



## Natural Gas Income and Pennsylvania Personal Income Tax

Tax season will be especially worrisome this year for landowners who may have received natural gas lease payments during 2008. Below is a brief Q & A regarding Pennsylvania personal income tax and individuals who received natural gas lease bonus income in 2008. Please visit the Pennsylvania Department of Revenue web site at: [www.revenue.state.pa.us](http://www.revenue.state.pa.us) for complete information.

1. Question: Is the money I receive from a gas lease taxable?

Answer: Yes, the income is taxable and should be reported on PA Schedule E and Line 6 Rents, Royalties, Patents or Copyrights of the PA-40. Income paid under a gas lease is normally reported by the payer on a Form 1099 MISC.

2. Question: Can I deduct any expenses from my gas lease?

Answer: You may deduct those expenses that you paid or incurred during the taxable year that are ordinary and necessary for the production or collection of rents and royalties or the management, conservation or maintenance of rents, royalties, patents, copyrights and similar property.

Normally the only expenses that can be taken as deductions against rents or royalties for gas leases are property taxes and mortgage interest; however, these will need to be apportioned for the percentage of the land leased. See the PA-40 Schedule E instructions for other allowable expenses.

You may not deduct expenses for your own labor, capital investment or capital improvements. You recover costs associated with capital improvements through depreciation deductions. You may not deduct personal expenses or the part of any expense that is personal.

See also the PA Personal Income Tax Guide, Chapter 13 (III) at:

[http://www.revenue.state.pa.us/revenue/lib/revenue/pitguide\\_chapter\\_13.pdf](http://www.revenue.state.pa.us/revenue/lib/revenue/pitguide_chapter_13.pdf)



3. Question: Is the percentage depletion calculated and recognized as an expense on the federal return also allowable for Pennsylvania purposes?

Answer: The individual is entitled to offset his gross income from rents, royalties, patents and copyrights with his depletion expense associated with the oil/gas partnership. The computation of the allowable depletion expense must be based on generally accepted accounting principles. The individual must reduce his basis in the land from which the oil/gas is extracted by the depletion expense.

4. Question: Do I need to make estimated payments on the income received from my gas lease?

Answer: To avoid penalties and interest, you must make quarterly estimated tax payments if you have taxable income – not subject to employer withholding – over \$8,000 annually. To determine the amount of estimated payments you should make, see the Individuals Worksheet, REV-414(I).

5. Question: What if I didn't receive gas lease money until the end of the year--do I still need to make estimated payments?

Answer: When income is earned unevenly throughout the year, complete REV-1630. You should make your first estimated payment at the end of the quarter in which you determine you will receive in the year more than \$8,000 of taxable income that is not subject to withholding. The date the income is received during the taxable year is irrelevant to the payment of estimated tax.

6. Question: I have a five-year gas lease and received one lump-sum payment for all five years. Can I carry income over to future years?

Answer: No, you must report rental/royalty income in full, in the year in which it is received.

7. Question: Once drilling begins on my land and I start receiving royalties, the land is no longer developable. May I depreciate the value of my land from the earnings?



Answer: As a general matter, land itself does not depreciate. Therefore, someone who leases land under an oil and gas lease may not claim a depreciation deduction for the land. If the landowner had existing equipment on the land for the production or extraction of oil or gas, which is included as part of the gas and oil lease, then he may be able to claim some depreciation for that equipment against his rental income.

There is no depreciation deduction for the removal of oil or gas, since that is covered by the depletion deduction. In the case of an oil and gas lease, the depletion deduction is apportioned between the lessor and lessee in accordance with federal income tax requirements.

8. Question: Is my natural gas lease bonus payment subject to my local earned income tax?

Answer: No, neither bonus nor royalty payments are considered earned income so they are not subject to local earned income taxes.

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