

The Ultimate Guide to **Using Royalties in a 1031 Exchange.**

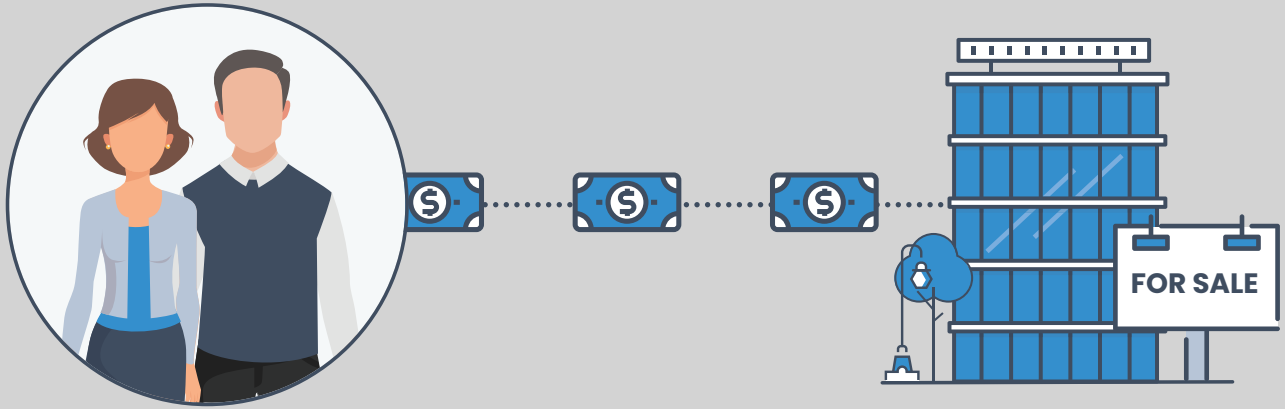


RESOURCE ROYALTY^{LLC}
UNCONVENTIONAL ROYALTY

Meet the Masons.

They've recently accepted an offer on an office complex they own and would like to defer their taxable gain.

They have consulted with their Tax and Financial Advisors, and rather than paying the tax on the gain; they may utilize a 1031 exchange.



Option 1: Traditional Sale

Taxes May exceed **20-35%** of the capital gain.



May include:

- Federal Taxes
- State Taxes
- Depreciation Recapture
- Net Investment Income Tax

Option 2: 1031 Exchange

Defer 100% of capital gains tax!



Benefits include:

- Tax Deferral
- Wealth Preservation
- Attractive Income Potential
- Efficient Estate Planning

★ **PLUS**, the Masons can continue the 1031 process until it is time to pass their assets to their heirs.

At that time, the basis, aka the purchase price of their asset, "steps-up", which means their heirs can sell the asset at current value and recognize **ZERO** capital gains!

The 1031 Exchange Process

| | | |
|------------|--|---|
| STEP 1. | Sell Your Property | Relinquish your investment property and utilize a 1031 exchange. |
| STEP 2. | Engage Qualified Intermediary | When you sell your property, you cannot receive the sales proceeds, or you will have to pay the taxes. In order to complete a 1031 exchange, the proceeds must be held by a Qualified Intermediary. |
| STEP 3. | Identify Replacement Property | Once the Q.I. has possession of your funds, you will work with your trusted investment advisor to identify appropriate replacement properties. |
| STEP 4. | Purchase Property or Properties | Once you have identified which properties you would like to purchase, the Q.I. will forward the funds for closing and complete the 1031 Exchange. |

The Three Simple Rules



Replacement properties must be “like-kind”.

Like-Kind” is a designation made by the IRS, which includes all deed, real property that is used for commercial or investment use. An individual and purchase any “like-kind” real estate and comply with 1031 guidelines. *Their personal residence or vacation property does not qualify for a 1031.*



All funds must be reinvested.

You must use all the proceeds from the sale of your relinquished property. You must reinvest all proceeds in order not to pay the capital gains. As a result, the replacement property, or properties, must be equal or greater in value.



You must find a home for your debt.

If your relinquished property has remaining leverage on it, you must find a home to service that debt. If you have remaining exchange proceeds after the debt is serviced, you can purchase an “all cash” option and avoid a “cash boot.” Mineral interests and royalties are often used as an all-cash solution.

How to Identify Your Replacement Properties.

Investors have the choice of three different identification rules for identifying replacement properties. They **only need to comply with one of these rules** to conduct an exchange.

3 Property Rule


Investors can identify three replacement properties regardless of their total value. Investors can then choose to exchange into one individual property or all three.



or

95% Rule

Investors can identify any number of replacement properties, regardless of their total value, if the replacement properties acquired amount to at least 95% of the total value of all the identified properties.

at least 
95%

or

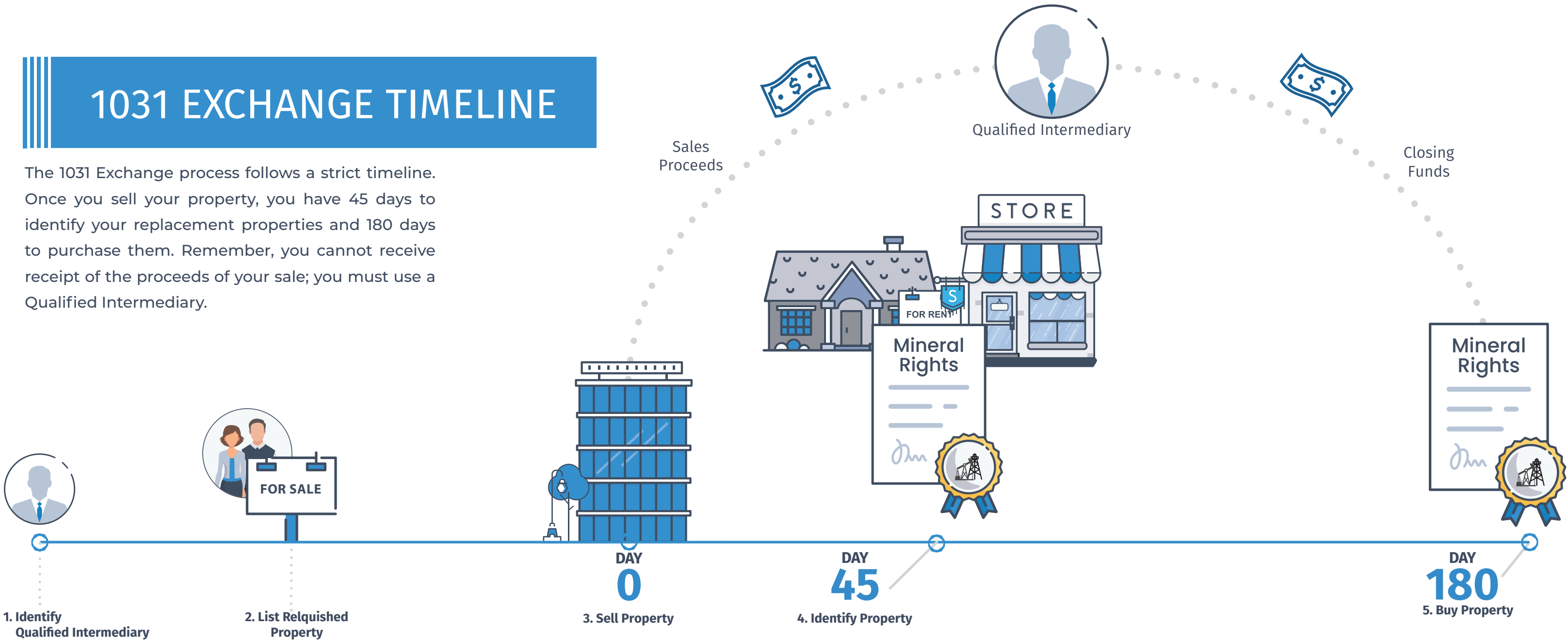
200% Rule

Investors can identify any number of replacement properties so long as their total value does not exceed 200% of the total value of the relinquished property.

 not more than
200%

1031 EXCHANGE TIMELINE

The 1031 Exchange process follows a strict timeline. Once you sell your property, you have 45 days to identify your replacement properties and 180 days to purchase them. Remember, you cannot receive receipt of the proceeds of your sale; you must use a Qualified Intermediary.



Royalties Are “Like-Kind”

Since 1954, millions of real estate investors across the country have taken advantage of 1031, tax-deferral “like-kind” exchanges. It is commonly thought that is this the IRS “like-kind” designation only qualifies for traditional, brick-and-mortar real estate, such as an apartment building, office building, or retail property. But what is not widely known, and maybe the best-kept secret of some of the country’s wealthiest families and institutions is that this “like-kind” designation includes Mineral Rights & Royalties!



Retail



Residential & Multi-Family Properties



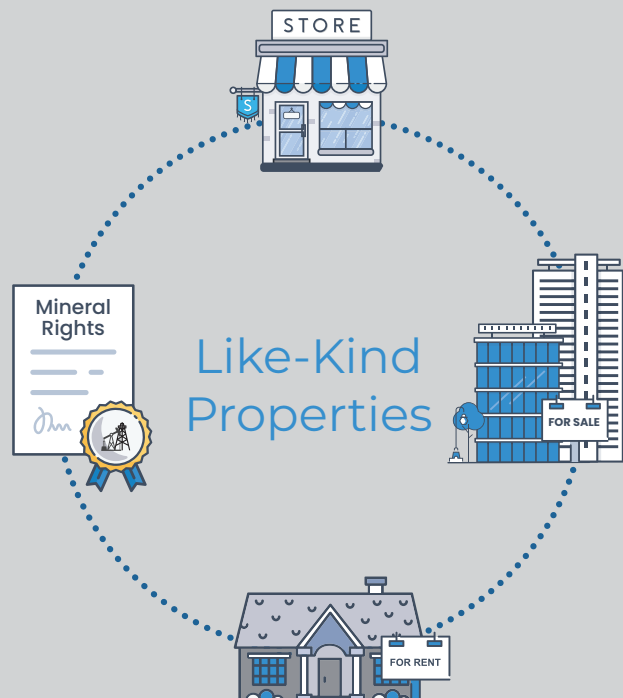
Mineral Rights & Royalties



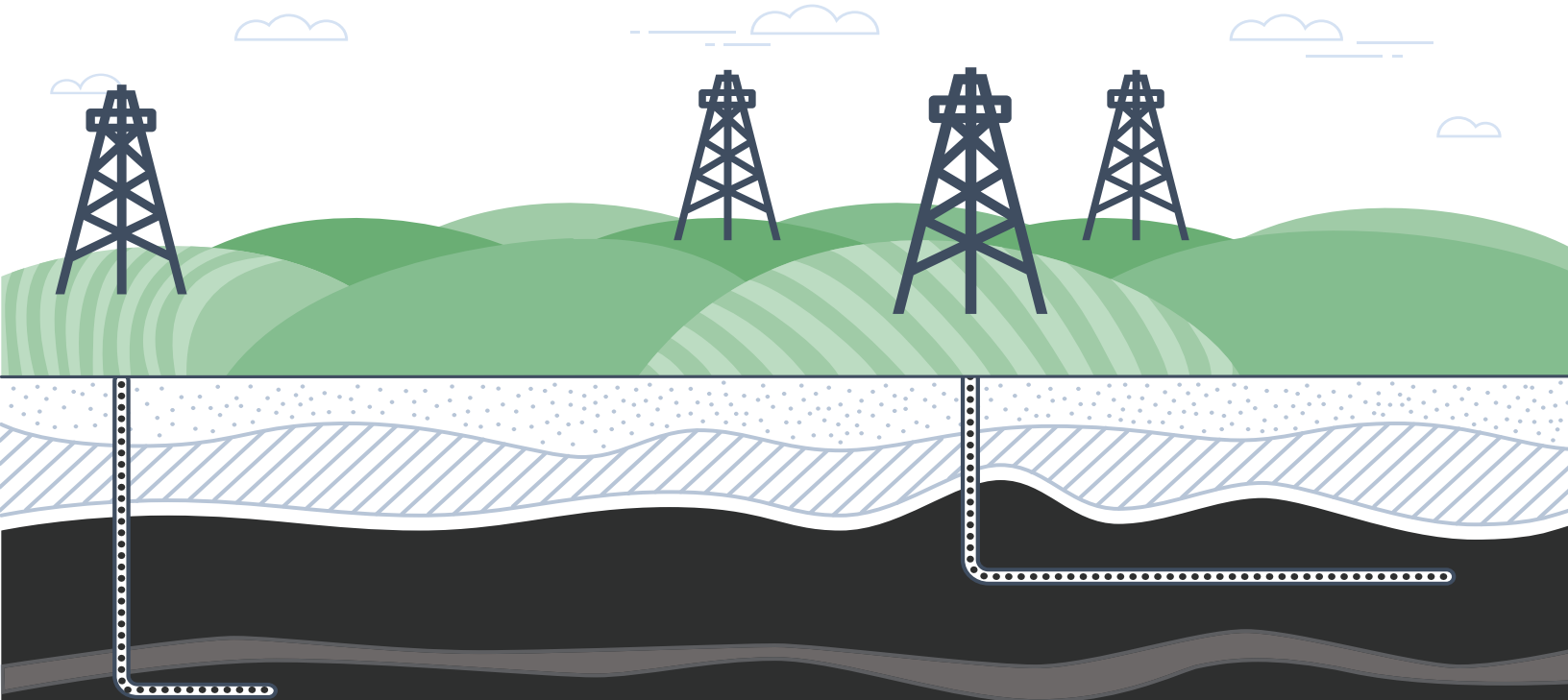
Office



Which means the Mason's can “1031” out of their office complex and purchase mineral rights, and vice versa!



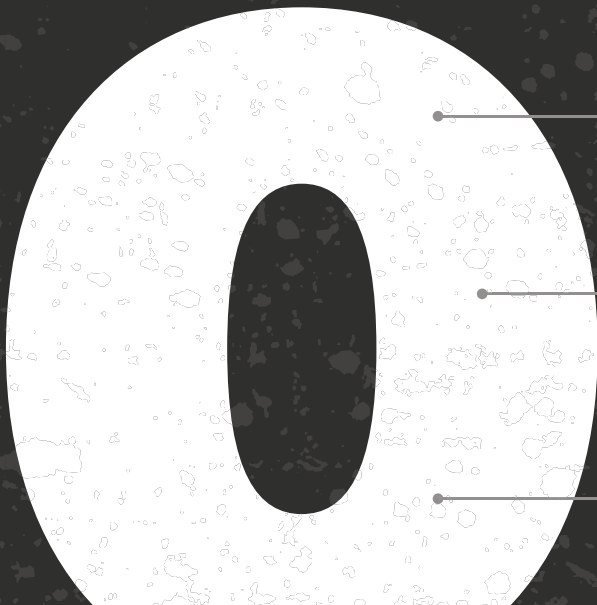
What Are Mineral Rights?



Mineral Rights are the deeded real estate beneath the surface.

Mineral Owners hold interest in this subsurface real estate—from the crust to the core—and are entitled to compensation for everything produced from their land.

Mineral owners do not partake in the drilling of wells and are free and clear of any drilling costs or liabilities.



drilling costs

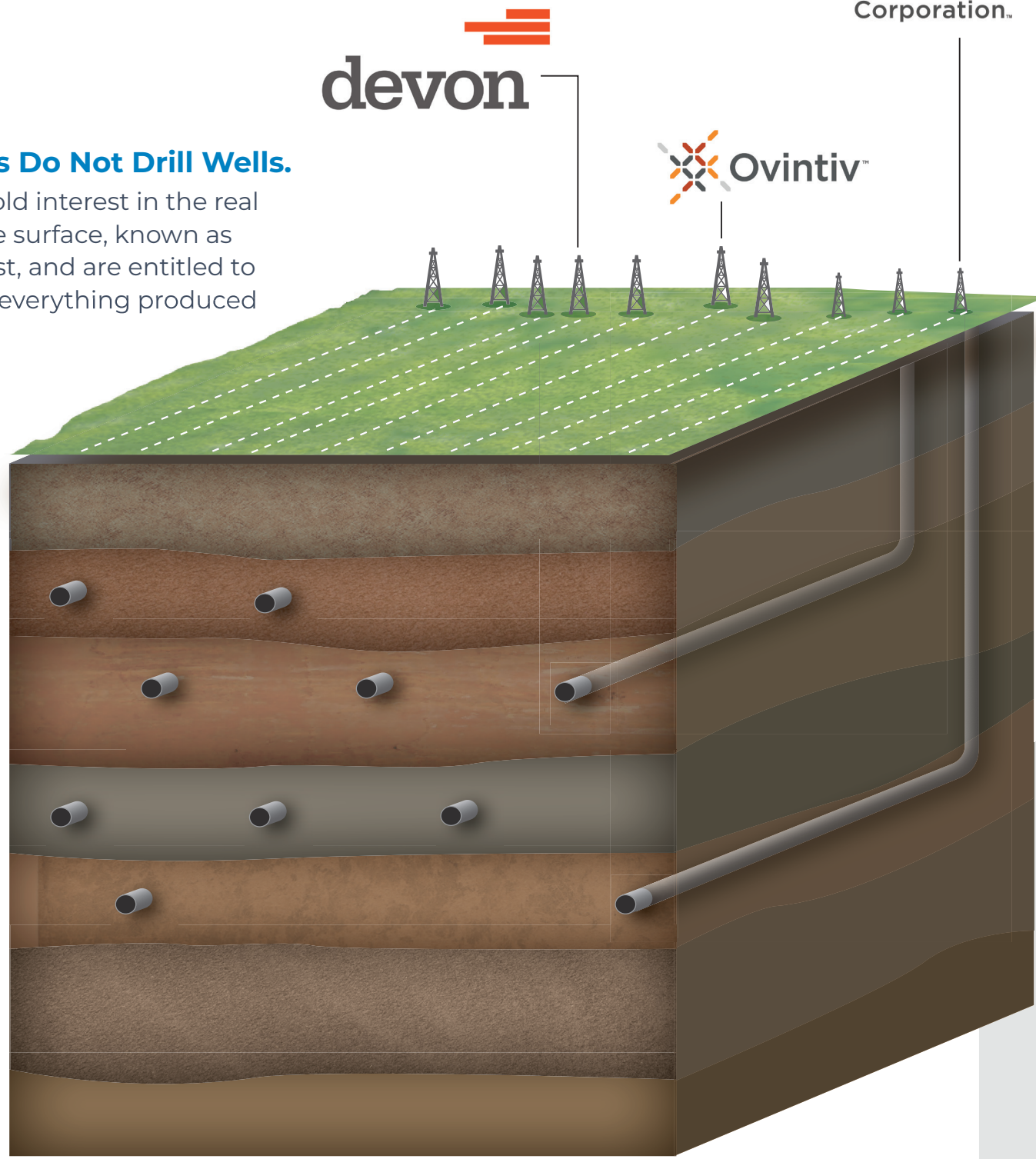
operational expenses

operational liabilities

Royalties. How Do They Work?

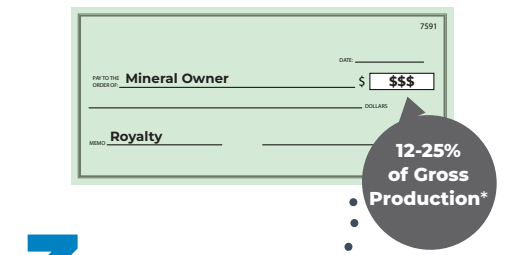
1. Mineral Owners Do Not Drill Wells.

Mineral Owners hold interest in the real estate beneath the surface, known as the mineral interest, and are entitled to compensation for everything produced from their land.



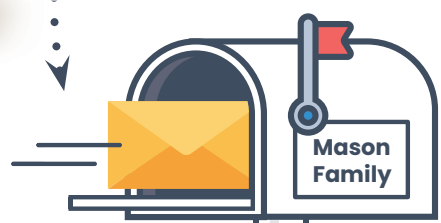
2. Energy Companies must pay a percentage to the Mineral Owners.

As energy companies, such as Devon Energy and Continental Resources, drill wells and produce hydrocarbons, they are required to pay a percentage of gross revenue to the Mineral Owners. This is called a Royalty. The energy companies, known as operators, pay all drilling and operating expenses in addition to assuming all drilling risks and liabilities.



3. Mineral Owners receive monthly royalty checks.

Mineral Owners receive monthly royalty payments from the energy companies based on the oil and gas produced on their property.



*This percentage range is not guaranteed and will vary based on individual lease agreements.

The Mason's will not only receive income from the wells that pass through their acreage; they will receive income from every producing well within their drilling section, which is typically 640 acres.

This is like owning in an office building downtown and receiving a portion of the income from every building in a square-mile radius!



Royalty Owners are entitled to a **15% tax depletion allowance** on their income received.

A Comparison of

Real Estate

VS.

Royalties



Leveraging Risks

Real estate is typically purchased using leverage. Debt opens the door for a variety of risks including interest rates, refinancing, sensitivity to occupancy and valuation risks.



Moderate Income

Net, cash-on-cash returns for many traditional real estate 1031 exchange offerings, such as Delaware Statutory Trusts (DST's) and Tenant-In-Commons (TIC's), historically start around 5-6% annually and leave very little room for increased cash flow.



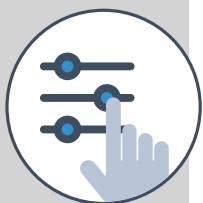
Concentration Risk

While there are many sub-categories available to investors, they all fall under the "real estate" umbrella and can be sensitive to similar market conditions.



Capital Calls

Real Estate investors may run the risk of capital calls if their portfolio is unable to satisfy its debt obligation.



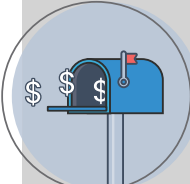
Limited Ownership & Control

Typically, real estate structures such as DST's & TIC's, investors have limited ownership and limited control of their holding period or exit strategy.



"Cash Boot"

If an owner is selling a highly leveraged property, they may not be able to find a home for all of their proceeds and may have to pay taxes on the remaining amount; this is referred to as a "Cash Boot."



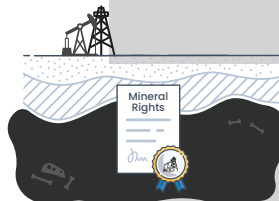
Zero Debt/Leverage

Royalties are purchased with no leverage or zero debt.



Competitive Income with Upside Potential

Royalty portfolios can be structured to generate competitive current income while additionally, leaving upside potential for increased income.



Diversification

Geographic diversification, as well as income from oil, natural gas, and natural gas liquids helps spread risk. The energy asset class tends to be non-correlated with financial assets or real estate.



No Capital Calls

Royalty Owners do not drill wells; bear no operational costs or liabilities, and do not bear the risk of capital calls. Royalties are true "mailbox money."



Direct Ownership & Investor Independence

Mineral Owners directly hold the deeds and title for their assets and have complete control and ownership of their holdings. They are untethered from other investors and are free to control their holding period and exit strategy to achieve their unique investment objectives.



Can Be Used to Avoid "Cash Boot"

Royalties are a debt-free asset and can be used to avoid a "cash boot."

Consider the Risks

- **Investment in oil and gas Royalties is speculative and involves a high degree of risk; investors should be able to bear the complete loss of their investment.**
- Oil and natural gas prices will fluctuate.
- Production levels will fluctuate.
- Operators are not obligated to drill or keep wells in production.
- Regulatory changes.
- There is no assurance that the Offering will achieve all or any of its investment objectives.
- Risks include dry wells, unpredictable oil and gas commodity prices.
- Production rates may be variable from region to region. Past performance is not indicative of future results.
- There is no assurance that these targets will be met.
- There is no assurance that additional drilling will take place or will achieve successful results.
- Risk factors including commodity prices and production can significantly impact the value of the asset and ability for an investor to get liquid.
- This material may contain forward-looking statements that are based on expectations and assumptions that are subject to risk and uncertainties.
- Actual results could differ materially because of changes to those expectations and assumptions.
- This is neither an offer to sell nor a solicitation of an offer to buy interests in the Offering as offers are made solely pursuant a PPM.
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