

# Exchanges of Oil, Gas and Mineral Interests

**Oil, gas and mineral interests are real estate interests** which qualify for a like-kind exchange with any other qualifying real estate interest including:

- A fee interest in real estate
- Fractional ownership interests
- 30+ year leasehold interests
- Other oil, gas and mineral interests
- Conservation easements
- Transferable development rights
- Right-of-way easements
- Water rights
- Mutual irrigation ditch stock

**A mineral interest is** a perpetual interest on all of the minerals on a parcel of land including oil and gas, coal, gold, sand, gravel, water, etc.

**There are several different kinds of ownership of oil, gas and mineral interests** which include:

- Mineral rights which are a part of fee ownership of the ground
- Mineral rights which are owned separately from ownership of the ground
- A mineral lease granted to a lessee by the owner of the mineral rights
- A royalty interest which can be viewed as a form of rent received by the owner of the mineral rights

**A mineral lease gives the lessee the right to extract the mineral** for a period of time, or until exhaustion of the mineral. Mineral leases are sometimes referred to as a working interest or an operating interest. The lessee is the operator who is extracting the mineral. A mineral lease can be subleased to other operators.

**Intangible drilling costs** are operating costs to extract the mineral. Costs for fuel, preparation of a site, and wages are examples of intangible drilling costs.

**An exchange of a working or operating interest** might include equipment or other tangible personal property which would need be viewed as a multi-asset exchange (more than one kind of property).

**A production payment is a right to the mineral in place for a specified sum of money**, payable out of a specified percentage of the mineral production. It is a “carved out production payment” and is not considered real property for exchange purposes.

**Depletion expense** can be deducted by the owner of an operating or royalty interest. There are two types of depletion: percentage depletion and cost depletion. Taxpayers use the method that yields the highest deduction.

**Mineral property exchanges may be subject to recapture under Section 1254** if deductions were taken for depletion or intangible drilling costs on the relinquished property. The replacement property must be both like-kind and natural resource recovery property (Section 1254 property) to avoid recapture.

**Talk to your tax advisor** when you are anticipating a sale of a mineral interest. Call us at 888-367-1031 or email us at 1031@1031cpas.com if we can assist with questions about an exchange of your mineral interest. See our Exchange Manual and visit us at [www.1031cpas.com](http://www.1031cpas.com). 1031 Corporation is the Intermediary of choice for real estate professionals, CPAs and investors.

**Give us a call today toll free at 888-367-1031**

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