

# Ten All Too Common Mistakes Royalty Owners Can Make

By Kevin Grubbs, CPA

In my practice, I deal with issues that arise when royalty owners, delighted to receive the income from their gas leases, fail to take some very important steps to assure they are ready and able to pay the tax man his due.

Yes, even those generous gas royalty checks must be shared with Uncle Sam.

And it's better to know what he gets in advance so there are no (expensive) surprises come April 15.

Here are mistakes you can make as a royalty owner that can lead to painful April 15 tax surprises.

1. Throw away your check stubs.  
DON'T toss those data-filled tear-off sections of the check. SAVE and KNOW what you're getting, net and gross.
2. Think all the money is yours.  
DON'T neglect taxes on this. Save at least 25-30% of the royalty check in an account to pay your tax on this income.
3. Forget your deductions.  
DON'T miss the deductions you can take from your gross income for transportation and marketing on the stub. Eventually all this will be deducted on IRS Schedule E
4. Neglect the depletion allowance.  
DON'T forget you can take 15% of the gross royalty income as a deduction, for the life of the well. This deduction is essentially like tax-free income.
5. Forget lease bonus income is taxable.  
DON'T neglect saving a portion of your up-front lease bonus to pay the tax man. This is FULLY taxable, with no depletion deduction allowed,
6. Pay taxes on all of your damage payments.  
DON'T think you'll have to pay taxes on all of the damages to your land (such as for pipelines or drilling locations) as a part of the game. In fact, damage payments reduce the cost basis of your land, thereby saving you money in the long run.
7. Take one check for a pipeline right-of-way.  
DON'T hesitate to ask for two checks: one for damages (this one is tax free) and one for pipeline right-of-way (this one is taxed). It's easier to keep track of this way.
8. Ignore the 1099.  
DON'T forget to review the 1099 carefully and pay attention to the total amount of your royalty checks. The checks are net. The 1099 will have the gross amount. This will be reconciled on your Schedule E.
9. Do it yourself.  
Don't hesitate to ask for help. Your accountant, a tax advisor, or a lawyer can make this much less painful, for a lot less than you think. So consider a sidekick to make everything understandable and accurate at tax time.
10. Hesitate to ask for advice.  
You're not the first one of our clients to be offered an oil and gas lease, and we may know some of the typical things others are negotiating for. If you need legal advice, we can refer you to a good lawyer, too.

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