Three Current Natural Gas Financial Issues
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While possible environmental issues of the hydro-fracturing utilized by the natural gas industry have received notice there has been relatively little written about financial issues. This short brief is to highlight three of those issues. The first relates to the taxability of the payments being made to the land owners. Some of the people receiving the payments from the gas companies are under the impression that this new found money or some portion of it is not taxable. The general population needs to know that as with any income it is reportable to the IRS unless it is excludable by an act of congress. There are no exclusions for reporting any of the types of payments that the landowners receive relative to the lease of mineral rights.

The second relates to the feedback that we are hearing of farmers receiving substantially large upfront payments, commonly referred to as “lease bonuses”, and spending these large sums on farm equipment, such as new tractors. The thought process of these farm operators doing so is that by spending these large sums on equipment, they may reduce or eliminate the amount of taxable income created by the rent payments. Under the income tax law, due to restrictions and limitations, this generally does not work. The current year expensing of assets under Internal Revenue Code Section 179 cannot be used for this purpose. Farmers are encouraged to consult with their professional tax consultant to “run the numbers” before making any large purchases. They may purchase that new $250,000 tractor only to later find out that money is sorely needed to pay the income tax due from the rent payment.

The third problem involves social clubs recognized as tax-exempt organizations by the IRS under Internal Revenue Code Section 501(c)(7). These social clubs are typically hunting clubs, rod and gun clubs, lake associations, private golf clubs and similar organizations. The rules concerning these social clubs and how they are affected by gas leasing are extremely complex and not well explained in tax research literature. Clubs that have already signed gas leases most likely lost this special income tax exemption the moment the lease was signed. This can create extremely costly problems for the club and the members personally both in terms of tax liabilities and the need for qualified professional advice to fix the problem. Those clubs that are contemplating signing a gas lease should consult with qualified professionals before signing the lease, preferably many months before. By properly structuring the lease deal ahead of time, complex and costly tax and legal problems may be reduced.