

WEST VIRGINIA
SECRETARY OF STATE
KEN HECHLER
ADMINISTRATIVE LAW DIVISION

Form #5

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THIS DATE July 26, 1991
ADMINISTRATIVE LAW DIVISION

**NOTICE OF AGENCY ADOPTION OF A PROCEDURAL OR INTERPRETIVE RULE
OR A LEGISLATIVE RULE EXEMPT FROM LEGISLATIVE REVIEW**

AGENCY: Tax TITLE NUMBER: 110

CITE AUTHORITY: _____

RULE TYPE: PROCEDURAL _____ INTERPRETIVE _____

EXEMPT LEGISLATIVE RULE X
CITE STATUTE(S) GRANTING EXEMPTION FROM LEGISLATIVE REVIEW

11-1C-5 (b)

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 ADOPTED: 1 K

TITLE OF RULE BEING ADOPTED: Valuation of Natural Resources
property other than coal, Oil or Natural gas.

THE ABOVE RULE IS HEREBY ADOPTED AND FILED WITH THE SECRETARY OF STATE. THE
EFFECTIVE DATE OF THIS RULE IS July 1, 1991

WEST VIRGINIA LEGISLATIVE REGULATIONS
DEPARTMENT OF TAX AND REVENUE
TITLE 110
SERIES 1K
1991

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SECRETARY OF STATE

VALUATION OF NATURAL RESOURCES PROPERTY OTHER THAN COAL, OIL
OR NATURAL GAS FOR AD VALOREM PROPERTY TAX PURPOSES

§ 110-1K-1. General.

1.1 Scope. - These regulations clarify and implement State law as it relates to the appraisal at market value of natural resources properties other than coal, oil or natural gas. Because these regulations provide context modifications of relevant parts of 110 C.S.R. 1 and such regulations with context changes were adopted by the Tax Commissioner W. Va. Code § 11-1C-5(b) eliminates the requirement that this filing be subject to the procedural requirements of W. Va. Code § 29A-3-1 et seq.

1.2 Authority. - W. Va. Code § 11-1C-5(b).

1.3 Filing Date. -

1.4 Effective Date. - July 1, 1991.

§ 110-1K-2. Introduction.

2.1 Other active natural resource interests, such as limestone, fireclay, dolomite, sandstone, shale, sand and gravel, and salt are some of the several estates in real property which may be owned either as a separate interest, or in conjunction with other interests, usually as fee ownership or as minerals ownership. If the other active natural resource interest is owned as a separate estate, either absolute or as a leasehold interest, West Virginia property tax law requires such ownership to be listed, valued and taxed based on its true and actual value.

2.2 Other West Virginia natural resource interests, such as lead and zinc, manganese, iron ore, radioactive minerals, and oil shale, which at present are not being actively mined shall be valued in accordance with this regulation, when such interests are separated from the fee interest or begin being leased or actively mined.

2.3 These other natural resource interests may be owned without being mined. These other natural resources interests may exist where the natural resource is not actually present, or where the natural resource is unmineable or mined out.

2.4 For valuation purposes, this regulation classifies other natural resource property ownership into the following categories:

- 2.4.1 Active
- 2.4.2 Reserves
- 2.4.3 Unmineable
- 2.4.4 Mined-Out/Barren

§ 110-1K-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 "Acres mined" means the average annual production, as defined in Section 3.3 of these regulations, divided by the product of the thickness in feet of the natural resource seam being mined, as detailed in mining permit reports, times the tons per acre foot, as set out below, times the recovery rate according to the actual recovery of the natural resource per acre being experienced at the mining operation.

For use in these regulations, the following in-place tons per acre-foot figures will be used:

Limestone = 3,600 tons per acre foot

Sandstone = 3,600 tons per acre foot

Clay and Shale = 3,050 tons per acre foot

Sand and Gravel = 2,400 tons per acre foot

Salt = 2,950 tons per acre foot

Average Annual Production

$\frac{\text{Thickness} \times \text{Tons per Acre Foot}}{\text{Recovery Rate}} = \text{Annual Acres Mined}$

3.2 "Active mining property" means the mineable natural resource on a parcel involved in a mining operation. For the purposes of determining active mining property, all contiguous parcels, regardless of ownership, that are under lease or involved in the permitted operation shall be treated as an active mining parcel. The active mining acreage of any natural resource or resources on a parcel shall be calculated by multiplying acres mined times the life of the mine. If this calculation, however, results in an acreage figure that is higher than the total mineable acreage of the natural resource on the parcel, the lower figure shall be used. This calculation shall be made of each "Other Natural Resource" activity being mined on the parcel.

For use in these regulations, the maximum active mining property for each natural resource will be as follows:

3.2.1 Surface limestone. - The active mining property of a surface limestone mine shall be derived by multiplying five (5) years times acres mined.

3.2.2 Deep limestone. - The active mining property of a deep limestone mine shall be derived by multiplying fifteen (15) years times acres mined.

3.2.3 Sandstone. - The active mining property of a surface sandstone mine shall be derived by multiplying five (5) years times acres mined.

3.2.4 Surface clay and shale. - The active mining property of a surface clay and shale mine shall be derived by multiplying five (5) years times acres mined.

3.2.5 Deep clay and shale. - The active mining property of a deep clay and shale mine shall be derived by multiplying fifteen (15) years times acres mined.

3.2.6 Sand and gravel. - The active mining property of a sand and gravel mine shall be derived by multiplying five (5) years times acres mined.

3.2.7 Salt. - The active mining property around each salt well shall be a maximum of thirty-five (35) acres. After a well's first year of production, active mining property shall be derived by subtracting acres mined from the thirty-five (35) acres.

3.3 "Average annual production" means the average annual rate of natural resource production, determined by a weighted average of the three (3) years' production, that has occurred between January 1 and December 31 of the most current calendar years.

The weighted average shall be determined by multiplying the most recent year's production by four tenths (.4), each of the previous two (2) years' production multiplied by three tenths (.3), and the resulting three (3) figures added together to arrive at the average annual production. However, if there is no production during the most recent year then the property will not be valued as active mining property for that year.

Where there has been no production during the second (2nd) or third (3rd) most recent year, the production for the current year will be factored by five tenths (.5) and the production for the earlier year in which production existed will be factored by five tenths (.5) and the resulting two (2) figures will be added together to arrive at the average annual production.

If there was no production in both the second (2nd) and third (3rd) most recent years then the production for the most recent year will be factored by one (1.0) and the resulting figure will be the average annual production.

3.4 "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.

3.5 "Barren" means and includes those properties where other natural resource rights are separately and/or individually owned, and the existence of any natural resource has not been established.

3.6 "Capitalization rate" means a rate used to convert an estimate of income into an estimate of market value. (For further explanation see Section 4.1.8 of these regulations).

3.7 "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.

3.8 "Economic life method of recapture" means a method of developing a recapture rate by estimating the period of time an investment will produce a return and estimating an equal periodic rate of recapture of the investment over this return period.

3.9 "Life of mining operation" means the life of the mining operation (in years) shall be equal to the active mining property acreage divided by acres mined. The maximum mine life shall be five (5) years for surface mines involving limestone, sandstone, clay and shale, and sand and gravel, ten (10) years for wells used in the production of salt, and fifteen (15) years for deep mines involving limestone, and clay and shale. In calculating the years involved in the life of active mining property, all fractional figures will be rounded to the nearest whole number.

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

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

3.12 "Market comparison method of recapture" means a recapture rate estimated by dividing income net of return on investment and property taxes by the arms-length selling price of the property.

3.13 "Mineable natural resource" means a natural resource which is so situated that it may be mined using generally accepted mining practices and suitable equipment and which is of such quality so as to be commercially saleable (as either a mined natural resource or as a recoverable reserve).

3.14 "Mined-out" means a natural resource, or any portion thereof, determined to be depleted by prior mining operations, and which is not mineable by modern technology.

3.15 "Mining operation" means an enterprise engaged in actively obtaining or preparing to obtain a natural resource or its by-products from the earth's crust, including underground, surface and auger mines. Each mining operation may have more than one area designated as "Active Mining Property" as defined in Section 3.2 of these regulations. This designation of "Active Mining Property" areas shall be determined as follows:

3.15.1 If the mining operation is producing a natural resource from a Department of Commerce, Labor, and Environmental Resources permit, then that operation will be designated as "Active Mining Property". However, if the mining operation is producing from more than one (1) natural resource under a

Department of Commerce, Labor and Environmental Resources permit, then each active natural resource will be designated as an "Active Mining Property".

3.15.2 If the mining operation is producing a natural resource at different locations, portals and/or faces under one (1) specific permit, then that operation will be designated as one (1) "Active Mining Property". However, if the production of the natural resource involves different mining techniques (e.g. surface, auger or deep mining method), or if mining sites are separate and generally independent, then such sites will be designated as separate "Active Mining Properties".

3.16 "Multiplier" means the "Present Worth of One (1) Per Period" for the life of the mining operation employing the capitalization rate determined in Section 4.1.8 of these regulations, as determined by a standard mid-year life Inwood table.

3.17 "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.

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

3.20 "Recovery rate" means the percentage of the natural resource thickness that is economically recovered through the mining process.

3.21 "Reserves" means the natural resource acres or portions thereof, which are mineable and contain recoverable natural resources but are not active mining property.

3.22 "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.

3.23 "Royalty rate" means the rates determined annually by the Tax Commissioner and are the current market royalty rates for arms-length, willing-buyer, willing-seller, transactions for each of the different types of natural resources and types of mining operations derived in Section 4.1.6 of these rules. The royalty rates are deemed to be paid to each owner of natural resource estate for all actively mined property.

3.24 "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.

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

3.26 "Thickness" means the measurement of all the visible natural resource, including any thinner resource strands (splits) seen above or below the main block; (this is also known as the natural resource or seam height).

3.27 "Tons per acre foot" means the result of the calculation used in converting a natural resource's specific gravity into a quantity measurement.

3.28 "Unmineable natural resource" means a natural resource which is not mineable as defined above.

§ 110-1K-4. Valuation methods.

4.1 Method for determining value of active mining property.

4.1.1 General. - The value of active mining property shall be the value per active acre times the amount of active acres. In no case will the active mining property be valued at less than its value as reserve property.

4.1.2 Value per active acre. - The value per active acre is determined through the following formula:

Thickness x Tons per acre foot x Recovery rate x Multiplier (divided by)
Mine life (yrs.) = Value per active acre

4.1.3 Thickness (ft.). - See definition in Section 3.26 of these regulations.

4.1.4 Tons per acre foot. - See definition in Section 3.27 of these regulations, and actual tons per natural resource in Section 3.1 of these regulations.

4.1.5 Recovery rate. - See definition in Section 3.20 of these regulations.

4.1.6 Royalty rate. - For use in the formula prescribed by this regulation, the royalty rate(s) will be determined for each of the different types of natural resources and types of mining operations. These will include specific royalty rates for (1) limestone (dolomite) surface mine; (2) limestone (dolomite) deep mine; (3) sandstone (industrial) surface mine; (4) sandstone (aggregate) surface mine; (5) clay and shale surface mine; (6) clay and shale deep mine; (7) sand and gravel surface mine; and (8) salt wells. These royalty rates shall be established annually by the Tax Commissioner after review of recorded, willing seller-willing buyer arms-length natural resource property leases that have occurred in the State of West Virginia during at least the five (5) years prior to appraisal date, and through inspection of other appropriate information. This review will place a greater emphasis on the information and leases transacted during the most recent years. For those natural resources that are not involved in any recorded lease agreements, the Tax Commissioner will derive a royalty rate through surveys conducted with private appraisal and/or engineering companies, data provided by the other pertinent State agencies and other appropriate information from the specific natural resource companies involved. The Tax Commissioner will maintain and publish this survey (report) of royalty rates (which will include the preliminary rates) on or

before May 31 of each year; will accept written public comment on the survey until June 15 of each year; and will issue final royalty rates on or before July 1 of each year. This survey of royalty rates will be constructed to indicate the following: (1) county in which leased property is located; (2) deed book, page number; (3) lessor-lessee; (4) date recorded; (5) acreage involved; (6) type of mining operation; (7) consideration; and (8) a narrative on rates derived for those nonleased natural resources. From this survey, the Tax Commissioner will select the royalty rate(s) that best typify such transactions. In order to convert percentage royalty rates into specific value per ton rates, the Tax Commissioner will conduct a review of the specific natural resource selling prices in West Virginia by requesting such information from private purchasers, State Department of Highways, and West Virginia Geological and Economic Survey, as well as other informative sources available and select specific selling price rate(s) based on prices best typifying activity in each appraisal year. The selected selling prices per ton when multiplied by the percentage royalty rate will result in a price per ton royalty rate factor.

4.1.7 Amount of active acres. - The maximum amount of active acres are described in Section 3.2 of these regulations.

4.1.8 Capitalization rate. - The capitalization rate will be developed considering the techniques found in general practice in the appraisal profession when developing an income approach valuation estimate. Following is a listing of terms and definitions employed in developing various capitalization rate indicators.

4.1.8.1 Discussion. - The capitalization rate as defined in Section 3.6 of these regulations will be determined annually by the Tax Commissioner through the use of generally accepted methods for estimating such rates. The rate so developed will consider a level-terminal income series which is indicative of active mining properties. The capitalization rate used to value active mining properties will be developed giving consideration to the following three (3) approaches:

4.1.8.1.a Discount component.

4.1.8.1.a.1 Market Comparison. - Sufficient sales data permitting, the market comparison technique will be employed as the primary indicator for an appropriate discount component. The market comparison discount component will be developed by dividing aggregate royalty rate income streams adjusted for recapture by verified recorded arms-length sales transactions for active mining properties which have occurred in the State of West Virginia during the five (5) years prior to the annual appraisal date. The market comparison discount component selected will be based upon those rate indicators best typifying activity in this five (5) year research period. In selecting the discount component, greater emphasis will be given to information from arms-length sales occurring during the most recent years of the study.

4.1.8.1.a.2 Summation Technique. - In the absence of sufficient data to statistically support primary consideration of the market comparison technique, the summation techniques will be given primary consideration. The summation discount component will be developed reflecting the following four (4) major subcomponents:

- 4.1.8.1.a.2.a Safe Rate
- 4.1.8.1.a.2.b Risk Rate
- 4.1.8.1.a.2.c Nonliquidity Rate
- 4.1.8.1.a.2.d 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 three (3) years 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 properties. This survey will be conducted for a three (3) 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 three (3) year period. An interest differential will then be selected representing the "Risk Rate". The "Nonliquidity Rate" will be developed through an annual survey to determine a reasonable estimate of time that natural resource 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 of investment firms to identify charges for the management of investment portfolios.

4.1.8.1.a.3 Bands-of-investment. - Data permitting the bands-of-investment technique will be considered in conjunction with the two (2) previously mentioned discount estimate components.

4.1.8.1.b Recapture component. - Selection of a multiplier will be accomplished through access of a standard mid-year life Inwood table. The Inwood table has a factor for recapture built into the table coefficients. Inclusion of a recapture component in the capitalization rate is therefore not appropriate.

4.1.8.1.c Property tax component. - The effective property tax rate will be estimated by multiplying the assessment ratio by the average statewide levy rate for Class 3 property. At the present time, research indicates that the natural resource property tax is paid by the property owner with no additional compensation from the producer. Thus, since property taxes are part of royalty rates, this component will be used in the capitalization rate. However, if this described general practice changes, (property taxes paid by producer) then the use of this component will be deleted.

4.1.8.2 The development of components referenced in Section 4.1.8.1 of these regulations will be conducted and tentative results published by the Tax Commissioner on or before May 31 of each year. Public comment on such surveys will be accepted until June 15 of each year, and final results will be issued on or before July 1 of each year.

that producing properties will be reported by the producer (with authorization from natural resource owner).