

REDACTED DECISION – DK# 23-1361

**BY: CRYSTAL S. FLANIGAN, DEPUTY CHIEF ADMINISTRATIVE LAW
JUDGE**

**SUBMITTED FOR DECISION ON MARCH 5, 2024
ISSUED ON AUGUST 15, 2024**

**NOTE: THIS ADMINISTRATIVE DECISION WAS APPEALED BEYOND THE
OFFICE OF TAX APPEALS**

FINAL DECISION

On January 17, 2023, the Property Tax Division of the West Virginia State Tax Commissioner's Office ("the Tax Department" or "the Respondent") issued a Tentative Notice of Increase in Appraisal for the parcel at issue in this matter, parcel XXXX to XXXX ("the Petitioner").¹

The Notice stated that the appraisal of her mineral interests increased from \$1,549,230 in 2022 to \$2,171,220 in 2023 for parcel XXXX. This Notice was issued pursuant to the authority of the State Tax Commissioner, granted to him by the provisions of Chapter 11, Article 6k, Section 4 of the West Virginia Code.

Upon receipt of these notices, the Petitioner timely filed her Petition for Property Tax Appeal with this Tribunal on March 3, 2023. The parties agreed to waive an evidentiary hearing and submit this case on briefs alone.² The evidence closed on March 5, 2024, and the matter became ripe for decision at that time.

JOINT STIPULATION OF FACTS

1. The property at issue in this case consists of oil and gas interests owned by the Petitioner.

¹ The style of this matter was originally styled XXXX, XXXX, and XXXX Life Estate due several tax tickets included with the Petition for Property Tax Appeal. However, the parcel at issue is only in XXXX's name. Accordingly, the style of the case is now XXXX v. XXXX, as State Tax Commissioner of West Virginia.

² The Petitioner's counsel represents two other taxpayers who have similar facts and are governed by the same law in docket numbers 23-1064 and 23-1340 pending before this Tribunal.

2. The oil and gas interests are located on 151.79 acres in Marshall County, West Virginia, designated in the Tax Division's database as County Parcel Number XXXX.
3. For property tax year 2023, real property tax in the amount of \$35,950.92 was assessed against the oil and gas interests by the Marshall County Assessor payable in half year increments of \$17,975.46.
4. By a Petition dated February 28, 2023, Petitioner appealed the valuation for their oil and gas interests to the Office of Tax Appeals.³

DISCUSSION

The issue in this matter is whether the Respondent has properly valued the Petitioner's royalty interest of producing wells. The Petitioner argues that the Respondent has improperly assessed her mineral interest by not following the guidelines set out in Emergency Rule sections 3.12 and 3.34 and seeks to have her mineral interest reassessed.

The Petitioner's argument relies on two definitions. The first being section 3.12 which states that a "communitized area" means an area involving more than one lease, due to a cooperative agreement or legal mandate, and is developed for the drilling and operation of a single or multiple oil or gas wells, or both, by one or more operator[s]." W.Va. Code R. § 110-1J-3.12. The second definition being section 3.34 which is the definition of "natural gas producing property" and states as follows:

"Natural gas producing property" means the property from which natural gas or natural gas liquids 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 vertical well for property with active wells on the parcel; and communitized acres of surface per horizontal well for properties with one or more active wells. All acreage of a natural gas producing property in excess of one hundred twenty-five (125)

³ The Petition for Property Tax Appeal was signed and dated February 28, 2023, and received by the Office of Tax Appeals on March 3, 2023. The date received by the Office of Tax Appeals is the filing date.

acres per vertical well, or the communitized acres per horizontal well, shall be valued at the non-producing rate per acre referenced in section heading 4 of this rule.

W. Va. Code R. § 110-1J-3.34. (West 2022).

The following is directly quoted from the Petitioner's brief on pages 5-8:

Given the language of Emergency Rule § § 3.12 and 3.34 above, the Petitioner's mineral acreage should be split into two categories and assessed accordingly. Specifically, the amount of acreage owned by Petitioner that is included in a Unit (i.e. communitized acreage) should be divided by the total acreage of the unit, and multiplied by 100 to result in a percentage figure representing the amount of acreage owned by Petitioner within the boundaries of a natural gas producing unit. Further, aforesaid percentage should be multiplied by 125, since that is the upper limit of what is taxable at the producing acreage-according to § 3.34-to yield an acreage amount that is taxable at the production rate.⁴ That acreage amount should be subtracted from Petitioner's total acreage within the producing unit to yield a number that should be taxed at the non-production rate in the district where the acreage lies. An example of this language applied to real numbers is provided below:

As referenced above, part of Petitioner's acreage is contained within the boundaries of multiple drilling units being XXXXs and XXXX as well as XXXX and XXXX. The illustration below combines all acreage in each XXXXs Unit as one large unit, and the same for XXXX XXXX. The same is done for the XXXX and XXXX Respectively. The total acreage of XXXXs Units is 1,431.7417 acres; Petitioner's acreage total within these units is 151.79 acres. Given those totals, the first step is to divide 151.79 acres by 1,431.7417 acres, multiply the sum by 100 to yield a percentage (i.e., $(151.79/1,431.7417) \times 100=10.60\%$). Next, Petitioner's percentage is multiplied by 125 (i.e., $125 \times 10.60\%=13.25$). Finally, subtract Petitioner's total acreage from the taxable percentage (i.e., $151.79-13.25=138.54$). The aforementioned calculation result in the two relevant numbers, being the acreage taxable at the production rate (13.25 acres) and the acreage taxable at the non-producing rate (138.54 acres). This process is illustrated below:

Non-Production Rate Tax Calculation

⁴ The term "production rate" is utilized generically throughout this Brief to mean the taxation method as outlined in Emergency Rule §§4.1;5.1; and 5.2.2 as well as all other relevant sections.

Non-production acreage x rate levy rate = $138.54 \times \$105/\text{acre} = \text{value of } \$14,546.70.$

Assessed value = total value x 60% = $\$14,546.70 \times 60\% = \$8,728.02$

Levy= assessed value x Levy Rate of 2.02% = $\$8,728.02 \times .0202 = \underline{\underline{\$176.31}}.$

****See Below for total Production Rate Tax Calculation****

The total acreage of XXXX XXXX is 1,286.7738 acres; Petitioner's acreage total within these units is 151.79 acres. Given those totals, the first step is to divide 151.79 acres by 1,286.7738 acres, multiply the sum by 100 to yield a percentage (i.e. $(151.79/1,286.7738) \times 100=11.80\%$). Next, Petitioner's percentage is multiplied by 125 (i.e., $125 \times 11.80\%=14.75$). Finally, subtract Petitioner's total acreage from the production rate taxable percentage (i.e., $151.79-14.75=137.04$). The aforementioned calculation result in the two relevant numbers, being the acreage taxable at the production rate (14.75 acres) and the acreage taxable at the non-producing rate (137.04 acres). The process is illustrated below:

Non-Production Rate Tax Calculation

Non-production acreage x non-production rate levy rate = $137.04 \times \$105/\text{acre} =$
value of \$14,389.20.

Assessed value = total value x 60% = $\$14,389.20 \times 60\% = \$8,633.52$

Levy= assessed value x Levy Rate of 2.02% = $\$8,633.52 \times .0202 = \underline{\underline{\$174.40}}.$

****See Below for total Production Rate Tax Calculation****

The total acreage of XXXX Units is 1,062.3628 acres; Petitioner's acreage total within these units is 151.79 acres. Given those totals, the first step is to divide 151.79 acres by 1,062.3628 acres, multiply the sum by 100 to yield a percentage (i.e. $(151.79/1,062.3628) \times 100=14.29\%$). Next, Petitioner's percentage is multiplied by 125 (i.e., $125 \times 14.29\%=17.8625$). Finally, subtract Petitioner's total acreage from the production rate taxable percentage (i.e., $151.79-17.8625=133.9275$). The aforementioned calculations result in the two relevant numbers, being the acreage taxable at the production

rate (17.8625 acres) and the acreage taxable at the non-producing rate (133.9275 acres). The process is illustrated below:

Non-Production Rate Tax Calculation

Non-production acreage x non-production rate levy rate = $133.9275 \times \$105/\text{acre} =$
value of \$14,062.39.

Assessed value = total value x 60% = $\$14,062.39 \times 60\% = \$8,437.43$

Levy= assessed value x Levy Rate of 2.02% = $\$8,437.43 \times .0202 =$ **\$170.44.**

****See Below for total Production Rate Tax Calculation****

The total acreage of XXXX Units is 1,632.6103 acres; Petitioner's acreage total within these units is 151.79 acres. Given those totals, the first step is to divide 151.79 acres by 1,632.6103 acres, multiply the sum by 100 to yield a percentage (i.e. $(151.79/1,632.6103) \times 100=9.30\%$). Next, Petitioner's percentage is multiplied by 125 (i.e., $125 \times 9.30\%=11.625$). Finally, subtract Petitioner's total acreage from the production rate taxable percentage (i.e., $151.79-11.625=140.165$). The aforementioned calculations result in the two relevant numbers, being the acreage taxable at the production rate (11.625 acres) and the acreage taxable at the non-producing rate (140.165 acres). The process is illustrated below:

Non-Production Rate Tax Calculation

Non-production acreage x non-production rate levy rate = $140.165 \times \$105/\text{acre} =$
value of \$14,717.33.

Assessed value = total value x 60% = $\$14,717.33 \times 60\% = \$8,830.40$

Levy= assessed value x Levy Rate of 2.02% = $\$8,830.40 \times .0202 =$ **\$178.37.**

****Total Production Rate Tax Calculation****

$35,501.53/151.79=y/57.4875$

$151.79y=\$2,040,894.2059$ [i.e., $35,501.53 \times 57.4875$]

$$y=2,040,894.2059/151.79$$

$$y=\underline{\$13,445.52}$$

Total assessment = production + non-production rate

Therefore, the total tax levied for Petitioner's acreage is \$699.52 +
 $\$13,445.52=\underline{\$14,145.04}$

Pet'r's Br. 5-8.

The Respondent counters that she followed the required valuation method as set out in West Virginia Code Section 11-1C-10 in assessing the Petitioner's mineral interest.

West Virginia Code Section 11-1C-10 states as follows:

(3) *Property producing oil, natural gas, natural gas liquids* —

(A) The Tax Commissioner shall value property producing oil, natural gas, natural gas liquids, or any combination thereof in the state at its fair market value determined through the process of applying a yield capitalization model to the net proceeds.

(iii) "Net proceeds" means actual gross receipts on a sales volume basis determined from the actual price received by the taxpayers as reported on the taxpayer's returns, less royalty interest receipts, and less actual annual operating costs as reported on the taxpayer's returns.

(iv) "Royalty interest receipts" means the fractional interest in production of oil, natural gas, natural gas liquids, or any combination thereof, that may or may not be subject to development costs or operating expenses and extends undiminished over the life of the property. Typically, it is retained by the mineral owner, mineral lessor, or both.

(v) "Capitalization rate" means a single state-wide capitalization rate for oil, natural gas, and natural gas liquids producing property, which shall be determined annually by the Tax Department based on a "Build-up-Model" of the Weighted Average Cost of Capital (WACC).

(C)(i) For all assessments made on or after July 1, 2022, the valuation of property producing oil, natural gas, natural gas liquids, or any combination thereof shall be calculated using a yield capitalization model. The yield capitalization model shall be composed of a working interest model and a royalty interest model. The summation of the working interest model and the royalty interest model shall represent the fair market value of the property.

(II) The royalty interest model shall be calculated as the sum of the royalty interest receipts income series for natural gas, oil, and natural gas liquids. The royalty interest receipts income series shall be calculated as a terminating series of royalty interest receipts discounted by applying a capitalization rate multiplier and a decline rate multiplier. The initial term of the terminating series of royalty interest receipts shall be the royalty interest receipts for that product multiplied by a six month capitalization rate multiplier and an eighteen month decline rate multiplier.

In each subsequent term of the royalty interest receipts income series, the calculation shall use the value from the previous term and multiply that term by a capitalization rate multiplier and an applicable twelve-month decline rate multiplier.

W. Va Code § 11-1C-10 (West 2022).

The Respondent further argues that the Emergency Rule, Legislative Rule 110 C.S.R. 1J, section 1 *et seq.*, implements statutory directives. Specifically, 110 C.S.R. § 1J-4.1 states:

The value of natural gas producing property, shall be determined through the process of applying a yield capitalization model to the net receipts (gross receipts less receipts paid and less actual annual operating cost) for the working interest and a yield capitalization model applied to the gross royalty payments for the royalty interest.

W.Va. Code R. § 110-1J-4 (West 2022).

The Respondent takes the position that the Legislative Rule operates under the presumption that only 125 acres of a vertical well, or 125 communitized acres of a horizontal well, are the producing portions of the acreage. Since the producing portion of the calculation is not calculated on acreage, but rather on gross proceeds, a royalty owner's portion of the calculation is valued

using the income approach to value as provided under the statute and expressed in the Legislative Rule. The calculation of value for a producing well is clearly based on gross receipts and not acreage.

The royalty interest model dictates the value of a royalty owner's interest up to 125 acres. If the royalty owner has more than 125 acres, then Section 4.8 of the Legislative Rule provides the method for determining the additional value of the portion of the acreage considered non-producing.

The valuation of non-producing acreage is defined as follows:

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 or natural gas lease agreements, or lease agreements addressing both, 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 nonproducing 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 or production have not been established and the property is presumed to be barren.

W. Va. Code R. § 110-1J-4.8 (West 2022).

The Respondent's calculation of the appraised value of the Petitioner's mineral interests begins with the royalty payments received by the Petitioner as reported by the producer of the active wells on the Petitioner's parcels. The Respondent then applied the formula under the provisions of West Virginia Code Section 11-1C-10(d) to determine the value of the Petitioner's interest.

This Tribunal finds that the controlling law in this matter is West Virginia Code Section 11-1C-10 and 110 C.S.R. 1J, §1 *et seq.*, where the valuation of mineral rights is upon based upon the royalty payments received as reported by the producer and the income approach to value, not acreage. The Legislative Rule operates under the presumption that only 125 acres of a vertical well or 125 communitized acres of a horizontal well are the producing portion of the acreage, no matter how much larger the communitized acres may be. Since the producing portion of the calculation is not calculated on acreage, but gross proceeds, the Petitioner's portion of the communitized acreage is valued using the income approach.

The Petitioner bases her argument entirely on two definitions, Sections 3.12 and 3.34 of 110 CSR 1J, while not considering or addressing West Virginia Code Section 11-1C-10 and 110 C.S.R. 1J, §1 *et seq.* These statutory and regulatory provisions provide a methodology to determine how to assess the value of mineral rights, which begins with the royalty payments reported by the producer and not acreage. The Petitioner's mathematical theory and calculations are less than illuminating and appear to be a methodology of her own creation. She neither cites any additional legal authority nor can this Tribunal locate any regulation or statute that supports the Petitioner's methodology. Sections 3.12 and 3.34 of 110 CSR 1J only define communitized acreage and natural gas producing property, but do not provide a methodology for calculating value. It appears that the Petitioner is attempting to use these calculations in lieu of an alternative appraisal to challenge the Respondent's valuation. While the Petitioner does not explicitly discuss equity, she appears to be making an equitable argument regarding how large tracts of land are valued in comparison with smaller tracts of land. However, the Office of Tax Appeals has limited jurisdiction and cannot provide an equitable result based on these arguments. Accordingly, the Petitioner's calculations are unsupported by West Virginia law, she did not consider the legal

authority that does provide a methodology for valuation, and the Office of Tax Appeals cannot provide equitable results. Therefore, the Petitioner has not met her burden of proof.

CONCLUSIONS OF LAW

Based upon all the above, it **FINDS** and **CONCLUDES** that:

1. In a hearing before the Office of Tax Appeals on a petition for reassessment or refund, the burden of proof is on the petitioner to show the West Virginia State Tax Department's actions are erroneous, unlawful, void or otherwise invalid. W.Va. Code Ann. § 11-10A-10(e) (West 2002) and W.Va. Code R. § 121-1-63.1 (West 2003).

2. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W.Va. Code Ann. § 11-1-2 (West 2010).

3. It is the duty of the Tax Commissioner to ascertain the fair market value of all industrial and natural resource property within the state. W.Va. Code Ann. § 11-1C-10 (West 2022).

4. The Tax Commissioner is required to calculate a statewide capitalization rate. W.Va. Code Ann. § 11-1C-10(d)(3)(B)(v) (West 2022).

5. The Tax Commissioner is required to calculate a decline rate. W.Va. Code Ann. § 11-1C-10(d)(3)(C)(i)(II) (West 2022).

6. The Tax Commissioner is required to value natural gas royalty interest properties as specified in West Virginia Code Ann. § 11-1C-10(d)(3)(C)(i)(II) and 110 C.S.R. 1J § 5.2.2 (West 2022).

7. The Tax Commissioner shall value property producing oil, natural gas, natural gas liquids, or any combination thereof in the state at its fair market value determined through the

process of applying a yield capitalization model to the net proceeds. W.Va. Code Ann. § 11-1C-10 (West 2022).

8. “Actual annual operating costs” shall include, without limitation, all lease operating expenses, lifting costs, gathering, compression, processing, separation, fractionation, and transportation costs; as further defined herein. W. Va. Code Ann. § 11-1C-10(d)(3)(ii) (West 2022).

9. “Net proceeds” means actual gross receipts on a sales volume basis determined from the actual price received by the taxpayers as reported on the taxpayer's returns, less royalty interest receipts, and less actual annual operating costs as reported on the taxpayer's returns. W. Va. Code Ann. § 11-1C-10(d)(3)(iii) (West 2022).

10. “Royalty interest receipts” means the fractional interest in production of oil, natural gas, natural gas liquids, or any combination thereof, that may or may not be subject to development costs or operating expenses and extends undiminished over the life of the property. Typically, it is retained by the mineral owner, mineral lessor, or both. W. Va. Code Ann. § 11-1C-10(d)(3)(iv) (West 2022).

11. “Capitalization rate” means a single state-wide capitalization rate for oil, natural gas, and natural gas liquids producing property, which shall be determined annually by the Tax Department based on a “Build-up-Model” of the Weighted Average Cost of Capital (WACC). W. Va. Code Ann. § 11-1C-10(d)(3)(v) (West 2022).

12. The royalty interest model shall be calculated as the sum of the royalty interests income series for natural gas, oil, and natural gas liquids. The royalty interest receipts income series shall be calculated as a terminating series of royalty interest receipts discounted by applying a capitalization rate multiplier and a decline rate multiplier. The initial term of the terminating series of royalty interest receipts shall be the royalty interest receipts for that product multiplied by a six

month capitalization rate multiplier and an eighteen month decline rate multiplier. In each subsequent term of the royalty interest receipts income series, the calculation shall use the value from the previous term and multiply that term by a capitalization rate multiplier and an applicable twelve-month decline rate multiplier. W. Va. Code Ann. § 11-1C-10(d)(3)(C)(i)(II) (West 2022).

13. The value of natural gas producing property, shall be determined through the process of applying a yield capitalization model to the net receipts (gross receipts less royalties paid and less actual annual operating costs) 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 first calendar year of production, 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. *See* W. Va. Code R. § 110-1J-4 (West 2022). (Emergency Rule).

DISPOSITION

Based upon the above, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the valuation by the Tax Commissioner is hereby deemed correct and is **AFFIRMED**.

WEST VIRGINIA OFFICE OF TAX APPEALS

Crystal S. Flanigan
Deputy Chief Administrative Law Judge

Date