

## **Opinion No. 69-123**

October 28, 1969

**BY:** OPINION OF JAMES A. MALONEY, Attorney General

**TO:** William Brown, Chief Counsel, New Mexico State Tax, Commission, Santa Fe, New Mexico 87501

### **QUESTIONS**

#### **FACTS**

A mining company has entered a lease agreement with the State concerning certain mineral-bearing lands. The provisions of this lease are governed by Section 7-9-23, N.M.S.A., 1953 Compilation.

Subsequent to entering the agreement with the State, the lessee entered a second agreement, sub-leasing its interest in the land to another mining company. Among the provisions of the sub-lease was an agreement that the sub-leasing company would pay to the lessee all royalties due the State under Section 7-9-23, and that the original lessee would transmit those payments to the State. The lessee paid no ad valorem taxes for production on the property in question.

The Tax Commission has allowed the original lessee to deduct from its ad valorem rendition the amount of the royalties, and has refused to allow the producing sub-lessee to deduct the payments from its rendition.

#### **QUESTIONS**

Should the Tax Commission have refused to allow the lessee to deduct the royalties and permitted their deduction by the producing sub-lessee?

#### **CONCLUSION**

Yes.

### **OPINION**

#### **{\*198} ANALYSIS**

The rule followed by the Tax Commission in this case was incorrect. The State of New Mexico has provided that lands whose ownership lies with the State may be leased for production and exploitation to private companies. Section 7-9-23, N.M.S.A., 1953 Compilation, provides that in addition to receiving the rental payments due under such

leases, the State is entitled to participate in the proceeds of mining operations by way of royalty payments.

"In addition to the annual rental, lessee shall be required to pay to the commissioner a royalty of not less than two per cent (2%) of the gross returns from the smelter, mill, reduction process, or other sale, less reasonable transportation and smelting or reduction charges, if any, of all ores or materials mined and extracted from the land. In addition, lessee shall pay to the commissioner as royalty not less than two per cent (2%) of any and all premiums and bonuses received in connection with the discovery, production or marketing. Provided that on deposits of rare earths, precious stones or semi-precious stones, and on uranium, thorium plutonium, or any other materials which have been or may hereafter be determined by the Atomic Energy Commission to be peculiarly essential to the production of fissionable materials, lessee shall pay a royalty to be agreed upon by the lessee and the commissioner, but not less than five per cent (5%) of the gross returns from the smelter, mill, reduction process or other sale, less reasonable transportation and smelting or reduction charges, if any, any, of all ores or materials mined and extracted from the land. In addition, lessee shall pay to the commissioner as royalty not less than five per cent (5%) of any and all premiums and bonuses received in connection with the discovery, production or marketing of such ores or materials.

Accounting for all royalties shall be made on the twentieth (20th) day of the month following the month of sale or receipt of premium or . . ."

A system for the taxation of mining operations and mineral property is established by Section 72-6-7, N.M.S.A., 1953 Compilation. The special nature of mining operations conducted on land leased from the State is acknowledged in the statute, and paragraphs (5) and (12) of Section 72-6-7 provide specific methods for the valuation of such operations and property.

Paragraph (5) of the statute requires that those persons owning or operating any mineral property shall render an accounting of their production costs and income.

"Every person owning or holding any mineral property, subject to valuation by the commission, shall make a return to the commission on or {\*199} before February 1st of each year, showing such facts and in such form as the commission may determine and prescribe.

In addition thereto, **every owner or operator of any productive mineral property, and every owner or operator of any mineral property falling in classes Two and Three shall**, between the first day of January and the first day of February in each year, make and forward to the commission at its office in Santa Fe, New Mexico, a sworn return or statement showing, in such form and detail as the commission shall prescribe, the total quantities and kinds of ores, metals, coal, coke, petroleum, natural gas, and other valuable minerals or metals produced and sold during, and on hand at the end of, the next preceding calendar year, together with the name and post-office address of the

owner and operator, and such information as to the description, location and area of such mineral property **and the cost of production** value and amount realized from such output, and such other facts as may be required by the commission. Every person engaged in mining or operating any such property shall keep and preserve at such mine, mineral property, or at the principal office of such person in this state, accurate books and accounts showing in such detail as may be prescribed by the commission, all facts relating to the quantities and kinds of minerals and metals produced, **the cost of production**, milling, reduction, treatment, transportation and sale thereof, the quantities sold, the amount realized therefrom and the quantities and value of such mineral and metal produced and not disposed of." (Emphasis added)

It will be noted that the requirement extends to those parties **operating** mineral properties. It would thus appear that a sublessee of a mineral tract leased from the State is required to file his rendition by virtue of his operation of mineral-recovery facilities in substantially the same manner as if he were an original lessee.

Paragraph (12) of the statute permits the deduction from the statement of value-of-operations any royalties paid to the State.

"The commission shall, in each year, determine the average annual output value, being the market value of such average annual output, including any bonus or subsidy payments, less the deductions provided for in subsection 6 hereof, to be the taxable value of such year of all properties falling in classes (2) and (3) enumerated in subsection (2) hereof. **In calculating the average annual output value of the severed product falling in class 3, the commission shall first deduct from the gross product any royalties belonging to the state or United States.**" (Emphasis added)

In effect, the statute permits the actual operator to include in his rendition of costs of production the royalty payments made to the State, as the cost at which his exploitation of State resources is permitted.

The case at hand offers a situation in which two parties claim the right to include these royalties as part of their operating costs. The original lessee may be regarded as the first claimant, that party having no other relation to the mining operations save that of transmitter of the payments. It is not subject to ad valorem taxation of production on the property in question. The sub-lessee, which in this case is the operating and producing party, is the actual payor of the royalties, is the actual payor of ad valorem production {\*200} tax, and it is to this claimant's actual operating costs that the royalty payments are ultimately charged.

It would appear quite clear that to permit the lessee to deduct the royalty payments would improperly allow the deduction intended to benefit the party being taxed on production, while to deny the inclusion of the payments in the producer's costs would deny it the benefit of the statute's obvious intention. The correct procedure in this matter would seem to require disallowance of royalty-payment deductions by the original

lessee, and to permit the deduction by the producing sub-lessee of the payments claimed.