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LAGOS WEALTH ADVISORS
BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

Income and Estate Tax Savings
A Tax Advantaged Strategy

This discussion is focused on the tax characteristics and the income and estate tax planning opportunities of oil and gas development investments. It is not intended to promote or solicit the sale of any specific investment.

The programs providing the tax benefits discussed are those that drill for ***"developmental wells",*** which is drilling within a proven area of a natural gas or oil reservoir. Unlike *"exploratory drilling"*, *"developmental"* programs provide investment results with some degree of predictability. The intended result is to provide investors with a long term cash flow return, since the economic life of these wells are usually between 15 to over 20 years for oil and up to 50 years for natural causes.

Estate tax benefits are derived from the income tax savings realized by the investor. An investor will typically get an ***income tax deduction of 70% to 80%*** of their investment in the initial year of investment. The income tax deduction in the initial year is primarily from intangible drilling costs, with additional income tax deductions in subsequent years from depreciation of the equipment costs for the wells, and deductions from percentage depletion.

The income tax deductions are attributable to a ***"General Partnership interest"***, under which the investor will have *unlimited liability for the partnership's operations*. This exposure remains until the partnership completes the drilling of all wells and should be within twelve months, at which time the investor is then converted to a *"limited partnership interest"*.

To mitigate the liability exposure most sponsors require third-party contractors to maintain substantial liability insurance coverage; the sponsor will provide additional liability insurance coverage; and beyond insurance coverage the partnership aggregate capital, often supplemented by the sponsors capital. These measures may offer assurance that general partner interests are insulated from potential liability.

The income tax deduction is taken on line 17 carried forward from Schedule E. The deduction should not trigger AMT, subject to remaining within the 40% rule of a tax sheltered investment to earned income.

In most cases the incentive of income tax savings would be more than sufficient for investor consideration. However, additional tax advantages can be realized in the second year of the investment ***providing the ability for income shifting, and estate tax planning opportunities***.

The capital account (***tax basis)*** in year two ***as reported on the K1 will be at 5% to 15%*** of the initial investment. This results in the ability to ***gift the investment at a substantial valuation discount.*** Historical performance of similar programs may afford a more conservative valuation based on three years annual cash flow as reported by the sponsor. However, as "past performance does not guarantee future results", *tax basis is often the valuation method*.

This provides planning opportunities for income shifting or gifting of the investment. Gifting to trust can remove the investment from the estate, shifting future income to the trust for asset accumulation.

Alternatively, the future trust income may be employed to purchase life insurance *("on a self-completing plan")* and leverage the estate liquidity, or create an inheritance for an investors children and or grandchildren. With multiple years of investments, trust income in future years can grow significantly allowing for the leveraging in financing life insurance within the trust, and substantially increasing the legacy planning with no additional gifting.

Having your cake and eating it too may be preferable, and the investment may be a ***desirable investment for a Spousal Lifetime Access Trust ("SLAT")***. Income from the trust may be retained by the spouse, for their use or indirectly joint use, while removing the asset from estate tax.

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