



Case Study: **ENERGY**



A leading, privately owned, independent oil and gas exploration and production company.

For the past 25 years, this oil and gas exploration and production company has focused its operations in the Appalachian Basin and adjacent areas. This company has capitalized on new technology, seismic testing and experienced personnel to successfully locate rich oil and gas reserves, many in areas that had previously been extensively explored. This company's success can also be attributed to the acquisition of oil- and natural gas-producing wells, along with oil, gas and mineral rights to hundreds of thousands of acres of prime oil- and gas-bearing land located in and around the Appalachian Basin.

Nationwide Exchange Services

The Challenge

The company had negotiated a \$160 million sale of leases and wells to another large petroleum company, and the closing was rapidly approaching. The transaction was structured with an initial \$40 million payment at closing, and a subsequent payment of \$120 million, contingent upon the successful assignment and sale of more than a thousand additional leases, all of which would take a considerable amount of time and effort to finalize. Each of the relinquished properties had a very low cost basis, and the company wanted to defer as much capital gains tax as possible. Unfortunately, the contingent closing was not scheduled to take place until nine months after the initial closing, which would put the numerous leases in the second portion of the transaction well beyond the 180-day exchange period allowed by the IRS. The client assumed that they could only defer the taxes on the sale of the leases outlined under the first portion of the closing.

Details Of The Transaction

- Two different closing periods within one purchase and sale agreement.
- Second closing beyond the 180-day exchange period allowed by the IRS.
- Defer as much capital gains tax on the very low basis of all relinquished leases.

The NES Solution

While working with the company regarding the structure of this transaction, it became clear to the experienced NES Account Team that the company was interpreting the purchase and sale of the leases as one transaction with installment payments. Indeed, in their minds, this structure would prevent an exchange on the larger payment of \$120 million nine months after the first payment.

After conducting research and analysis, the NES Account Team helped the company develop a 1031 exchange solution that converted this transaction into two separate transactions, rather than the single transaction installment sale approach to the exchange. As such, the first payment was structured as an independent transaction (Deal A), with the option of selling the additional leases if they were, in fact, assignable.

Since many of the leases in the second group might not have been assignable, the NES Account Team suggested that the transaction could be structured as a separate sale (Deal B, contingent upon the assignability of the leases) rather than an installment sale as originally understood by the company. Utilizing this two-sale approach successfully allowed the company to take advantage of the significant tax deferral on the second \$120 million sale (Deal B).

Benefits And Results

NES worked with the company's legal and tax advisers to draft an Exchange Agreement for the closing of the \$40 million portion of this transaction. The company elected to roll \$25 million into an exchange account fully insured by the FDIC at one of NES' outstanding custodial banking partners and was able to immediately begin shopping for replacement leases on that exchange. This tailored 1031 exchange solution also gave the company the option to do an exchange on the contingent sale of the remaining leases that were scheduled to close nine months later. As a result, the company would be able to realize a substantially greater tax savings on the sale of the remaining leases (Deal B). A conservative estimate of the tax savings on the leases earmarked for the contingent sale was thought to be three times that of the first closing.

- **Innovative Approach.** The company had never broken out a purchase and sale agreement into separate transactions, each with its own individual tax consequences, which resulted in a much larger tax deferral. While NES does not provide legal or tax advice, our experience in complex oil and gas transactions helped us identify and point out strategic tax-saving advantages for consideration by the company's advisers.
- **More Buying Power.** By structuring a series of 1031 exchanges, the company was able to reinvest their tax savings from both portions of the sale. By doing this, the company gained additional buying power toward the purchase of more desirable replacement properties.
- **Intelligent Approach to the 180-Day Rule.** Again, through the use of multiple 1031 exchanges, the company was able to take advantage of a separate 180-day exchange period allowed by the IRS for each set of relinquished leases.

Tax-Deferral Comparison Chart		
Sale of Leases and Wells	Without NES Solution	With NES Solution (Deals A & B)
Asset Value	\$160M	\$160M
Asset Basis	\$35M	\$35M
Taxable Gain	\$125M	\$0
Tax on Sale at 40%	\$50M	\$0

Unmatched Expertise – Matched Only By Our Best Practices

Every year, NES conducts thousands of successful 1031 exchanges of varying forms and complexities across a wide spectrum of industries. NES Exchange Specialists are supported by an in-house legal team unparalleled in the 1031 industry. Our highly experienced attorneys are leaders in their field and include a former IRS National Office official who was instrumental in the development of important IRS 1031 guidance and is a nationally recognized author and speaker on 1031 exchange issues. This marketplace expertise along with our fully compliant business practices and processes have set new standards of excellence in the 1031 industry.

These best practices add immeasurable value to every client's exchange, addressing the critically important areas of funds security, transactional transparency, and voluntary and regulatory compliance. All of which helps explain why we conduct more types of exchanges for more Fortune 500 companies than any other QI in the 1031 industry.

The NES Difference

- NES offers a comprehensive set of 1031 exchange and LKE Program solutions with the highest level of expertise in the industry.
- NES annually subjects its business practices, financial policies and customer provisions to an independent audit to ensure the highest level of funds security, transactional transparency and compliance.
- NES is the only SOX 404 compliant provider for Section 1031 exchanges.
- NES is the only QI to be awarded SAS 70 Type II certification (the same level of audit and certification required to obtain a federal bank charter).
- NES' innovative technology platform provides full audit and reporting capabilities while providing 24/7 visibility of all account transactions to each client through a password-protected website.
- NES carries errors and omissions and fidelity bond coverage on every transaction.

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