

WEST VIRGINIA
SECRETARY OF STATE
KEN HECHLER
ADMINISTRATIVE LAW DIVISION

Form #3

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1991 JUN 18 PM 3:04
OFFICE OF WEST VIRGINIA
SECRETARY OF STATE

NOTICE OF AGENCY APPROVAL OF A PROPOSED RULE
AND
FILING WITH THE LEGISLATIVE RULE-MAKING REVIEW COMMITTEE

AGENCY: STATE TAX DIVISION TITLE NUMBER: 110

CITE AUTHORITY W. VA. CODE § 11-1C-1 ET SEQ.

AMENDMENT TO AN EXISTING RULE: YES NO

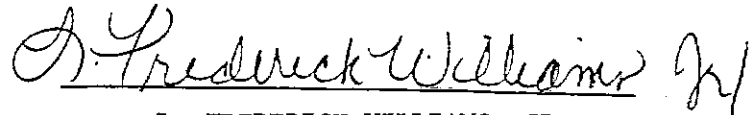
IF YES, SERIES NUMBER OF RULE BEING AMENDED: _____

TITLE OF RULE BEING AMENDED: _____

IF NO, SERIES NUMBER OF NEW RULE BEING PROPOSED: 1J

TITLE OF RULE BEING PROPOSED: APPRAISAL OF PRODUCING AND RESERVE OIL
AND NATURAL GAS PROPERTY FOR PERIODIC STATEWIDE REAPPRAISAL FOR
AD VALOREM TAX PURPOSES

THE ABOVE PROPOSED LEGISLATIVE RULE HAVING GONE TO A PUBLIC HEARING OR A PUBLIC COMMENT PERIOD IS HEREBY APPROVED BY THE PROMULGATING AGENCY FOR FILING WITH THE SECRETARY OF STATE AND THE LEGISLATIVE RULE MAKING REVIEW COMMITTEE FOR THEIR REVIEW.


L. FREDERICK WILLIAMS, JR.
STATE TAX COMMISSIONER

NET

3.30



State of West Virginia
Department of Tax and Revenue

GASTON CAPERTON
GOVERNOR

Charleston 25305

L. FREDERICK WILLIAMS, JR.
SECRETARY

STATEMENT OF PURPOSE

The purpose of the rule is to establish the procedure for the classification and valuation of producing and reserve oil and natural gas property for ad valorem property tax purposes.

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1991 JUN 21 PM 3:12

OFFICE OF WEST VIRGINIA
SECRETARY OF STATE



State of West Virginia
Department of Tax and Revenue

Charleston 25305

FILED

1991 JUN 18 PM 3:04

OFFICE OF WEST VIRGINIA
SECRETARY OF STATE
L. FREDERICK WILLIAMS, JR.
SECRETARY

GASTON CAPERTON
GOVERNOR

June 18, 1991

TO: LEGISLATIVE RULE-MAKING REVIEW COMMITTEE

FROM: STATE TAX DIVISION

LEGISLATIVE RULE TITLE: APPRAISAL OF PRODUCING AND RESERVE OIL AND NATURAL
GAS PROPERTY FOR PERIODIC STATEWIDE REAPPRAISAL FOR
AD VALOREM PROPERTY TAX PURPOSES

1. Authorizing statute(s) citation: W. Va. Code § 11-1c-1 et seq.

2.
 - a. Date filed in State Register with Notice of Public Comment Period:
April 26, 1991
 - b. What other notice, including advertising, did you give of the hearing? None
 - c. Date of public comment period: April 26, 1991 through May 27, 1991
 - d. Attach list of persons who appeared at hearing, comments received, amendments, reasons for amendments.

Attached X No comments received _____
 - e. Date you filed in State Register the agency approved proposed Legislative Rule following public hearing: (be exact)
June 18, 1991
 - f. Name and phone number of agency person to contact for additional information: Robert Hoffman - 348-3940

AGENCY APPROVED PROPOSED
WEST VIRGINIA LEGISLATIVE REGULATIONS
DEPARTMENT OF TAX AND REVENUE
TITLE 110
SERIES 1J
1991

FILED
1991 JUN 18 PM 3:04
OFFICE OF WEST VIRGINIA
SECRETARY OF STATE

APPRAISAL OF PRODUCING AND RESERVE OIL AND NATURAL GAS PROPERTY FOR PERIODIC
STATEWIDE REAPPRAISALS FOR AD VALOREM PROPERTY TAX PURPOSES

Filed: June 18, 1991

§ 110-1J-1. General.

1.1 Scope. - These regulations clarify and implement State law as it relates to the appraisal at market value of producing and reserve oil and natural gas properties.

1.2 Authority. - W. Va. Code § 11-1C-1 et seq.

1.3 Filing Date. - June 18, 1991.

1.4 Effective Date. -

§ 110-1J-2. Introduction. - Oil and/or natural gas is one of the several estates in real property which may be owned either as a separate interest in real property or in conjunction with other interests, usually as fee ownership, oil and/or natural gas ownership or as minerals ownership. If oil and/or natural gas is owned as a separate estate, West Virginia property tax law requires such ownership to be listed, valued and taxed based on its true and actual value. If the interest in oil and/or natural gas is part of a larger interest in a tract of property, the value of the oil and/or natural gas interest shall be included in the value of the larger interest. Oil and/or natural gas may be owned without being produced. Oil and/or natural gas rights may exist where no oil and/or natural gas is actually present, or where the oil and/or natural gas is unproducible or depleted.

2.1 Categories for valuing oil and/or natural gas properties. - Parcels of property thought to bear oil and/or natural gas or having the oil and/or natural gas mineral interest separated from the fee of the property will be classified as producing property; non-producing property; plugged and abandoned property.

§ 110-1J-3. Definitions. - As used in these regulations and unless the context clearly requires a different meaning, the following terms shall have the meaning ascribed herein, and shall apply in the singular or in the plural.

3.1 "Bands of investment discount component" means a discount rate derived by assigning rates to various debt and equity investment financing tiers and summing these rates, weighted by their respective percentages of total financing.

3.2 "Discount component" means a rate reflecting a provision for returning to an investor a sum of money equal to the aggregate of the anticipated return-on-investment over the economic life of an investment.

3.3 "Flush Production" means the production of oil and/or natural gas from any well on a producing oil and/or natural gas producing property with an initial production date that is two (2) years or less prior to the date of valuation.

3.4 "Management rate" means a rate reflecting a return to an investor for the management of similar investment portfolios.

3.5 "Market comparison discount" means a discount rate derived by dividing income net of the recapture component and property taxes by the arms-length selling price of the property.

3.6 "Natural gas producing property" means the property from which natural gas has been produced or extracted at any time during the most recent assessment year. Natural gas producing property includes the interest or interests underlying an area of one hundred twenty-five (125) acres of surface per well for property with active wells on the parcel. Also to be included on natural gas producing property is the parcel acreage above one hundred twenty-five (125) acres per well, to be valued at a specific rate per acre, determined by the Department of Tax and Revenue; such rate not to exceed the average producing rate per acre of the property.

3.7 "Nonliquidity rate" means a rate reflecting a return to an investor representing the loss of interest on an investment arising from the time required to sell the investment.

3.8 "Oil and/or natural gas, non-producing property" means properties that were not engaged in production during the previous assessment year period of July 1 through June 30. This category shall include any acreage that has been shut-in for the entire year. This category shall also include any acreage owned by a company or individual whose primary business involves the production or leasing of any oil and gas properties.

3.9 "Oil and/or natural gas plugged and abandoned property" means the one hundred twenty-five (125) acres of surface per well of natural gas or the forty (40) acres of surface per well of oil producing properties if the well has been plugged and abandoned as required by W. Va. Code § 22-4-1 et seq.

3.10 "Oil Producing Property" means property from which oil has been produced or extracted at any time during the most recent assessment year. Oil producing property includes the interest or interests underlying an area of up to forty (40) acres of surface per well with one or more active well(s) on the parcel. Also to be included on oil producing property is the parcel acreage above the forty (40) acres per well, to be valued at a specific rate per acre determined by the Department of Tax and Revenue; such rate not to exceed the producing rate per acre of the property.

3.11 "Overriding royalty" means the fractional interest reserved or purchased by a seller of a lease to another party, thereby participating in the

gross proceeds of production from the lease while at the same time not incurring operating expenses.

3.12 "Personal Property" used in oil and/or natural gas production means machinery and equipment in and about the well and all other tangible personal property used in producing oil and/or natural gas from the well. It shall not include vehicles or other tangible personal property not permanently used in production.

3.13 "Producer/Operator" means any person or persons, corporation, partnership, joint venture or other enterprise which proposes to or does locate, drill, manage or abandon any well.

3.14 "Property tax component" means a rate reflecting a provision for returning to an investor a sum of money equal to property taxes paid over the economic life of an investment.

3.15 "Recapture component" means a rate reflecting a provision for returning to an investor a sum of money equal to his investment.

3.16 "Risk rate" means a rate reflecting a return to an investor necessary to attract capital to an investment containing a possible loss of principal and/or interest.

3.17 "Royalty Interest" means the fractional interest in oil and/or natural gas production not subject to operating expenses and retained by the oil and/or natural gas rights owner or lessor.

3.18 "Safe rate" means a rate reflecting a return to an investor on an investment which has little, if any, likelihood of loss of principal or of loss in anticipated return on investment.

3.19 "Settled Production" means the production of oil and/or natural gas from all wells on a producing property with an initial production date that is more than two (2) years prior to the date of valuation.

3.20 "Storage wells" means any property used as a reservoir for the storage of natural gas. These properties shall be valued as non-producing natural gas property, such value not inclusive of inventories stored therein.

3.21 "Summation discount component" means a discount rate expressed as the aggregate of a safe rate, risk rate, nonliquidity rate, and management rate.

3.22 "Working Interest" means the fractional interest in oil and/or natural gas production subject to operating expenses and owned by the leasehold or operator.

§ 110-1J-4. Methods of valuation.

4.1 **General.** - Oil and/or natural gas producing property value shall be determined through the process of applying a yield capitalization model to the net receipts for the working interest and a yield capitalization model applied to the gross royalty receipts for the royalty interest. Where ownership is

split through a lease or royalty arrangement, different values will be determined for the working interest and the royalty interest. Each term in this valuation is discussed below.

4.2 Percentage interest in oil and/or natural gas. - Where the ownership of oil and/or natural gas in place is divided through a lease or other arrangement, the compensation to the owner of the property is derived by designating a percentage of the production to be the royalty payment to the owner. The remainder is the working interest. The Tax Commissioner will annually determine an assumed standard working and royalty percentage interest through a review of oil and gas leases from throughout the State.

4.3 Average production rate. - Gas - The Tax Commissioner will annually determine and report the production rate of natural gas wells through review of information filed with other State agencies and data provided by companies and individuals. Oil - The average daily production of an oil well is its production rate, measured in terms of oil field standard forty-two (42) gallon barrels, for the year preceding the annual tax assessment date, divided by the number of full or partial days of well production. Partial days shall include time allowed for oil to collect between pumpings. Full or partial days shall not include time when well non-production results from workover, redrilling, or well maintenance.

4.4 Average industry market price. - Oil - The Tax Commissioner will annually derive the average industry market price by reviewing the price per barrel paid by the major West Virginia crude oil purchasers. The Tax Commissioner's annual report on the average industry market price should reflect a reduction for average Federal Windfall Profits Tax and West Virginia Severance Taxes deemed to be paid by the working or royalty interests in the production. The average industry market price will be used in the method described in the regulations for determination of the formulas to be used to appraise oil production properties.

Gas - The Tax commissioner will annually derive and report the average industry market price by reviewing the price paid per MCF by the major West Virginia natural gas purchasers, a survey of oil and gas associations, and other statistical data.

4.5 Average industry operating expenses. - The Tax Commissioner will annually determine the average industry operating expenses per well. The average industry operating expenses will be deducted from gross receipts in developing an income stream for application of a yield capitalization procedure.

4.6 Average industry production decline rates. - The Tax Commissioner will annually derive and report the average industry production decline rates by a review of well production records of various State agencies and data provided by companies and individuals.

4.7 Capitalization rate. - A capitalization rate will be developed considering the three (3) components set out in Section 4.7.1 of these regulations. This rate will be used to select the factor(s) from a standard mid-year life present worth of one table using a compound interest premise.

4.7.1 Discussion. - The capitalization rate will be determined annually by the Tax Commissioner through the use of generally accepted methods for estimating such rates. The rate so developed will be applied to a declining-terminal income series which is indicative of oil and/or natural gas producing properties. The capitalization rate used to value oil and/or natural gas properties will be developed considering (1) a discount rate determined primarily by the summation technique, (2) a recapture component, and (3) a property tax component.

4.7.1.1 Discount component.

4.7.1.1.a Summation technique. - The summation technique will be given primary consideration in the valuation of oil and/or natural gas producing property. The summation technique will determine a discount component which will be used to calculate the present value of the future income of the oil and/or natural gas producing property utilizing the following four (4) major subcomponents:

- 4.7.1.1.a.1 Safe rate
- 4.7.1.1.a.2 Risk rate
- 4.7.1.1.a.3 Nonliquidity rate
- 4.7.1.1.a.4 Management rate

The "Safe rate" will be developed through review of quarterly interest rates offered on thirteen (13) week United States Treasury Bills for a period of one (1) year prior to the appraisal date. The "Risk rate" will be developed through review of data resulting from an annual survey of lending institutions, such survey reflecting interest rates required on loans for acquisition and/or development of natural resource producing properties. This survey will be conducted for a one (1) year period prior to the appraisal date. Results of the survey will be compared to quarterly interest rates offered on thirteen (13) week United States Treasury Bills for the same one (1) year period. An interest differential will then be selected representing the "Risk rate" assignable to various financing tiers. The "Nonliquidity rate" will be developed through an annual survey to determine a reasonable estimate of time that oil properties remain on the market before being sold. The market time thus determined will be used to identify United States Treasury Bills with similar time differentials in excess of thirteen (13) week Treasury Bills. The interest differential between these securities will be deemed to be representative of the "Nonliquidity rate." The "Management rate" will be developed through a survey to identify charges for the management of similar investment portfolios.

4.7.1.1.b Bands-of-investment/market comparison. - Data permitting, the bands-of-investment and market comparison techniques will be used to verify the summation discount component.

4.7.1.2 Recapture component. - Construction of the discount models will be accomplished through access of a standard mid-year life present worth of one table, premised on a compound interest rate. This table has a

factor for recapture built into the table coefficients. Inclusion of a recapture component in the capitalization rate is therefore not appropriate.

4.7.1.3 Property tax component. - This component will be derived by multiplying the assessment rate by the statewide average of tax rates on Class III property.

4.8 Yield capitalization model. - A yield capitalization model will be developed for each producing property. The model will use as a beginning point gross receipts from each producing well. Gross receipt will be proportionately reduced by application of the appropriate production decline rate, referenced in Section 4.6 of these regulations, to yield a declining terminal income series typical of the producing area. The income series will be apportioned to the working interest and to the royalty interest based upon percentage interests referenced in Section 4.2 of these regulations.

4.8.1 Working interest model. - The working interest income series referenced in Section 4.8 of these regulations will be reduced by the annual operating expenses referenced in Section 4.5 of these regulations to yield a net income series. The net income series will be discounted by applying, on an annual basis, a mid-year life Inwood coefficient reflecting the capitalization rate referenced in Section 4.7 of these regulations. The summation of the annual discounted income streams will be the market value estimate for the working interest of the producing oil and/or natural gas well for an area of up to one hundred twenty-five (125) acres for producing natural gas wells and forty (40) acres for producing oil wells.

4.8.2 Royalty interest model. - The royalty interest income series referenced in Section 4.8 of these regulations will be discounted by applying, on an annual basis, a mid-year life Inwood coefficient reflecting the capitalization rate referenced in Section 4.7 of these regulations. The summation of the annual discounted income streams will be the market value estimate for the royalty interest of the producing oil and/or natural gas well for an area of up to one hundred twenty-five (125) acres for producing natural gas wells and forty (40) acres for producing oil wells.

4.9 Valuation of non-producing acreage. - The value per acre of non-producing acreage shall equal the discounted annual lease payment per acre. A valuation schedule for non-producing properties will be determined annually by the Tax Commissioner on a county basis where data is available. The Tax Commissioner will annually conduct a review of oil and/or natural gas agreements transacted at arms length in all fifty-five (55) counties to determine the annual lease payment per acre, as well as the lease term, that oil and gas properties in the county typically command. The per-acre value for non-producing property will be the sum of the projected annual income stream during the lease term discounted in each year by a capitalization rate.

4.10 Valuation of plugged and abandoned acreage. - Plugged and abandoned acreage will be valued at the nominal rate of one dollar (\$1.00) per acre. This category includes any plugged and abandoned acreage of up to one hundred twenty-five (125) acres per gas well and forty (40) acres per oil well.

4.11 Valuation of wells that produce both oil and gas. - The valuation of these producing wells shall be determined by use of the methods described herein for oil and natural gas. These values shall then be summed to result in the overall value of the oil and/or natural gas producing acreage.

4.12 Annual reports. - The Tax Commissioner will publish an annual report for the variables to be considered in arriving at the value of the specific oil and/or natural gas related property. This report will be filed with the office of the Secretary of State on or before May 31st of each year, followed by a fifteen (15) day period for written public comment. The Tax Commissioner will review the comments and present final variables and multipliers to be used on or before July 1.

4.13 Active farm properties. - The oil and gas rights, that are part of a "fee" estate where the use of the surface has qualified as an active farm, will be valued in the following manner: (For a definition of an active farm see § 110-1R-1 et seq.)

4.13.1 Where income or royalty is not derived from the oil and gas rights the oil and gas interest shall not be valued.

4.13.2 Where income or royalty is derived from the oil and gas rights the oil and gas interest shall be valued as follows:

4.13.2.1 Fee estates, where the annual wholesale value of farm commodities or products is fifty percent (50%) or more of the usual annual gross income from all uses of the property, shall be subject to farm use valuation. Thus oil and gas interests shall not be valued under this situation.

4.13.2.2 Fee estates, where the annual wholesale value of farm commodities or products is less than fifty percent (50%) of the usual annual gross income from all uses of the property, shall be valued by adding the applicable oil and gas values referenced in this rule to the surface farm use value.

4.14 Property reports. - Prior to September 1 of each year the producer and oil and gas owner will be required to file a report with the Department of Tax and Revenue for each county where the oil and gas property is to be assessed. These reports will be designed by the State Tax Commissioner so that information pertinent to the valuation of such producing property, non-producing property, and plugged and abandoned property will be reported by the oil and gas producer, lessee, and owner.



TAYLOR COUNTY COURT HOUSE

RECEIVED
1991 MAY 28 AM 10:10
JUDITH L. COLLETT
ASSESSOR OF TAYLOR COUNTY

COURT HOUSE
GRAFTON, WEST VIRGINIA 26354
(304) 265-2420 or 2422

STATE TAX DEPARTMENT
LEGAL DIVISION

May 24, 1991

Legal Division
Department of Tax and Revenue
P.O. Box 1005
Charleston, WV. 25324-1005

Re: Legislative Rule--Title 110 Series 1J
Appraisal of Producing and Reserve Oil and Natural Gas Property For
Periodic Statewide Reappraisals For Valorem Property Tax Purposes

Dear Sirs:

As an Assessor who believes in fair and equitable property taxes for all West Virginians, I wish to make the following comments regarding the above-mentioned proposed legislative rules:

Section 4.13 dealing with Active farm properties should be deleted. Oil and gas rights, whether producing income or not should be appraised at market value regardless of the surface use. House Bill 4127 and Senate Bill 8 give preferential treatment to active farm land because of its surface use and should not extend to subsurface estates because the use of the minerals would be no different under an active farm than under any other surface.

Producing oil and gas properties are in Classes 3 or 4. Perhaps a compromise (if necessary) would be to appraise oil and gas rights at market value, but allow those under active farms to be Class 2 property rather than Class 3 or 4.

In my opinion, West Virginia will not have a fair and equitable property tax system until all property is appraised at fair market value. If the Legislature feels that certain properties deserve preferential treatment perhaps it could be done by establishing new tax classes or by giving income tax credits.

Thank you for your consideration.

Sincerely,

Judith L. Collett, Assessor

cc: Mr. Fred Williams, Jr.
Secretary of Department of Tax & Revenue

WEST VIRGINIA ASSOCIATION

CHARLESTON, WEST VIRGINIA 25301

TELEPHONE 346-0591

922 QUARRIER ST.

OF COUNTIES

May 23, 1991

Legal Division
Department of Tax & Revenue
P. O. Box 1005
Charleston, West Virginia 25324-1005

RECEIVED
1991 MAY 24 AM 10:00
STATE TAX DEPARTMENT
LEGAL DIVISION

RE: Legislative Rules, Series 1J, Title 110, "Appraisal of Producing And Reserve Oil And Natural Gas Property For Periodic Statewide Reappraisals For Ad Valorem Property Tax Purposes"

WRITTEN COMMENTS ON THE PROPOSED LEGISLATIVE RULE

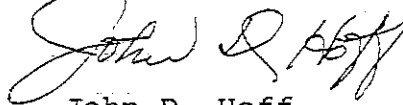
The West Virginia Assessors Association have unanimously voted to take exception to the language of Section 4.10, "Valuation of plugged and abandoned acreage", wherein it proposes to set a minimum value of \$1.00 per acre.

While no specific minimum dollar per acre amount was proposed, in the ensuing discussion no amount below \$5.00 was suggested by any assessor, and many higher dollar amounts were suggested. At the \$1.00 level, it was pointed out that thousands of tax tickets of just a few cents value would be the result, costing the counties much more in processing, mailing and collecting costs than taxes received.

It was clear from the discussion that \$1.00 per acre minimums ought to be a thing of the past for any type of surface, mineral, or natural resource property.

The above comment respectfully submitted on behalf of the Assessor's Association.

Sincerely,



John D. Hoff
Executive Director

PUBLIC COMMENTS
RE: LEGISLATIVE RULE TITLE 110 SERIES 1J

Appraisal of producing and reserve oil and natural gas property for periodic statewide reappraisals for ad valorem property tax purposes.

I. Ms. Judith L. Collett, Assessor of Taylor County.

Comment: "Section 4.13 dealing with Active farm properties should be deleted. Oil and gas rights, whether producing income or not should be appraised at market value regardless of the surface use. House Bill 4127 and Senate Bill 8 give preferential treatment to active farm land because of its surface use and should not extend to subsurface estates because the use of the minerals would be no different under an active farm than under any other surface."

Response: The language contained in Section 4.13 of the proposed Emergency Rule is taken from Title 110, Series 1A "Approved Farmland and Structures Situated Thereon Valuation Regulations". The referencing of the procedures contained in 4.13 are intended to negate the need for cross referencing of legislative rules. Modification of this language would require modification to Title 110, Series 1A, Approved Farmland and Structures Situated Thereon Valuation Regulations rather than Title 110, Series 1J, Appraisal of Producing and Reserve and Natural Gas Properties for Periodic Statewide Reappraisals for Ad Valorem Property Tax Purposes.

II. Mr. John D. Hoff, Executive Director, West Virginia Association of Counties.

A. Comment: "The West Virginia Assessors Association have unanimously voted to take exception to the language of Section 4.10, "Valuation of plugged and abandoned acreage", wherein it proposes to set a minimum value of \$1.00 per acre."

Response: Plugged and abandoned properties are those properties where oil and gas reserves have been removed. In situations where a natural resource has been removed from the property a nominal rate is usually assigned for property tax purposes. In this instance the nominal rate of

\$1.00 per acre has been chosen. The Department believes this rate to be indicative of the fair market value of the oil and gas rights in the property and would therefore not recommend modification to the nominal rate of \$1.00 per acre for valuation of plugged and abandoned oil and gas property.