WEST VIRGINIA
SECRETARY OF STATE
JOE MANCHIN, III
ADMINISTRATIVE LAW DIVISION

Form #2

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2004 JUN 17 A 11:48

OFFICE WEST VIRGINIA
SECRETARY OF STATE

NOTICE OF A COMMENT PERIOD ON A PROPOSED RULE

AGENCY: State Tax Department TITLE NUMBER: 110

RULE TYPE: Legislative CITE AUTHORITY W. Va. Code §§ 11-1C-5(b), 11-1C-5a & 11-1C-10(d)

AMENDMENT TO AN EXISTING RULE: YES X NO ____

IF YES, SERIES NUMBER OF RULE BEING AMENDED: 1J

TITLE OF RULE BEING AMENDED: Valuation of Producing and Reserve Oil and Gas for Ad Valorem Property Tax Purposes

IF NO, SERIES NUMBER OF RULE BEING PROPOSED: ____

TITLE OF RULE BEING PROPOSED: ____

IN LIEU OF A PUBLIC HEARING, A COMMENT PERIOD HAS BEEN ESTABLISHED DURING WHICH ANY INTERESTED PERSON MAY SEND COMMENTS CONCERNING THESE PROPOSED RULES. THIS COMMENT PERIOD WILL END ON 7/19/04 AT 4:30 P.M. ONLY WRITTEN COMMENTS WILL BE ACCEPTED AND ARE TO BE MAILED TO THE FOLLOWING ADDRESS:

Legal Division
State Tax Department
P.O. Box 1005
Charleston, WV 25324-1005

THE ISSUES TO BE HEARD SHALL BE LIMITED TO THIS PROPOSED RULE.

John C. Musgrave
Acting Secretary of Tax and Revenue

ATTACH A **BRIEF** SUMMARY OF YOUR PROPOSAL

$6.40

MEMO

RECEIVED
MAY 27 2004
SECRETARY of
TAX & REVENUE

TO: Rebecca Melton Craig
State Tax Commissioner

FROM: John E. Montgomery
Managing Attorney

RE: 110 C.S.R. 1J, Valuation of Producing and Reserve Oil and Natural Gas Ad Valorem Property Tax Purposes

DATE: May 26, 2004

Attached please find the referenced rule. It is prepared for filing for public comment. You should be advised that the final document in the package is the form to be filed with the Small Business Development Center. That document has been prepared to state that it is exempt from Executive Order 20-03 because it implements state-mandated standards where there is no distinction permitted between large and small business.

If you agree with the filing, please sign the fiscal note and the SBDC form. Additionally, Secretary Musgrave needs to sign the comment period filing form.

Please return everything to me and we will make the necessary copies and file with the Secretary of State. Thank you.

APPENDIX B

FISCAL NOTE FOR PROPOSED RULES

Rule Title: Valuation of Producing and Reserve Oil and Natural Gas for Ad Valorem Property Tax Purposes

Type of Rule: X Legislative ___Interpretive ____Procedural

Agency: State Tax Department
Address: Legal Division
P.O. Box 1005
Charleston, WV 25324-1005

1. Effect of Proposed Rule

	ANNUAL		FISCAL YEAR		
	INCREASE	DECREASE	CURRENT	NEXT	THEREAFTER
ESTIMATED TOTAL COST	$ 0	$ 0	$ 0	$ 0	$ 0
PERSONAL SERVICES	0	0	0	0	0
CURRENT EXPENSE	0	0	$ 0	0	0
REPAIRS & ALTERNATIONS	0	0	0	0	0
EQUIPMENT	0	0	0	0	0
OTHER	0	0	0	0	0

2. Explanation of above estimates:

The proposed changes to the Rule will not require additional funding to implement.

3. Objectives of these rules:

This Rule provides a statement of the methodology to be employed by the State Tax Commissioner to determine the appraised value of producing and reserve oil and natural gas properties for ad valorem property tax purposes.

RULE TITLE: Valuation of Producing and Reserve Oil and Natural Gas for Ad Valorem Property Tax Purposes

4. Explanation of Overall Economic Impact of Proposed Rule.

A. Economic Impact on State Government.

The revenue effects on the changes are relatively neutral over time and will result, short term, in slightly less revenue during trends of price increases and slightly more revenue during trends of price declines. The changes will not require additional funding to implement.

B. Economic Impact on Political Subdivisions; Specific Industries; Specific groups of Citizens.

See response to A above.

C. Economic Impact on Citizens/Public at Large.

See response to A above.

Date: May 26, 2004

Signature of Agency Head or Authorized Representative

Rebecca Melton Craig

Rebecca Melton Craig, State Tax Commissioner

RULE SUMMARY
VALUATION OF PRODUCING AND RESERVE OIL AND NATURAL GAS FOR AD VALOREM PROPERTY TAX PURPOSES
110 C.S.R. 1J

Title 110 Series 1J, provides a statement of the methodology to be employed by the State Tax Commissioner to determine the appraised value of producing and reserve oil and natural gas properties for property tax purposes. In this regard the following proposed changes are made to the existing Rule.

1. Subsection 3 (the definition section) has been amended by adding thereto a definition for "flat rate royalty" and for "non-producing or shut-in wells."

2. Section 4.1 relating to the methods of valuation for a well producing for less than twelve months, has been amended to make the section more clearly state the current methodology employed in this situation.

3. Section 4.3 regarding average industry operating expenses has been amended to require that a review of such expenses shall occur at least every five years.

4. Section 4.5 has been amended to strike all references to United States Treasury Bills as these instruments are no longer issued and replaces all references with the reference of "Constant Maturity Treasury Yields."

5. Section 4.5 is also amended to indicate the State Tax Department will begin to use a three year weighted average in estimating the beginning point for income capitalization purposes.

6. Section 4.6 relating to the yield capitalization model is amended to reflect the fact that the Tax Department will begin the use of a three year weighted average as a beginning point on the income series.

7. Section 4.6.3 is amended to increase the appraised value of home use wells from $300 to $500 and the assessed value for home use wells from $180 to $300.

8. Section 4.11, valuation of storage well areas, is amended to more clearly reflect the methodology employed in valuing storage areas as non-producing natural gas property.

9. Section 4.12 is amended to require that the Tax Commissioner file, on or before July 1 of each year, an annual summary of the variables to be considered in arriving at the value of specific oil and natural gas related property.

10. Section 4.14, property reports, is amended to move the required filing date from September 1 to July 1 in order to provide more time for processing of tax returns.

11. A new Section 4.16 is added providing that the valuation of machinery and equipment at non-producing and shut-in wells shall be determined based upon a minimum of a five year review of salvage value of such equipment and that the personal property value will be no less than $500, the amount applicable to home use wells.

12. A new Section 4.17 is added providing that the county assessor is responsible for the entry and value of chattel real accounts, as personal property accounts, for pre-production permit leaseholds.

13. A new Section 4.18, valuation of production flat rate royalty accounts, is added providing that flat rate royalties will be valued utilizing a level terminal income series rather than a declining terminal income series as discussed in Section 4.6.

STATEMENT OF CIRCUMSTANCE
VALUATION OF PRODUCING AND RESERVE OIL AND NATURAL GAS
FOR AD VALOREM PROPERTY TAX PURPOSES
110 C.S.R. 1J

Prior to calendar year 2000, prices for oil and natural gas were fairly predictable. However, since calendar year 2000, the selling price for oil and natural gas has varied considerably. Values should not be sensitive to short-term price fluctuations because those fluctuations will affect the values for property tax purposes.

The amendments to the rule are designed to reduce the effect of those fluctuations because the rule will provide a three-year data stream which will mitigate the short-term fluctuations. As a result, there will be more stable and accurate valuations for local government operations.

PROPOSED
TITLE 110
LEGISLATIVE RULE
STATE TAX DEPARTMENT

FILED
2006 JUN 17 A 11: 48
WEST VIRGINIA
SECRETARY OF STATE

SERIES 1J
VALUATION OF PRODUCING AND RESERVE OIL AND NATURAL GAS FOR AD VALOREM PROPERTY TAX PURPOSES

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§ 110-1J-1. General.

1.1 **Scope**. -- This rule provides the methodology the State Tax Commissioner shall use to determine the appraised value of producing and reserve oil and natural gas properties for ad valorem tax purposes.

1.2 **Authority**. -- W. Va. Code §§ 11-1C-5(b), 11-1C-5a, and 11-1C-10(d).

1.3 **Filing date**. --

1.4 **Effective date**. -- This rule applies to tax years beginning on or after January 1, 2006.

§ 110-1J-2. Introduction.

Oil and/or natural gas is one of the several estates in real property which may be owned either separately or in conjunction with other estates. If oil and/or natural gas is owned as a separate estate, either absolute, as a leasehold, or in conjunction with other estates, West Virginia property tax law requires that ownership be listed, valued and taxed in proportion to its value to be ascertained as directed by law. If oil and/or natural gas is owned in conjunction with other estates, the value of the oil and/or natural gas shall be included in the value of the other estate. Oil and/or natural gas may be owned without being produced. Oil and/or natural gas title may exist where no oil and/or natural gas is known to be 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 bearing or having the potential to bear oil and/or natural gas or having the oil and/or natural gas mineral interest separated from the fee of the property shall be categorized as:

2.1.1 producing property (to include home use/industrial on-property consumption); or

2.1.2 non-producing property; or

2.1.3 barren property; or

2.1.4 plugged and/or abandoned property.

§ 110-1J-3. Definitions.

As used in this rule and unless the context clearly requires a different meaning, the following terms shall have the meaning ascribed in this section.

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 **"Barren oil and natural gas property"** means those fee and mineral parcels in West Virginia where data suggests that the presence of oil and natural gas is very unlikely.

3.3 **"Capitalization rate"** means a rate used to convert an estimate of income to an estimate of market value. For further explanation, see Section 4.5 of this rule.

3.4 **"Commissioner"** or **"Tax Commissioner"** means the Tax Commissioner of the State of West Virginia, or his or her delegate.

3.5 **"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.

3.6 "**Flat Rate royalty**" means a royalty rate in which the amount paid per year (e.g. $100 per year) is set within a lease and is not dependant on the production or income derived from the well.

3.~~6~~ 7 **"Flush production"** means the production of oil and/or natural gas from any well on an oil and/or natural gas property with an initial production date that is two (2) calendar years or less prior to the July 1st assessment date. Production beginning after December 31st and prior to the July 1st assessment date must be reported.

3.~~7~~ 8. **"Gross receipts"** means total income received from production on any well, at the field line point of sale, during a calendar year before subtraction of any royalties and/or expenses.

3.~~8~~ 9. **"Management rate"** means a rate reflecting a return to an investor for the management of similar investment portfolios.

3.~~9~~ 10. **"Natural gas producing property"** means the property from which natural gas has been produced or extracted at any time during the calendar year preceding the July 1 assessment date. Natural gas producing property includes the interest or interests underlying an area of up to one hundred twenty-five (125) acres of surface per well for property with active wells on the parcel. All acreage of a natural gas producing property in excess of one hundred twenty-five (125) acres per well, shall be valued at the non-producing rate per acre referenced in Subsection 4. of this rule.

3.~~10~~ 11. **"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.

3.12 **"Non-Producing or Shut-in Well"** means a well, which due to the producer's decisions, market reasons and/or product performance, was non-productive during the entire most recent calendar year preceding the July 1st assessment date.

3.~~11~~ 13 **"Oil and/or natural gas, non-producing property"** means properties that were not engaged in production during the previous assessment year period of July 1st through June 30th. This category includes any acreage that has been shut-in for the entire year.

3.~~12~~ 14 **"Oil and/or natural gas plugged and abandoned property"** means plugged and abandoned oil and/or natural gas well(s).

3.~~13~~ 15 **"Oil producing property"** means property from which oil has been produced or extracted at any time during the calendar year preceding the July 1 assessment date. Oil producing property includes the interest or interests underlying an area of up to forty (40) acres of surface per well with one (1) or more active well(s) on the parcel. All acreage of an oil producing property in excess of forty (40) acres per well, shall be valued at the non-producing rate per acre referenced in Section 4 of this rule.

3.~~14~~ 16 **"Operating expenses"** means only those ordinary expenses which are directly related to the maintenance and production of natural gas and/or oil. These expenses do not include extraordinary expenses, depreciation, ad valorem taxes, capital expenditures or expenditures relating to vehicles or other tangible personal property not permanently used in the production of natural gas or oil.

3.~~15~~ 17 **"Overriding royalty"** means the fractional interest in the gross production payable to a person who is neither the producer nor the owner of the oil and natural gas estate and who is not required to bear a share of the development or operating costs of the well.

3.~~16~~ 18 **"Personal property"** used in oil or natural gas production means machinery and equipment in and about the well and all other tangible personal property used in oil and/or natural gas production from the well to the fieldline point of sale. It shall not include vehicles or other tangible personal property not permanently used in production.

3.~~17~~ 19 **"Producer/operator"** means any person or persons, corporation, partnership, joint venture or other enterprise which proposes to or does locate, drill, produce, manage, or abandon any well.

3.~~18~~ 20 **"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.~~19~~ 21 **"Recapture component"** means a rate reflecting a provision for returning to an investor a sum of money equal to his or her investment.

3.~~20~~ 22 **"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.~~21~~ 23 **"Royalty interest"** means the fractional interest in oil and/or natural gas production that is not subject to development costs or operating expenses and extends undiminished over the life of the property. Typically, it is retained by the oil and/or natural gas rights owner or lessor.

3.~~22~~ 24 **"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.~~23~~ 25 **"Settled production"** means the production of oil and/or natural gas from all wells on a property with an initial production date that is more than two (2) calendar years prior to the July 1st assessment date.

3.~~24~~ 26 **"Storage wells"** means drilled and completed wells on any property used for the artificial injection or storage of natural gas into a natural reservoir strata.

3.27 "**Sum of the Years digit**" means the weighted average that will be utilized in the calculations. For a 3 year weighted average, the sum of the years digit method places the first year at 50%, the second year at 33.33% and the third year at 16.67%.

3.~~25~~ 28 **"Summation discount component"** means a discount rate expressed as the aggregate of a safe rate, risk rate, nonliquidity rate, and management rate, adjusted for inflation.

3.~~26~~ 29 **"Well"** means any shaft or hole sunk, drilled, bored or dug into the earth or into underground strata for the extraction of oil or gas.

3.~~27~~ 30 **"Working interest"** means the fractional interest in oil and/or natural gas production subject to development and operating expenses and owned by the leaseholder and/ 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 (gross receipts less royalties paid less operating expenses) for the working interest and a yield capitalization model applied to the gross royalty payments for the royalty interest. Where ownership is split through a lease or royalty arrangement, different values shall be determined for the working interest and the royalty interest. If the well produced for less than twelve (12) months during the ~~entire~~ first calendar year of production, ~~and if the gas and/or oil well has been in operation and/or production for less than six years~~, or during the first calendar year of production after being shut-in during the previous calendar year, the gross receipts and royalties paid shall be annualized prior to the process of applying a yield capitalization rate. 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 (generally one-eighth) of the production income to be the royalty payment to the owner. The remainder (generally seven-eighths) is the working interest. The Tax Commissioner shall annually determine working and royalty percentage interests on a per well or lease basis, through a review of oil and natural gas producer/operator annual property tax returns. These percentages shall be determined annually by dividing the total royalty paid by the reported gross income.

4.3 **Average industry operating expenses.** -- The Tax Commissioner shall, ~~biennially~~ every five (5) years, determine the average annual industry operating expenses per well. The average annual industry operating expenses shall be deducted from working interest gross receipts to develop an income stream for application of a yield capitalization procedure.

4.4 **Average industry production decline rates.** -- The Tax Commissioner shall every five (5) years derive and report the average industry production decline rates by reviewing well production records of various State agencies along with data provided by companies and individuals.

4.5 **Capitalization rate.** -- A single statewide capitalization rate for oil and natural gas shall be determined annually by the Tax Commissioner through the use of generally accepted methods. The rate shall be based on the assumption of a declining-terminal, non-inflating income series. The capitalization rate used to value oil and natural gas shall be developed through consideration of: (1) a discount rate determined by the summation technique, and (2) a property tax component.

4.5.1 **Discount component.**

The summation technique shall be used in developing a discount component of the capitalization rate. The five subcomponents of the discount rate are;

4.5.1.a **Safe rate.** -- The "safe rate" shall reflect a rate of return that an investor could expect on an investment of minimal risk. It shall be developed through review of interest rates offered on thirteen (13) week United States ~~Treasury Bills~~ Constant Maturity Treasury Yields for a period of ~~one (1)~~ three (3) calendar years immediately prior to the July 1st assessment date. A weighted average (sum of years digits) will be used in order to arrive at a Safe Rate.

4.5.1.b **Risk rate** -- The relative degree of risk of an investment in oil and natural gas property is difficult to determine from published interest rates. Interest rates required on loans for acquisition and/or development of oil and natural gas properties shall be calculated by adding two percent (2%) to the Prime Interest Rate Charged By banks as published in the Economic Indicators Prepared By The Council Of Economic Advisors For The Joint Economic Committee for the three (3) calendar years immediately prior to the July 1 assessment date. The loan rate shall be compared to quarterly interest rates offered on thirteen (13) week United States ~~Treasury Bills~~ Constant Maturity Treasury Yields for the same ~~one (1)~~ three (3) calendar years period. The weighted average (sum of years digits) difference between the two, combined with bands-of-investment analysis, shall be used as a basis to estimate the risk rate;

4.5.1.c **Nonliquidity rate.** -- The "nonliquidity rate" shall be developed through an annual survey to determine a reasonable estimate of time that oil and natural gas properties, when exposed to the market for sale, remain on the market. The time determined in this manner shall be used to identify United States ~~Treasury Bills~~ Constant Maturity Treasury Yields with similar time differentials in excess of thirteen (13) week United States ~~Treasury Bills~~ Constant Maturity Treasury Yields. The interest

differential between these securities shall be used to represent the nonliquidity rate. For example, if it is determined that oil and natural gas property remains on the market for an average of nine months (39 weeks) before being sold, the nonliquidity rate shall be derived by taking the rate on one (1) year United States ~~Treasury Bills~~ Constant Maturity Treasury Yields minus the rate on 13-week United States ~~Treasury Bills~~ Constant Maturity Treasury Yields; The rate utilized will be a weighted average (sum of years digits) of the data from the three (3) calendar year periods prior to the July 1 assessment date.

4.5.1.d **Management rate.** -- The "management rate" represents the cost of managing the investment, not the cost of managing the oil and natural gas property. Because the management rate has historically been one-half of one percent (0.5%) of the value of investment portfolios, for purposes of determining the discount component the management rate shall be one-half of one percent (0.5%); and

4.5.1.e **Inflation rate (negative).** -- Nominal interest rates, including the "safe rate" mentioned in paragraph 4.5.1.a of this subdivision, are higher than real rates by an amount representing expectation of future inflation; however, net annual income from oil and natural gas property is to be estimated assuming level future royalties (no inflation). The capitalization rate shall be a real rate, net of expectation of inflation. The inflation rate shall be estimated through analysis of the most recent calendar year's urban consumer price index as determined by the U.S. Department of Labor, Bureau of Labor Statistics. The weighted average (sum of years digits) rate will be utilized from the data of the three (3) calendar year periods prior to the July 1 assessment date.

4.5.2 In determining the discount component of the capitalization rate, the Tax Commissioner shall deduct the inflation rate from the sum of the safe rate, the risk rate, the nonliquidity rate and the management rate.

4.5.3 **Property tax component.** -- This component shall be estimated by multiplying the assessment rate by the prior tax year's statewide average for Class III property. At the present time, research indicates that royalty rates on oil and natural gas include a component for property tax, with no additional compensation from the producer. As a result, the property tax component shall be used in the capitalization rate; however, if this described general practice changes and property taxes are paid as additional compensation, the use of this component shall be deleted. The rate utilized will be a weighted average (sum of years digits) of the data from the three (3) tax year periods prior to the July 1 assessment date.

4.5.4 **Results of capitalization rate survey** -- A review of economic data for development of components referenced in Subdivision 4.5.1 of this rule shall be conducted annually and results filed by the Tax Commissioner in the State Register on or before July 1st of each year. Public comment on the published results shall be accepted

until August 1st of each year with final results filed in the State Register on or before September 1st of each year.

4.6 **Yield capitalization model.** -- A yield capitalization model shall be developed for each producing property. The model shall use as a beginning point and include for each producing well, the gross receipts (both working interest and royalty interest) and production amounts based on those gross receipts from the most recent consecutive three (3) full production calendar years preceding the July 1 assessment date. These amounts will be weighted average (sum of years digits) and then adjusted for production decline to reflect the income available to the property owner beginning with the July 1st assessment date to June 30 next succeeding the assessment date. Gross receipts and production amounts shall be proportionately reduced by application of the appropriate production decline rate, referenced in Subsection 4.4 of this rule, to yield a declining terminal income series typical of the producing area and strata. The income series shall be apportioned to the working interest and to the royalty interest based upon percentage interests referenced in Subsection 4.2 of this rule. Where the well did not produce during the entire calendar year, the gross receipts and royalties paid will be annualized prior to the process of applying a yield capitalization procedure.

4.6.1 **Working interest model.** -- The working interest weighted average (sum of years digits) gross receipts income series referenced in Subsection 4.6 of this rule shall be reduced by the annual operating expenses referenced in Subsection 4.3 of this rule to yield a net working interest income series. The net working interest income series shall be discounted by applying, on an annual basis, a mid-year life Inwood factor reflecting the capitalization rate referenced in Subsection 4.5 of this rule. The summation of the annual discounted income streams shall be the market value estimate for the working interest of the producing oil and/or natural gas well including personal property as defined by Section 3 of this rule. -The minimum appraised value for any producing well will not be less than the machinery and equipment value discussed in Section 4.16 of this rule. This minimum rate will not apply to home-use only wells.

4.6.2 **Royalty interest model.** -- The royalty interest weighted average (sum of years digits) gross receipts income series referenced in Subsection 4.6 of this rule shall be discounted by applying, on an annual basis, a mid-year life Inwood factor reflecting the capitalization rate referenced in Subsection 4.5 of this rule. This amount will then be proportionally distributed to each royalty owner based on the royalty percentage received during the most recent calendar year to the July 1 assessment date. The summation of the annual discounted income streams shall 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 per producing natural gas wells and up to forty (40) acres per producing oil wells.

4.6.3 **Valuation of home-use only wells.** -- The appraised value of wells utilized for home-use only will be an annual appraised value of ~~$300.00~~ 500.00 resulting in an assessed value of ~~$180.00~~ 300.00. If the home-use well owner has ownership in the mineral rights, the assessed value will be added to the real property assessment. However, if the home-use well owner only has rights in the surface, the assessed value will be added to the personal property assessment.

4.6.4 **Valuation of industrial use wells.** -- The appraised value of wells utilized for industrial purposes only will be based on the actual most recent calendar year preceding the July 1 appraisal date MCF usage times the average West Virginia spot price for that calendar year determined by the "Natural Gas Monthly," published by the U.S. Department of Energy, Energy Information Administration.

4.7 **Valuation of non-producing acreage.** -- The value per acre of non-producing acreage, which includes shut-in wells, shall equal the discounted annual lease payment per acre. A valuation schedule for non-producing properties shall be determined annually by the Tax Commissioner for each district within a county, where data is available. The Tax Commissioner shall annually conduct a review of oil and/or natural gas lease agreements transacted at arms-length in all fifty-five (55) counties to determine the average annual delay rental lease payment per acre, and lease term. The per-acre value for non-producing property shall be the sum of the projected annual income stream from delay rental during the lease term discounted in each year by a capitalization rate. A valuation of $1.00 per acre shall be used where property is located in those areas of the State where drilling activity/production have not been established and the property is presumed to be barren.

4.8 **Valuation of plugged and abandoned acreage.** -- Plugged and abandoned acreage shall be valued to the oil or gas owner 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 natural gas well and up to forty (40) acres per oil well.

4.9 **Valuation of barren oil and natural gas areas.** -- These oil and natural gas areas (fee accounts) shall be valued at $1.00 per deed acre.

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

4.11 **Valuation of storage well areas.** – The valuation of ~~S~~storage well areas shall equal the discounted annual lease payment per acre that is applied to the reserve oil and gas acreage within the county.. ~~be valued as non-producing natural gas property~~.

The minimum value applied to such areas will not be less than $5.00 per deed acre. The value shall not include inventories stored within. Natural gas storage inventories shall be assessed to the inventory owner.

4.12 **Annual reports.** -- The Tax Commissioner shall on or before July 1st of each year publish and file in the State Register an annual summary of the variables to be considered in arriving at the value of the specific oil and/or natural gas related property. Public comments shall be accepted until August 1st of each year with the final results filed in the State Register on or before September 1st of each year.

4.13 **Farm properties.** -- The oil and gas rights, that are part of a "fee" estate where the use of the surface has qualified for farm use appraisal, shall be valued as described in the Tax Commission's rule, Valuation of Farmland and Structures Situated Thereon For Ad Valorem Property Tax Purposes, 110 C.S.R. 1A.

4.14 **Property reports.** -- ~~Prior to September~~ On or before July 1st of each year the producer shall file the West Virginia Oil and Gas Producer/Operator Return with the State Tax Commission, with acknowledgement to the county assessors in the counties where the oil and natural gas property is located. ~~The gas and/or oil volumes reported shall correspond to the production reported to the Office of Oil and Gas.~~ This Return form shall be designed by the State Tax Commissioner so that information pertinent to the valuation of the producing property, and plugged and abandoned property shall be reported properly by the oil and gas producer.

4.15 **Confidentiality** -- All information provided by or on behalf of a natural resources property owner or by or on behalf of an owner of an interest in natural resources property to any state or county representative for use in the valuation or assessment of natural resources property or for use in the development or maintenance of a legislatively funded mineral mapping or geologic information system is confidential. The information is exempt from disclosure under the provisions of West Virginia Code § 29B-1-4, and shall be kept, held, and maintained confidential except to the extent the information is needed by the state tax commissioner to defend an appraisal challenged by the owner or lessee of the natural resources property subject to the appraisal: Provided, That this section may not be construed to prohibit publication or release of information generated as part of the minerals mapping or geologic information system, whether in the form of aggregated statistics, maps, articles, reports, professional talks, or otherwise presented in accordance with generally accepted practices and in a manner so as to preclude the identification or determination of information about particular property owners.

4.16 **Valuation of Machinery & Equipment at Non-Producing or Shut-In wells**—The valuation of the machinery and equipment that is part of a non-producing or shut-in well's appraisal will be determined by the Tax Commissioner based on a minimum

of a five year review of the salvage value for such equipment. This personal property value, which will be assigned to the producer, will have a minimum value of not less than $500, the amount applicable to home use only wells.

4.17 **Valuation of Pre-Production/Permit Leaseholds----**Chattel real accounts (personal property) for pre-production/permit leaseholds will be valued by the county assessor.

4.18 **Valuation of Producing Flat-Rate Royalty accounts** ---- The appraised value of a producing flat-rate royalty will be valued utilizing a level terminal income series rather than the declining terminal income series as discussed in Section 4.6.

§ 110-1J-5. Severability.

5.1 If any provision of this rule or the application of this rule to any person or circumstances is for any reason held to be invalid, the remainder of the rule and the application of the provisions to other persons or circumstances shall not be affected by the holding.

CERTIFICATION OF NON-APPLICATION OF EXECUTIVE ORDER 20-03

Name of Agency:

State Tax Division

Description of Proposed Rule:

Valuation of Producing and Reserve Oil and Natural Gas for Ad Valorem Property Tax Purposes

1. **Purpose of the Proposed Rule (scope of the problem addressed, public benefit from the rule):**

This Rule was first implemented in 1991 and looked to 1 year's gross receipts for purposes of developing a yield capitalization model. In the 1990's, when oil and gas prices were relatively stable, use of 1 year's data was acceptable. However, since 2000 oil and gas prices have experienced severe fluctuations and values have fluctuated accordingly. The primary rule change will require use of a three (3) year average. Use of the 3-year average will make the model less susceptible to short term price fluctuations, provide for a more predictable and stable tax for taxpayers and provide for a more steady revenue source for levying bodies.

2. **Is the Rule Exempt from Executive Order 20-03?** Yes

If "yes," state the exemption (make reference to the Exemptions section of this *Guide),* stop the analysis, sign and submit as required by the *Guide.*

The Rule implements state-mandated standards where there is no distinction permitted between large and small businesses (page 7, Item #3 – Exemptions from Executive Order 20-03).

If "no," continue with the analysis.

3. **Will the rule have only beneficial impacts?**

If "yes," state the beneficial impacts and state why there will be no adverse impact, stop the analysis, sign and submit as required by the *Guide.*

If "no," continue with the analysis.

4. **Is there an applicable statutory definition of "small business" that differs from that contained in the Executive Order?**

If yes, cite the applicable definition, skip section 5, and use that definition for the analysis beginning in section 6 below.

If no, continue with section 5.

5. **Analysis of "Small Businesses" Affected by the Proposed Regulation:**

NAICS/SIC Groups Examined:

a. Number of for profit and nonprofit enterprise that have either gross annual receipts not exceeding $5 million or total payroll not exceeding $1.5 million. It is not required that a small business meet both tests, only one test.

b. Number of businesses included in smallest 10 percent of those businesses affected by the Executive Order (by either gross receipts or number of employees, whichever produces the larger number of businesses).

c. State the number that is greater (5-a or 5-b). Use that number of businesses in section 6.

6. **Is quantitative analysis of "adverse impact costs" possible?**

If "no," state the reasons in detail, stop the analysis, sign and submit as required by the *Guide.*

If "yes," proceed to section 7.

7. **Complete the following Analysis Tables (effect of proposed rule):**

Number of small businesses	Form completion cost – record keeping cost*	Cost to read/ comprehend regulation*	Additional personnel/ consultant cost*	Additional investment required – equipment hardware software (new or modified)*	Employee training cost*	Lost sales/ profit*	Changes in market competition or (gov't procurement practices)*

*For one small business annually

Total cost for one small business $___

Number of affected small businesses _
Total cost for all affected small businesses $_
Average gross sales for one small business $
Average profit margin for one small business $
Average retained earnings for one small business $

Number of large businesses	Form completion cost – record keeping cost*	Cost to read/ comprehend rule*	Additional personnel/ consultant cost*	Additional investment required – equipment hardware software (new or modified)*	Employee training cost*	Lost sales/ profit*	Changes in market competition or (gov't procurement practices)*

*For one large business, annually

Total cost for one large business $ _____
Number of affected large businesses _____
Total cost for all affected large businesses $ _____
Average gross sales for one large business $ _____
Average profit margin for one large business $ _____
Average retained earnings for one large business $ _____

Data Sources:

8. **Compare and contrast the effects of the proposed rule upon small versus large businesses by completing the following table (use either "substantial (S)," "moderate(M)," or "not substantial(NS)":**

Business Size (One)	Economic Viability*	Competitiveness**	Productivity	Profitability	Employment (number of persons employed)	Entry into market by new firms
Small						
Large						

*Ability to pay the costs imposed by the proposed rule and remain in business.
** Ability to pay the costs imposed by the proposed rule and to pass on costs to customers or suppliers, to maintain quality, or to expand to meet market needs.

9. **Based upon the foregoing analysis, I certify that the proposed rule will not impose a significant adverse economic upon a substantial number of small businesses. The factual basis of this conclusion is as follows:**

10. **Cost of preparing this certification**:

    a. Class of employee involved (state each class)
    b. Number of hours spent by class
    c. Average wage for each class
    d. Consultant costs
    e. Other costs (itemize by category)
    f. Total

Date: May 26, 2004

Name of Agency Head: Rebecca Melton Craig
State Tax Commissioner

Note: This completed document is to be forwarded in electronic format (MS Word) to the Director, West Virginia Small Business Development Center at least 60 days prior to the date the proposed rule is filed with the Secretary of State pursuant to the West Virginia Administrative Procedures Act.* **csalyer@wvsbdc.org**

*If the agency has previously timely filed its "Initial Adverse Impact Analysis and Report" and determines after public comment that a Certification of Nonapplication should be filed instead of a "Final Adverse Impact Analysis and Report," it may file the Certification in place of and at the time required for filing the Final Adverse Impact Analysis and Report.