



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
TELEPHONE (916) 322-4286
FAX 916-323-3387
www.boe.ca.gov

BETTY T. YEE
Acting Member
First District, San Francisco

BILL LEONARD
Second District, Sacramento/Ontario

CLAUDE PARRISH
Third District, Long Beach

JOHN CHIANG
Fourth District, Los Angeles

STEVE WESTLY
State Controller, Sacramento

RAMON J. HIRSIG
Executive Director

June 19, 2006

Re: *Change in Ownership – Lease of Mineral Rights*

Dear Mr. :

This letter is in response to your April 13, 2006 correspondence to Tax Counsel III Tom Hudson of Honorable Bill Leonard's Office. In that letter, you ask about the property tax consequences of an agreement between a farmer (Farmer) and your client (Client) to mine sand and gravel from a river bed located on Farmer's real property.

Background and Facts

As described in your letter and discussed during our subsequent telephone conversations, the following facts are relevant to this analysis:

1. Client wishes to enter into a lease or lease option with Farmer for a term of less than 35 years to mine sand and gravel from a river bed located on Farmer's real property.
2. Permits are required to mine the sand and gravel.

Law and Analysis

- 1. Does a lease for a term of less than 35 years to mine sand and gravel constitute a change in ownership?**

A lease for a term of less than 35 years to mine sand and gravel constitutes a change in ownership of the mineral rights; however, no change in ownership of the balance of the property will result.

A change in ownership occurs upon the transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the

fee interest. (Rev. & Tax. Code, § 60.) For mineral properties, a lease of mineral rights constitutes a change in ownership of only the mineral estate regardless of the term of the lease, but does not result in a change in ownership of the balance of the property. (Rev. & Tax. Code, § 61, subd. (a).) Leases of mineral interests are not governed by Revenue and Taxation Code section 61, subdivision (c) which provides that the creation or transfer of leasehold interest having a term of 35 years or more constitutes a change of ownership. Rather, section 61, subdivision (a) is controlling as to leases of mineral interests. (See *Howard v. Amador County* (1990) 220 Cal.App.3d 962, 976-977.)

Furthermore, Property Tax Annotation 590.0035 explains the impact permits to extract minerals have on changes in ownership of mineral rights.

The annotation states:

While the acquisition of the necessary permits may have impact on the value of the proved reserves (when either of these two events occur), it is not, in and of itself, an event triggering change in ownership or the commencement of production of proved reserves. Likewise, the failure to acquire permits does not prevent a change in ownership and does not automatically preclude production.

Thus, the acquisition of permits, or the lack of thereof, has no effect on whether a change in ownership of the mineral estate has occurred.

In this case, Client proposes to enter into a lease for a term of less than 35 years with Farmer to mine sand and gravel. This lease will result in a change in ownership of only the right to mine (the mineral estate), not the balance of Farmer's property. Additionally, whether necessary permits to produce or extract minerals are obtained or whether Client or Farmer pays the costs associated with obtaining the necessary permits does not affect the determination of whether the mineral estate has undergone a change in ownership. As discussed above, the lease of mineral rights will result in a change in ownership of the mineral rights, but not the balance of Farmer's property.

2. Is there a change in ownership if Client and Farmer execute a lease option to mine sand and gravel?

No change in ownership of the mineral estate results until the lease option is exercised. In addition, the balance of Farmer's property does not result in a change in ownership if the lease option is exercised.

For a change in ownership of real property to occur, the beneficial use of that property must be transferred. (See Rev. & Tax. Code, § 60.) A true option to lease is not a change in ownership until it is exercised because the option holder acquires no beneficial use of the property until that time. (See Property Tax Annotation 220.0440.)

In this case, Client is considering entering into a lease option to mine sand and gravel from Farmer's property, which cannot be exercised until necessary permits are approved. Client does not acquire the beneficial use of the mineral rights until the option is exercised. Therefore, no beneficial interest in the mineral rights transfers to Client and no change in ownership of the mineral interest occurs as a result of entering into the lease option. As discussed above, a change in ownership of the mineral rights will result once the lease option is exercised. However, as to the balance of Farmer's property, no change in ownership will result upon either the creation or exercise of the lease option of the mineral rights.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity. The change in ownership consequences of these transactions are complex; your local county assessors have the ultimate authority to determine whether or not a change in control occurred.

Sincerely,

/s/ Dana Flanagan-McBeth

Dana Flanagan-McBeth
Tax Counsel

DFM:eb

Prec/Petro-Mineral/06/231.dfm

cc: Honorable
County Assessor

Mr. Tom Hudson, MIC:78
Mr. David Gau, MIC:63
Mr. Dean Kinnee, MIC:64
Ms. Mickie Stuckey, MIC:62
Mr. Todd Gilman, MIC:70