

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 063

June 27, 1958

ASSOCIATIONS TAXABLE AS CORPORATIONS: OIL AND GAS JOINT OPERATING AGREEMENTS

Syllabus:

A joint operating agreement which irrevocably vests in some person or persons, acting in a representative capacity, the authority to extract and sell gas and oil for the joint account of two or more co-owners, thereby embodying a joint profit objective, creates an association which is taxable as a corporation.

Advice is requested as to whether certain types of joint operating agreements entered into between co-owners of oil and gas properties have the effect of creating associations taxable as corporations.

A joint operating agreement creates an association that is taxable as a corporation if it embodies a joint profit objective and such an objective exists if the agreement irrevocably vests in some person or persons, acting in a representative capacity, the authority to extract and sell the gas or oil for the joint account of two or more co-owners. (Such authority is irrevocable unless it is terminable at will by the grantors thereof; limiting it to a fixed or determinable period by terms of the agreement does not make it revocable.) An agreement of this type creates an organization which meets the established tests of an association taxable as a corporation. Management is centralized in one or more persons acting in a representative capacity. The co-owners give up the right to exercise their own business discretion as individuals, and their interests become joint rather than several. Consequently, the position is correct under the general principles of income taxation. Therefore, such an organization is subject to taxation as a corporation. It must be noted, however, that nonresident participants therein are not subject to personal income tax in California on the income they receive therefrom.