Low oil and gas prices create opportunity for estate tax planning

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Act now to preserve your estate. Low oil and gas prices create opportunity for estate tax planning.

The current economic downturn in the oil and gas industry combined with the low interest rate environment and the availability of valuation discounting techniques creates a number of unique opportunities for tax planning.

Two planning concepts used to save estate taxes that work especially well while oil and gas prices are low are the gifting or sale of equity interests in a family business to children or trusts created for their benefit. The following is a typical structure of this planning concept.

The depressed value of oil and gas prices means business valuations are substantially lower than they were a year and a half ago. As a result, more assets can be given away to family members or trusts for the benefit of family members within the confines of the lifetime gift tax exclusion. All the while, the business owner can still maintain control over the business after the gifts.

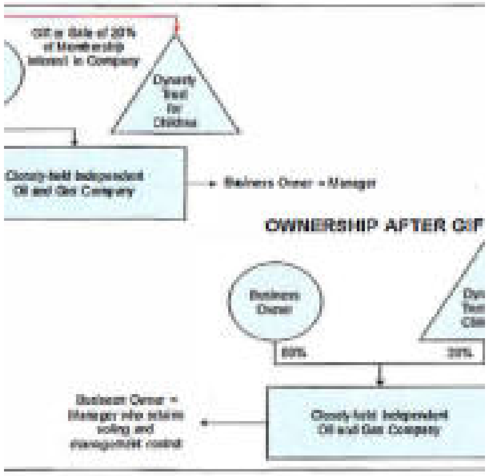
Currently, there is a $5,450,000 (or $10,900,000 for a husband and wife) estate and gift tax exemption available to shelter assets transferred during lifetime or at death from gift and estate tax. This means that a business owner and his/her spouse can transfer up to $10,900,000 in asset value (either during lifetime or at death) in the aggregate to any one or more family members or others with no gift or estate tax liability. The value of assets transferred during lifetime or at death in excess of $5,450,000 (or $10,900,000 for a couple) is generally subject to estate tax on the death of the survivor of the business owner and his/her spouse.

If the business owner and his/her spouse have a net worth that exceeds $10,900,000, other planning techniques, such as gifting, can substantially reduce any potential estate tax liability. By the gifting or sale of interests in an independent oil and gas company, the value of the interest transferred is in effect “frozen” as of the date of the gift so that future appreciation in the value of the gifted interest is excluded from the business owner’s estate for estate tax purposes.

Gifts of equity interests in the oil and gas company made in trust instead of outright to the business owner’s children have other advantages as well. For example, if the business owner makes a gift of equity interests in the oil and gas company to a “granter trust,” the business owner will continue to be treated as the owner of the gifted interests after the gift for income tax purposes (but not for estate tax purposes).

As a result, the business owner will continue to pay the income tax on the income generated by the gifted equity interest in the oil and gas company. By doing so, the income tax attributable to the gifted interests paid by the business owner (instead of by the trust or the children) is, in effect, an additional gift from the business owner to the business owner’s children that is not taxable for gift tax purposes.

Additionally, assets gifted to multi-generational trusts can pass to younger generations free of gift or estate tax. Finally, gifts of equity interests in the oil and gas company made to a trust are protected from the claims of both the business owner’s creditors and the children’s creditors.



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The benefit of gifting interests in an oil and gas company while oil and gas prices are down is illustrated by this example. If a 1 percent interest in an oil and gas company was worth $50,000 when oil prices were at $100 per barrel, a gift of a 20 percent interest in the oil and gas company would be worth $1,000,000 and would reduce the business owner's unified estate and gift tax exemption by $1,000,000 ($50,000 x 20), leaving an exemption of $4,450,000 to shelter future estate or gift tax liability. If that same 1 percent interest in the oil and gas company is now valued at $15,000 with oil prices at a little over $30 per barrel, then the value of a gift of a 20 percent interest in the oil and gas company would be only $300,000 ($15,000 x 20) and would reduce the business owner's gift tax exemption by only $300,000, leaving an exemption of $5,150,000 to shelter future estate or gift tax liability.

Any future appreciation in the value of the gifted or sold interest in the oil and gas company now valued at $300,000 would escape taxation in the business owner's estate. So, if next year, oil prices go back to $100 per barrel, the 20 percent interest in the oil and gas company would have appreciated by $700,000. That appreciation would escape taxation in the business owner's estate. In that event, the gift or sale of a minority interest in the oil and gas company made while prices are hovering around $30 per barrel would result in an overall tax savings of approximately $277,200

($700,000 x the maximum estate tax rate of 39.6%).

As the value of the gifted interests increases over time, the tax savings would be even greater. The result of lower oil and gas prices is that greater quantities of oil and gas assets can be transferred out of the business owner’s estate and sheltered from tax, given the current depressed state of the energy industry. This can be particularly helpful long-range when the inevitable turnaround in the energy industry does occur.

In addition to future increases in oil prices, other foreseeable factors very well may adversely impact these planning techniques in the near future, including increases in interest rates and the anticipated change in the tax law limiting the use of discounting techniques.

The Federal Reserve has made it known that it intends to increase interest rates periodically throughout the year and the IRS has been considering issuing proposed regulations to limit the use of discounts for lack of marketability and lack of control in determining the value of gifts of equity interests in a closely held business. The low interest rate environment, along with lower business valuations, make oil and gas company and other estate tax planning techniques work especially well at this point in time.

If you are concerned about the partial impact of estate taxes on your oil and gas business, now is a great time to plan – before the recovery in oil and gas prices, the inevitable increase in interest rates, and the possible elimination of discounting techniques.

Don’t let this opportunity pass you by.

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