral owner and surface owner the same
- Lease bonus can be immediate cash
 - Bonuses \$15/acre up to \$3,500/acre in MI 2010
- Lease has long term royalty potential
 - Short primary term may mean opportunity to lease again = bonus again

Mineral Retention Considerations Continued

- Technology constantly changing
 - Hydraulic fracturing and horizontal drilling examples
 - New technology increases production from old wells
- Potential to negotiate favorable lease

Sales of Mineral Rights “Reducing Risk?”

- Will severing minerals affect future sale of surface?
 - Mineral production present but no royalty to surface owner may reduce potential buyers
- Intact minerals with royalty income attractive to certain buyers – sale now could increase risk later

Sell Mineral Rights and Reclaim in 20 Years?

- Under Michigan's Dormant Minerals Act, severed oil or gas rights revert to the surface owner after twenty years, unless:
 - The severed interest is sold, leased, mortgaged, or transferred by recorded instrument.
 - A drilling permit is issued.
 - Oil or gas is actually produced or withdrawn from the severed holdings.
 - The interest is utilized for underground gas storage operations

Sell Mineral Rights and Get Them Back in 20 Years?

- Buyer must file record claim of interest with the county Register of Deeds (affidavit to retain) during the 20 years.
- Clock starts ticking day deed filed
- The Dormant Minerals Act applies only to oil or gas rights, and not other mineral rights.

I Wish You Tax Problems!

- DO NOT LET INCOME TAX DICTATE A DECISION
- Sale: 2013 MFJ if taxable income <\$72,500
Cap. gain rate 0%; earned income rate = 15%
+ SE tax
- Sale: 2013 MFJ taxable income >\$72,500 Cap.
gain rate 15%; earned income rate 25% + SE
tax

I Wish You Tax Problems!

- Oil & Gas lease bonus not earned income: tax @ ordinary rate; no SE tax
- Oil & gas royalties not earned income; tax @ ordinary rate; no SE tax
- Crop damages ordinary income subject to SE tax
- Surface damages ordinary income **not** subject to SE tax

Resources

- MSU Extension has the Oil and Gas web page at http://msue.anr.msu.edu/program/info/oil_and_gas
- Oil and gas leasing video on web page
- Lease addendum on webpage
- Quarterly Oil and Gas Newsletter contact talleycu@anr.msu.edu
- <http://news.msue.msu.edu> MSU Extension news articles
- Your county MSU extension office

THANK YOU

- QUESTIONS?