NOTICE OF AN EMERGENCY RULE

AGENCY: Tax

TITLE-SERIES: 110-01J

RULE TYPE: Legislative

Amendment to Existing Rule: Yes

RULE NAME: VALUATION OF PRODUCING AND RESERVE OIL, NATURAL GAS LIQUIDS, AND NATURAL GAS FOR AD VALOREM PROPERTY TAX PURPOSES

CITE STATUTORY AUTHORITY FOR PROMULGATING EMERGENCY RULE:

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

IF THE EMERGENCY RULE WAS PROMULGATED TO COMPLY WITH A TIME LIMIT ESTABLISHED BY CODE OR FEDERAL STATUTE OR REGULATION, CITE THE CODE PROVISION, FEDERAL STATUTE OR REGULATION AND TIME LIMIT ESTABLISHED THEREIN:

W. Va. Code §11-1C-10(d)(3)(F)

PRIMARY CONTACT:

NAME: Mark S Morton

ADDRESS: PO Box 1005

Charleston, WV 24324-1005

EMAIL: taxlegal@wv.gov

PHONE NUMBER: 304-558-5330

THE ABOVE RULE IS BEING FILED AS AN EMERGENCY RULE TO BECOME EFFECTIVE AFTER APPROVAL BY THE SECRETARY OF STATE OR THE 42ND DAY AFTER FILING, WHICHEVER OCCURS FIRST. THE FACTS AND CIRCUMSTANCES CONSTITUTING THE EMERGENCY ARE AS FOLLOWS:

Pursuant to W. Va. Code §11-1C-10(d)(3)(G), the Tax Commissioner is specifically authorized to draft an emergency rule regarding valuation of property producing oil, natural gas, natural gas liquids, or any combination thereof. Pursuant to W. Va. Code 11-1C-10(d)(3)(F), the valuation methodology set forth in the statute, and addressed in this rule, is to be effective for all assessments made on or after July 1, 2022. The current rule that will be replaced by this emergency rule expires on July 1, 2022, and the need for a rule to be in place on July 1, 2022 to address assessments made on and after that date constitutes an emergency.

DOES THIS EMERGENCY RULE REPEAL A CURRENT RULE? No

HAS THE SAME OR SIMILAR EMERGENCY RULE PREVIOUSLY BEEN FILED AND OR EXPIRED? No

SUMMARIZE IN A CLEAR AND CONCISE MANNER THE OVERALL ECONOMIC IMPACT OF THE PROPOSED LEGISLATIVE RULE:

A. ECONOMIC IMPACT ON REVENUES OF STATE GOVERNMENT:

This legislative rule provides guidance for the mass appraisal 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. This rule reflects recent legislation which updated the methodology for valuation of property producing oil, natural gas, and natural gas liquids. The revised methodology accounts for major industry changes in recent years that were not properly reflected in past valuation formulas. The revised formula recognizes various natural resource products income streams produced from natural gas and oil wells in West Virginia including natural gas liquids. Effective July 1, 2022, the new valuation formula will be used to value oil and gas well properties for purposes of the local property tax. Additional administrative costs to the State Tax Department would be $10,000 in FY2022 and $10,000 in FY2023.

B. ECONOMIC INPACT ON SPECIAL REVENUE ACCOUNTS:

This legislative rule provides guidance for the mass appraisal 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. This rule reflects recent legislation which updated the methodology for valuation of property producing oil, natural gas, and natural gas liquids. The revised methodology accounts for major industry changes in recent years that were not properly reflected in past valuation formulas. The revised formula recognizes various natural resource products income streams produced from natural gas and oil wells in West Virginia including natural gas liquids. Effective July 1, 2022, the new valuation formula will be used to value oil and gas well properties for purposes of the local property tax. Additional administrative costs to the State Tax Department would be $10,000 in FY2022 and $10,000 in FY2023.

C. ECONOMIC IMPACT ON THE STATE OR ITS RESIDENTS:

This legislative rule provides guidance for the mass appraisal 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. This rule reflects recent legislation which updated the methodology for valuation of property producing oil, natural gas, and natural gas liquids. The revised methodology accounts for major industry changes in recent years that were not properly reflected in past valuation formulas. The revised formula recognizes various natural resource products income streams produced from natural gas and oil wells in West Virginia including natural gas liquids. Effective July 1, 2022, the new valuation formula will be used to value oil and gas well properties for purposes of the local property tax. Additional administrative costs to the State Tax Department would be $10,000 in FY2022 and $10,000 in
FY2023.

D. FISCAL NOTE DETAIL:

Effect of Proposal	Fiscal Year		
	2022 Increase/Decrease (use "-")	2023 Increase/Decrease (use "-")	Fiscal Year (Upon Full Implementation)
1. Estimated Total Cost	10,000	0	0
Personal Services	10,000	0	0
Current Expenses	0	0	0
Repairs and Alterations	0	0	0
Assets	0	0	0
Other	0	0	0
2. Estimated Total Revenues	0	0	0

E. EXPLANATION OF ABOVE ESTIMATES (INCLUDING LONG-RANGE EFFECT):

This legislative rule provides guidance for the mass appraisal 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. This rule reflects recent legislation which updated the methodology for valuation of property producing oil, natural gas, and natural gas liquids. The revised methodology accounts for major industry changes in recent years that were not properly reflected in past valuation formulas. The revised formula recognizes various natural resource products income streams produced from natural gas and oil wells in West Virginia including natural gas liquids. The formula incorporates a greater range of costs
associated with natural gas and oil well production than past formulas. In addition, the revised formula is based on actual annual prices as opposed to a weighted three-year average price used in the past. Effective July 1, 2022, the new valuation formula will be used to value oil and gas well properties for purposes of the local property tax.
Additional administrative costs to the State Tax Department would be $10,000 in FY2022 and $10,000 in FY2023

BY CHOOSING 'YES', I ATTEST THAT THE PREVIOUS STATEMENT IS TRUE AND CORRECT.

Yes

Allen R Prunty--By my signature, I certify that I am the person authorized to file legislative rules, in accordance with West Virginia Code §29A-3-11 and §39A-3-2.

110CSR1J
TITLE 110
LEGISLATIVE RULE
STATE TAX DEPARTMENT
(EMERGENCY RULE)

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

§110-1J-1. General.

1.1. *Scope.* -- This rule provides the mass appraisal 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.* -- ~~May 5, 2005~~.

1.4. *Effective date.* -- ~~June 1, 2005 This rule applies to tax years beginning on or after January 1, 2006.~~

1.5. *Sunset Provision.* -- This rule shall terminate and have no further force or effect on August 1, 2028.

§110-1J-2. Introduction.

~~Oil~~ Estates in oil, natural gas liquids, or natural gas, or any combination of the three, ~~is one of~~ are among the several estates in real property ~~which~~ that may be owned either separately or in conjunction with other estates. If oil, natural gas liquids, 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, natural gas liquids, or natural gas is owned in conjunction with ~~other estates~~ an undivided or fee interest in an estate, the value of the oil or natural gas shall be included in the value of ~~the other~~ that estate. Oil, natural gas liquids, or natural gas may be owned without being produced. Oil, natural gas liquids, or natural gas title may exist where no oil, natural gas liquids, or natural gas is known to be present, or where the oil, natural gas liquids, or natural gas is unproducible or depleted.

2.1. *Categories for valuing oil ~~and/or~~, natural gas liquids, or natural gas properties.* -- Parcels of property bearing or having the potential to bear oil ~~and/or~~, natural gas liquids, or natural gas or having the oil ~~and/or~~, natural gas liquids, or natural gas mineral ~~interest~~ interests separated from the fee of the property shall be categorized as:

2.1.1. producing property (to include home ~~use/industrial~~ use, farm use, and industrial use on-property consumption);

2.1.2. non-producing property;

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 have the meaning ascribed in this section.

3.1. "Abandoned well" means any well which is required to be plugged under the provisions of W. Va. Code §22-6-19.

3.2. "Actual annual operating costs" means all lease operating expenses, lifting costs, gathering, compression, processing, separation, fractionation, and transportation costs. These costs are limited to the actual costs incurred by the producer, prior to the arm-length sale of the well output to a buyer, without reference to items such as general administration, overhead, or any costs indirectly related to producing, processing, or transporting the well output.

3.3. "Appraised value" means the value of oil producing properties or natural gas producing properties, including real and personal property, determined in accordance with this rule.

3.4. "Arm's-length" means a contract, agreement or transaction that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing or adverse economic interests regarding that contract. For purposes of this definition, two persons are affiliated if one person controls, is controlled by, or is under common control with another person. Any member of an affiliated group as defined in W. Va. Code §11-13EE-1 *et seq.*, will be deemed an affiliated person affiliated with every other member of the same affiliated group.

3.5. "Assessment date" means the July 1 date preceding the start of the property tax year as defined in W. Va. Code §11-3-1, *et seq.*

~~3.1.~~ 3.6. "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, as specified in the annual variables filed pursuant to section heading 10 of this rule.

3.7. "Barrel" or "BBL" means a unit of measurement of volume equal to 42 US gallons.

~~3.2.~~3.8. "Barren ~~oil and natural gas~~ property" means those acres, tracts, and parcels owned in fee ~~and mineral parcels~~ in West Virginia where data suggests with reasonable certainty that the presence of oil, natural gas liquids, ~~and~~ or natural gas is very unlikely.

~~3.3.~~3.9. "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).~~rate used to convert an estimate of income to an estimate of market value. Subsection 4.5 of this rule further explains this term.~~

3.10. "Coalbed methane" means methane gas, and other well output which can be produced from a coal seam, the rock or other strata in communication with a coal seam, a mined-out area, or a gob well.

~~3.4.~~3.11. "Commissioner" or "Tax Commissioner" means the Tax Commissioner of the State of West Virginia, or his or her delegate.

3.12. "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.

3.13. "Compression costs" are the actual costs in the process of raising the pressure of minerals.

3.14. "Condensate" means liquid hydrocarbons (normally exceeding 40 degrees of API gravity) recovered at the surface without processing. For purposes of this rule, condensate, along with certain other components of well output, constitutes a natural gas liquid.

3.15. "Deeded acre" means an acre of land one owner transferred, or deeded, to a new owner.

~~3.5.~~3.16. "Discount component" means an element in the determination of 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.

3.17. "Economic interest" in oil, natural gas liquids or natural gas means that the person has acquired by investment any interest in oil, natural gas liquids or natural gas in place and secures, by any form of legal relationship, current, future, or potential income derived from the extraction of the oil, natural gas liquids or natural gas, to which the person must look for a return of the person's capital.

3.18. "Farm-use well" means a gas well that produces gas solely for the use of the farmer who owns the land where the gas is in place. Ownership of the gas by the farmer is not required to qualify as a farm-use well. The gas produced may not be sold, traded, or bartered.

~~3.6.~~3.19. "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~~ dependent on the production or income derived from the well.

~~3.7.~~3.20. "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.

3.21. "Gathering costs" means the actual costs of transportation of oil, natural gas, natural gas liquids, condensate, or any combination thereof from multiple wells by separate and individual pipelines to a central point of accumulation, dehydration, compression, separation, heating and treating or storage.

~~3.8. "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~~

3.22. "Fractionation costs" means the actual costs incurred by the producer in fractionation. Fractionation is the separating of components of a mixture through differences in physical or chemical properties. Fractionation is the process by which raw hydrocarbons are separated into products.

3.23. "Gross receipts" or "gross proceeds" means the total income received for the production on any well, without reduction for any royalties, costs, allowances, expenses, or adjustments of any kind, determined at the point of a metered or measured first sale to an unrelated third party. "Gross receipts" or "gross proceeds" includes total monies and other consideration paid, payable or accruing to a producer for the disposition of the oil, natural gas liquids, natural gas, residue gas, well output, or gas plant products, or any combination thereof, produced. "Gross receipts" or "gross proceeds" also includes, but is not limited to, payments and accruals to the operator for certain services such as metering, dehydration, liquids separation, measurement, and gathering, or any combination thereof. Monies and other consideration, to which an operator is contractually or legally entitled, but which the operator does not seek to collect through reasonable efforts, are also part of "gross receipts" or "gross proceeds." For purposes of this definition, the total amounts paid, payable, or accruing shall be determined under the method of accounting used for federal income tax purposes.

3.24. "Horizontal well" or "directional well" – For purposes of this rule, and notwithstanding the definitions set forth in W. Va. Code §22-6A-4 and §22-6B-2, the term "horizontal well" or "directional well" means a well, the wellbore of which is initially drilled on a vertical or directional plane and which is curved to become horizontal or nearly horizontal, in order to parallel a particular geological formation and which may include multiple horizontal or stacked laterals.

3.25. "Home-use well" means a gas well that produces gas solely for the use of the homeowner who occupies the land where the gas in place. Ownership of the gas by the homeowner is not required to qualify as a home-use well. The gas produced may not be sold, traded, or bartered.

3.26. "Lease" means the area encompassed in the leasehold granting the right to explore for or produce oil or natural gas, which may include a single tract or multiple tracts of land described in the instrument granting the leasehold;

3.27. "Lease operating expenses" means the actual costs incurred to bring the subsurface minerals (oil, natural gas, and natural gas liquids) up to the surface and convert them to marketable products. Lease operating expenses refers to the costs of operating the wells and equipment. "Lease operating expenses" includes actual costs of labor, fuel, utilities, materials, rent or supplies, which are directly related to the production, processing, or transportation of oil, natural gas, natural gas liquids, or any combination thereof and that can be documented by the producer. For the purposes of this calculation, depreciation, depletion, extraordinary expenses, ad valorem taxes, capital expenditures, intangible drilling costs, expenditures relating to vehicles or other tangible personal property not permanently used in the production of oil, natural gas, natural gas liquids, or any combination thereof shall not be included as lease operating expenses.

3.28. "Lifting costs" means the actual costs incurred to operate a well during production.

3.29. "Marginal well" means a well that, in the calendar year immediately preceding the July 1 assessment date, has an average daily production of two (2) barrels of oil or less, and an average daily production of ten (10) MCF of natural gas or less.

~~3.9. "Management rate" means a rate reflecting a return to an investor for the management of similar investment portfolios.~~

3.30. "Marketing affiliate" means an affiliate of the lessee whose function is to acquire only the lessee's production and to market that production.

3.31. "M.C.F." or "MCF" when used with respect to natural gas, means 1,000 cubic feet of natural gas measured at a pressure of 14.73 pounds per square inch (absolute) and a temperature of 60 degrees Fahrenheit.

3.32. "Natural gas" means natural gas, coalbed methane, synthetic gas useable for fuel, or mixtures of natural gas and synthetic gas. For purposes of the valuation of natural gas producing property under this rule, references to "natural gas" includes natural gas liquids and liquefied natural gas when those products have not been processed from the natural gas.

3.33. "Natural gas liquids" means propane, ethane, butanes, and pentanes (also referred to as condensate), or a combination of them that are subject to recovery from raw gas liquids by processing in field separators, scrubbers, gas processing and reprocessing plants, or cycling plants.

~~3.10.~~ 3.34. "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 horizonal 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) acres per vertical well, or the communitized acres per horizontal well, shall be valued at the non-producing rate per acre referenced in section 4 of this rule.

3.35 "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.

~~3.11. "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.~~3.36. "Non-Producing or Shut-in Well" means a well, which due to the producer's decisions, market reasons ~~and/or~~ , or product performance, or any other reason or combination of reasons, was non-productive during the entire most recent calendar year preceding the July 1 assessment date.

3.37. "Non-producing property" means properties that were not engaged in production of well output, as herein defined, during the calendar year next preceding the July 1 assessment date. This category includes any acreage that has been shut-in for the entire year.

3.38. "Oil" means natural crude oil or petroleum, and other hydrocarbons, regardless of gravity, which are produced at the well in liquid form by ordinary production methods and which are not the result of condensation of gas after it leaves the underground reservoir.

3~~.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.~~

~~3.14. "Oil and/or natural gas plugged and abandoned property" means plugged and abandoned oil and/or natural gas wells.~~

~~3.15.~~3.39. "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.

~~3.16. "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.~~

~~3.17.~~3.40. "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~~ or natural gas estate and who is not required to bear a share of the development or operating costs of the well.

~~3.18.~~3.41. "Personal property" used in oil or natural gas production means machinery and equipment ~~in and about the well and all other tangible personal property~~ on the lease or communitized area used in oil production ~~and/or~~ or natural gas production from the well to the point of sale. It shall not include vehicles or other tangible personal property not permanently used in production, nor shall it include third party equipment used to enhance or remarket the gas after the oil or natural gas has left the lease or communitized area.

3.42. "Plant gas products" means separate marketable elements, compounds, or mixtures, whether in liquid, gaseous, or solid form, resulting from processing natural gas, excluding residual gas.

3.43. "Plugged and abandoned well property" means plugged and abandoned wells that produced or were intended to produce well output, as herein defined, without regard to whether the well historically produced well output or was a so-called "dry hole" that failed to produce well output.

3.44. "Processing costs" means the actual costs incurred by the producer for activities occurring beyond the inlet to an oil, natural gas, or natural gas liquids processing facility that changes the physical or chemical characteristics, enhances the marketability, or enhances the value of the separate components. Processing costs are limited to the costs for the following activities: fractionation, adsorption, flashing, refrigeration, cryogenics, sweetening, dehydration within a processing facility, beneficiation, stabilizing, compression, and separation which occurs within a processing facility.

3.45. "Processing, separation and fractionation costs" means de-ethnization fees, processing or fractionation fees, pipeline or transportation fees, fuel fees, and electric fees charged by a processing or fractionation plant to the producer.

~~3.19.~~ 3.46. ~~"Producer/operator"~~ "Producer" or "Operator" means any person or persons, corporation, partnership, joint venture or other enterprise or entity ~~which~~ that proposes to or does locate, drill, produce, manage, or abandon any well. "Producer" or "Operator" includes, but is not limited to, lessees, as herein defined, and any person or persons, corporations, partnership, joint venture or other enterprise or entity that owns the economic interest in the natural resource produced, as the term economic interest is defined in §110-13A-1, et seq., Code of State Rules.

~~3.20. "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.~~

3.47. "Property owner" means the person or persons who own the natural gas or oil in place, except where a different meaning is required by the context in which "property owner" is used in this article.

3.48. "Raw gas" or "raw natural gas" means natural gas as it is produced from the underground reservoir.

3.49. "Raw gas liquids" or "raw make" is a combined stream of propone, butane and pentanes, plus any other liquid hydrocarbon, or any mixtures thereof, which are separated from residue gas and processed at a processing or fractionation plant into plant gas products.

~~3.21. "Recapture component" means a rate reflecting a provision for returning to an investor a sum of money equal to his or her investment.~~

3.50. "Residue gas" means the hydrocarbon gas, consisting principally of methane, resulting from processing gas.

~~3.22.~~3.51. "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~~ or interest, or both.

~~3.23.~~3.52. "Royalty interest" means the fractional interest in oil production ~~and/or~~ or natural gas production, or both, that ~~is not~~ 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 oil ~~and/or~~ or natural gas rights owner or lessor or the oil or natural gas, or both.

~~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. "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.~~

~~3.26.~~3.53. "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 used 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%.~~

~~3.28. "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~~.

3.54. "Total Production" means the total amount of well output. It includes the total amount of oil, measured in barrels, total amount of natural gas liquids, measured in MCF, and the total amount of natural gas, measured in MCF, of all oil, natural gas liquids and, natural gas actually produced and sold from a single well that is developed and producing on the assessment date. For commonly metered wells, "total production" means the total amount of oil, the total amount of natural gas, and the total amount of natural gas liquids, of all oil, natural gas liquids, and natural gas actually produced and sold from the commonly metered wells divided by the number of the commonly metered wells.

3.55. "Transportation costs" means the actual costs of moving oil, natural gas, natural gas liquids, unprocessed gas, residue gas, or gas plant products or any combination thereof to a point of sale.

3.56. "Vertical well" means any well producing either gas or oil, or both gas and oil, that is not a horizontal well as defined in this rule.

~~3.29.~~3.57. "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.

3.58. "Well output" means oil, natural gas liquids, natural gas, condensate, raw gas, raw natural gas liquids, plant gas products, residue gas, or any other natural resource produced from a well or any combination thereof.

~~3.30.~~3.59. "Working interest" means the fractional interest in oil production ~~and/or~~ or natural gas production, or both, subject to development and operating expenses and owned by the leaseholder ~~and/ or~~ or operator, or both.

§110-1J-4. Methods of Valuation.

4.1. *General.* -- ~~Oil and/or natural gas producing property value~~The value of oil producing property or natural gas producing property, or property producing both, shall be determined through the process of applying a yield capitalization model to the net receipts (gross receipts less royalties paid ~~less operating expenses~~ 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. Each term in this valuation is discussed below.

4.2. *Method for valuing oil producing property.* -- Except as otherwise provided in this section, the appraised value of a producing oil well, including personal property at the well necessary to recover the oil, shall be determined as follows:

4.2.1. For producing oil wells, the appraised value shall be determined as in section heading 5 of this rule.

4.2.2. *Safe harbor.* – The Tax Commissioner may annually determine a safe harbor amount for operating costs to be published in the State Register. For those operators choosing to use the safe harbor amount rather than calculate their actual annual operating costs, that safe harbor amount will be considered the costs associated with the production of the oil, typical of the producing area and strata.

4.2.3. For the purposes of valuing oil wells, the appraised value is to include the net proceeds from the sale of oil and the net proceeds from the disposition of any condensate recovered after the decline rate and capitalization rate has been applied to each product.

4.3. *Method for valuing natural gas producing property.* – Except as otherwise provided in this section, the appraised value of a producing gas well on assessment dates beginning on and after the effective date of this rule, including personal property on the lease or communitized area necessary to recover the gas, shall be determined under this section.

4.3.1. For producing natural gas wells, the appraised value shall be determined as in section heading 5 of this rule.

4.3.2. *Safe Harbor.* -- The Tax Commissioner may annually determine a safe harbor amount for operating costs to be published in the State Register. For those operators choosing to use the safe harbor amount rather than calculate their actual annual operating costs, that safe harbor amount will be considered the costs associated with the production of the natural gas and natural gas liquids, typical of the producing area and strata.

4.3.3. For the purposes of valuing natural gas wells, if the natural gas is sold after processing or fractionation or if the producer receives proceeds from the sale of processed natural gas liquids based upon its sales contract, the appraised value is to include the combined net proceeds from the disposition of the plant gas products and the gross proceeds from disposition of the residue gas after the decline rate and capitalization rate has been applied to each product. If the natural gas is sold prior to processing, then the appraised value is to include the net proceeds from the disposition of the raw gas after the decline rate and capitalization rate has been applied.

~~4.2.~~4.4. Percentage interest in oil ~~and/or~~, natural gas liquids, or natural gas, or a combination thereof. -- Where the ownership of oil ~~and/or~~, natural gas liquids, or natural gas in place is divided through a lease or other arrangement, leases typically contain a royalty clause, designating the compensation to the ~~owner of the~~ property owner, typically measured as a percentage or portion of the gross value of production without deduction of costs of production.

4.4.1. For example: Where the ownership of oil or natural gas in place, or both, is divided through a lease or other arrangement, the compensation to the property owner is typically 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. Royalty clauses may have any number of different measures for calculation of royalties.

4.4.2. 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 ~~or 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 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 Constant Maturity Treasury Yields for a period of 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 Constant Maturity Treasury Yields for the same 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 Constant Maturity Treasury Yields with similar time differentials in excess of thirteen (13) week United States 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 Constant Maturity Treasury Yields minus the rate on 13-week United States Constant Maturity Treasury Yields; The rate used 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 used 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 used 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.~~4.5. Valuation of home-use only wells. -- The appraised value of home-use wells ~~used for home-use only will be an annual appraised value of $500.00 resulting in an assessed value of $300.00~~ will be an annual appraised value determined from information published by the U.S. Department of Energy, Energy Information Administration. 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. This value of home use gas wells will be included in the tentative natural resource variables published in the State Register on or before July 1 each year. If the well also produces oil, that portion of the well will be separately valued.

~~4.6.4.~~4.6. Valuation of industrial use wells. -- The appraised value of wells used 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 farm-use gas wells.* -- The appraised value of a gas well, when the gas produced by the well is used only for farm purposes, such as heating the barn and farmhouse, will be an annual appraised value determined from information published by the U.S. Department of Energy, Energy Information Administration. If the farm-use well owner has ownership in the mineral rights, the assessed value will be added to the real property assessment. However, if the farm-use well owner only has rights in the surface, the assessed value will be added to the personal property assessment. This value shall be included in the tentative natural resource variables published in the State Register on or before July 1 each year. If the well also produces oil, that portion of the well will be separately valued.

~~4.7.~~ 4.8. *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~~ 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/production~~ activity or production have not been established and the property is presumed to be barren.

~~4.8.~~ 4.9. *Valuation of plugged ~~and abandoned~~ acreage.* -- ~~Plugged and abandoned acreage~~ The appraised value of plugged well property 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 ~~up to forty (40) acres per oil well.~~, and the communitized acres per horizontal gas well. In the case of a plugged oil well, this section shall apply to up to forty (40) acres per vertical oil well and the communitized acreage per horizontal oil well. Any additional acreage will be valued as reserve acreage.

4.10. *Valuation of abandoned well property acreage.* -- The appraised value of abandoned well acreage shall revert to the value of reserve oil and gas acreage in the county provided there is no other producing or plugged well on the property.

~~4.9.~~ 4.11. *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.~~ The appraised value of oil or natural gas interests in barren oil and natural gas property shall be one dollar ($1.00) per deeded acre. When two or more persons own the acreage, this appraised value shall be allocated among the owners based upon the percentage of their ownership of the acreage.

~~4.10.~~ 4.12. *Valuation of wells that produce both oil and natural gas.* -- ~~The valuation of~~ The appraised value of wells that produce both oil and natural gas shall be determined by use of the methods described in this rule. These values shall then be summed to result in the overall value of the oil ~~and/or~~ or natural gas producing acreage or acreage producing both oil and natural gas.

~~4.11.~~ 4.13. *Valuation of storage well areas.* – The valuation of 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. The minimum value applied to the 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.~~ 4.14. *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. For purposes of this subsection, "farm fee estate" means absolute ownership of the farmland unencumbered by any other interest or estate.

~~4.14. Property reports. -- On or before August 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. 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.~~ 4.15. *Valuation of the Producer's Personal Property at Non-Producing or Shut-In wells.* -- ~~The valuation~~ The appraised value of the producer's personal property that is part of a non-producing or shut-in well's appraisal will be assigned to the producer at the same appraised value applied to machinery and equipment at home use only wells.

4.16. *Valuation of the producer's personal property at non-producing or shut-in wells.* -- The appraised value of the producer's personal property that is part of a non-producing or shut-in well's appraisal will be assigned to the producer at the same appraised value applied to machinery and equipment at home-use wells.

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

~~4.18.~~ 4.18. *Valuation of Producing Flat-Rate Royalty accounts*----The appraised value of a producing flat-rate royalty will be valued using ~~a level terminal income series rather than the declining terminal income series as discussed in Subsection 4.6 of this rule~~ a discounted cash flow series of the flat rate. It will not include production decline rates.

4.19. Valuation of tangible personal property not used in the production of gas or oil, or both gas and oil, in and about the well shall be valued by the county assessor, except that pipelines of public service businesses that are operating property shall be valued by the Board of Public Works as provided in W. Va. Code §11-6-1 *et seq*.

§110-1J-5. Yield Capitalization Model.

5.1 *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) based upon the total production amounts from the most recent production year preceding the July 1 assessment date. This total gross proceeds amount will be apportioned to the working interest model and royalty interest model.

5.2. The total amount determined under section 5.1 shall be apportioned to the working interest and to the royalty interest:

5.2.1. *Working interest model.* -- In order to determine the working interest gross receipts income series, the total gross receipts referenced in section 5.1 of this section heading shall be reduced by the actual annual operating expenses as set forth in 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 decline rate and a mid-year life Inwood factor reflecting the capitalization rate referenced in section 5.4 of this section heading. The total of the annual discounted income stream shall be the market value estimate for the working interest of the producing oil or natural gas wells, including personal property. The minimum appraised value for any producing well will not be less than the machinery and equipment value. This minimum rate will not apply to home-use only wells or farm-use wells.

5.2.2. *Royalty interest model.* – In order to determine the royalty interest gross receipts income series, the total gross receipts referenced in section 5.1 of this section heading shall be discounted by applying, on an annual basis, a decline rate and a mid-year life Inwood factor reflecting the capitalization rate referenced in section 5.4 of this section heading. 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 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.

5.3. *Decline Rate.* -- The net working interest gross receipts and the net royalty interest gross receipts will be multiplied by the applicable decline rates. The amounts determined under section 5.2 of this section heading will be adjusted by an appropriate production decline rate of 18 months that is derived and applied based upon the age of the well and typical of the producing area and strata. Gross receipts and production amounts shall then be proportionately reduced by application of the appropriate annual rate to yield a declining terminal income series typical of the producing area and strata. 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. This net amount is then multiplied by the applicable capitalization rate. Nothing shall prohibit a taxpayer from supplying information concerning additional actual gross receipts and actual operating expense information that may be supplemented or used in lieu of the annualization calculations.

5.4. *Capitalization Rate*. -- A single state-wide capitalization rate for oil, natural gas, and natural gas liquids shall be determined annually. The declining terminal series for the working interest and royalty interest, for each well, as set forth in section 5.3 of this section heading will be multiplied by the capitalization rate in order to determine the value of the well for property tax purposes.

5.4.1. Oil and gas reserves that are actively being produced represent depleting assets. The valuation of the reserves must take the rate of depletion into account by calculating the present worth of the likely future income related to the ongoing production. The present worth of the future income stream is calculated by discounting the annual amounts of production income estimated. The Tax Department will use an annual calculation to be applied when valuing natural gas and oil producing properties based on a "Build-up-Model" of the Weighted Average Cost of Capital (WACC). The WACC provides an estimate of the overall expected rate of return required by industry equity participants and financial investors to continue to invest in the relevant ongoing industry, and in comparison to other investment options. The rate is converted to a table of annual multipliers known as the Inwood Table.

5.4.2. On an annual basis, the Tax Commissioner will use published information as described below to determine the proportion of equity and debt generally used by the industry to support its ongoing exploration, development, and production activities. The WACC is developed annually by the Tax Commissioner using the following factors:

5.4.2.a. Equity Portion:

5.4.2.a.1. Risk Free Rate: Also known as the "safe rate" represents the rate of return on a low-risk investment. Examples of investments with safe rates include U.S. Treasury securities and investment grade bonds.

5.4.2.a.2. Equity Risk Premium: This factor represents the historical premium over the risk-free rate commanded by market participants to invest in the overall or broad portfolio of marketable securities. This premium is added to the risk-free rate.

5.4.2.a.3. Industry Risk Adjustment: This adjustment is related to the difference between the expectations of one specific industry to those of the overall market. It is typically measured as "beta." It is a measure of the risk inherent in an investment that cannot be diversified away in a portfolio. The beta coefficient is mathematically converted to a rate premium and added to the risk-free rate.

5.4.2.a.4. Size Premium: This premium is based on research which shows that, generally, there is a relationship between the size of a company or an industry and the expected returns on investment. Smaller companies and industries, especially less established ones, generally command higher rates of returns. This risk is added to the risk-free rate.

5.4.2.a.5. Real Estate Tax and Management Component: This factor represents the average cost to maintain the investment as real estate. It is based on an annual survey of costs as a percentage of net income. The factor is added to the above risk components.

5.4.2.b. Debt Portion:

5.4.2.b.1. Borrowing Rate: Based on surveys of published bank and bond rates applicable to the industry.

5.4.2.b.2. Income Tax Rate: Based on surveys of published effective tax rates applicable to the industry. This rate is used to modify the debt rate.

§110-1J-6. Gross proceeds.

6.1. Gross proceeds shall be determined at the point of ultimate sale of the well output, or any part thereof, by the producer of that product. The transaction price and volumes used to determine the gross proceeds must be in connection with a bona fide arm's-length sale.

6.1.2. Where the lessee's arm's-length contract for the sale of natural gas prior to processing provides for the sales price to be determined based upon a percentage of the purchaser's gross proceeds resulting from sales after processing the gas, the gross proceeds, for purposes of this section, shall never be less than a value equivalent to 100 percent of the sales price of the residue gas attributable to the processing of the lessee's raw gas plus the gross proceeds from sales of the natural gas liquids.

6.1.3. For purposes of this section, well output which is sold or otherwise transferred to the lessee's marketing affiliate and then sold by the marketing affiliate pursuant to an arm's-length contract shall be valued based upon the gross proceeds derived from the sale by the marketing affiliate.

6.1.4. If a purchaser, or any other person, is providing certain services, the cost of which ordinarily is the responsibility of the lessee to place the residue gas or gas plant products in marketable condition or to market the residue gas and gas plant products, then those costs are included in the gross proceeds.

6.2. The lessee has the burden of demonstrating that its contract is arm's-length. The gross proceeds that the lessee reports under this section is subject to monitoring, review, and audit.

6.2.1. The producer shall retain all data relevant to the determination of gross value. Such data shall be subject to review and audit by the Tax Commissioner.

6.2.2. In conducting reviews and audits, the Tax Commissioner may examine whether the contract reflects the total consideration actually transferred either directly or indirectly from the buyer to the seller for the well output. If the contract does not reflect the total consideration, then the Tax Commissioner may require that the well output sold pursuant to that contract be valued in accordance with section 6.3 of this section heading. Gross proceeds may not be less than the gross proceeds accruing to the lessee, including any additional consideration.

6.3. If the gross proceeds claimed by the producer are not received pursuant to an arm's-length contract, then the Tax Commissioner shall adjust the amount of the gross proceeds in accordance with the following methods:

6.3.1. The Tax Commissioner will permit those gross proceeds that are equivalent to the gross proceeds derived from, or paid under, comparable arm's-length contracts for purchases, sales, or other dispositions of like-quality well output in the same field (or, if necessary to obtain a representative sample, from the same area). In evaluating the comparability of arm's-length contracts for the purposes of these regulations, the following factors shall be considered: Price, time of execution, duration, market, or markets served, terms, quality of gas, volume, and such other factors as may be appropriate to reflect the value of the well output; or

6.3.2. The Tax Commissioner will adjust the gross proceeds with consideration of other information relevant in valuing like-quality well output, including gross proceeds under arm's-length contracts for like-quality well output in the same field or nearby fields or areas, posted prices for the well output, prices received in arm's-length spot sales of the well output, other reliable public sources of price or market information, and other information as to the particular lease operation or the salability of the well output.

§110-1J-7. Actual Annual Operating Costs.

7.1. For the working interest, the Tax Commissioner shall allow a deduction against the gross proceeds determined under this rule for the actual annual operating costs. Actual annual operating costs are those costs or fees incurred by the producer from the well to the point of an arms-length sale.

7.1.1. For costs incurred by a producer under an arm's-length contract, the annual actual operating costs shall be the actual costs incurred by the producer, under that contract, except as provided in subsection 7.2.2. of this section, subject to monitoring, review, and audit by the Tax Commissioner. The lessee shall have the burden of demonstrating that its contract is arm's-length.

7.1.2. If a lessee has a non-arm's-length transportation, processing, or fractionation contract, or the actual annual operating costs claimed by the producer, including those situations where the lessee performs the services for itself, then annual actual operating costs shall be adjusted by the Tax Commissioner to bring the costs in line with industry average.

7.2. Transportation costs must be allocated among all products produced and transported.

7.2.1. The deduction for transportation costs shall be determined on the basis of the lessee's cost of transporting each product through each individual transportation system. Where more than one product in a gaseous phase is transported, the allocation of costs to each of the products transported shall be made in a consistent and equitable manner in the same proportion as the ratio of the volume of each product (excluding waste products which have no value) to the volume of all products in the gaseous phase (excluding waste products which have no value).

7.2.2. Processing costs must be allocated among the gas plant products. A separate processing allowance must be determined for each gas plant product and processing plant relationship. Natural gas liquids shall be considered as one product for the purposes of allocation.

7.2.3. The costs of processing the NGLs after the residue gas has been removed cannot be applied against the value of the residue gas.

7.2.4. The lessee shall propose a cost allocation procedure to the Tax Commissioner. The lessee shall submit all relevant data to support its proposal. The Tax Commissioner shall then determine the transportation allowance based upon the lessee's proposal and any additional information the Tax Commissioner deems necessary.

7.3. *Allowable costs in determining actual annual operating costs.* -- Actual annual operating costs are limited to the following:

7.3.1. Lifting costs. Lifting costs are the actual costs incurred to operate a well during production.

7.3.2. Lease operating expenses. Lease operating expenses are the actual costs incurred to bring the subsurface minerals (oil, natural gas liquids, and natural gas) up to the surface and convert them to marketable products while on the lease or communitized area. Lease operating expenses refers to the costs of operating the wells and equipment on a producing lease. Items specifically listed as non-allowable costs in this Rule shall not be included in lease operating expenses.

7.3.2.a. Allowable lease operating expenses include the actual costs of labor, fuel, utilities, materials, rent, or supplies, which are directly related to the production, processing, or transportation of natural gas or oil, and that can be documented by the producer.

7.3.2.b. For the purposes of this calculation, depreciation, depletion, extraordinary expenses, ad valorem taxes, capital expenditures, intangible drilling costs, expenditures relating to vehicles or other tangible personal property not permanently used in the production of natural gas or oil shall not be included as lease operating expenses.

7.3.3. Transportation costs. Transportation costs are the actual costs of moving unprocessed gas, residue gas, or gas plant products to a point of sale. These costs are limited to the following:

7.3.3.a. *Firm demand charges paid to pipelines.* -- Lessees may deduct, as a component of the transportation allowance, firm demand charges or capacity reservation fees paid to a pipeline, including charges or fees for unused firm capacity that the lessee has not sold. If a lessee receives a payment from any party for release or sale of firm capacity or capacity reservation after reporting a transportation allowance that included the cost of that unused firm capacity, or reservation, or if a lessee receives a payment or credit from the pipeline for penalty refunds, rate case refunds, or other reasons, the lessee must reduce the allowance reported by the amount of the payment, credit or reduction of charges or fees claimed.

7.3.3.b. *Gas supply realignment (GSR) costs.* -- The GSR costs result from a pipeline reforming or terminating supply contracts with producers to implement the restructuring requirements of FERC Orders in 18 CFR part 284;

7.3.3.c. *Commodity charges.* -- The commodity charge allows the pipeline to recover the costs of providing service;

7.3.3.d. *Wheeling costs.* -- Hub operators charge a wheeling cost for transporting gas from one pipeline to either the same or another pipeline through a market center or hub. A hub is a connected manifold of pipelines through which a series of incoming pipelines are interconnected to a series of outgoing pipelines;

7.3.3.e. *Gas Research Institute (GRI) fees.* -- The GRI conducts research, development, and commercialization programs on natural gas related topics for the benefit of the U.S. gas industry and gas customers. GRI fees are allowable, provided such fees are mandatory in FERC approved tariffs;

7.3.3.f. *Temporary storage services.* -- This includes short duration storage services offered by market centers or hubs (commonly referred to as "parking" or "banking"), or other temporary storage services provided by pipeline transporters, whether actual or provided as a matter of accounting. Temporary storage is limited to 30 (thirty) days or less; and

7.3.3.g. *Costs for compression, dehydration, and treatment of gas.* -- The Tax Commissioner allows these costs only if such services are required for transportation or are necessary to place production into marketable condition.

7.3.3.g.1. "Gathering costs" are the actual costs of transportation of oil, condensate, or natural gas from multiple wells by separate and individual pipelines to a central point of accumulation, dehydration, compression, separation, heating and treating or storage.

7.3.3.g.2. "Compression costs" are the actual costs the process of raising the pressure of gas.

7.3.4. *Processing, Separation and Fractionation costs* -- The actual costs of processing, separation or fractionation may be included in the actual annual operating costs. These costs may include de-ethnization fees, processing or fractionation fees, pipeline or transportation fees, fuel fees, and electric fees charged by a processing or fractionation plant to the producer.

7.3.4.a. "Fractionation costs" means the actual costs incurred by the producer in the fractionation. Fractionation is the separating of components of a mixture through differences in physical or chemical properties. For the purposes of this rule, fractionation is the process by which raw make is separated into gas plant products.

7.3.4.b. "Processing costs" means the actual costs incurred by the producer for activities occurring beyond the inlet to a natural gas processing facility that changes the raw gas's physical or chemical characteristics, enhances the marketability of the raw gas, or enhances the value of the separate components of the raw gas. Processing costs are limited to the costs for the following activities: fractionation, adsorption, flashing, refrigeration, cryogenics, sweetening, dehydration within a processing facility, beneficiation, stabilizing, compression, and separation which occurs within a processing facility.

7.3.5. Producers may not use any cost as a deduction that duplicates all or part of any other cost that the lessee uses under this section heading 7.

7.4. *Nonallowable costs.* -- The costs that a producer may not include in their actual annual operating costs include, but are not limited to, the following:

7.4.1. *Overhead and administrative costs.* – These costs are not allowed, whether or not those costs are directly or indirectly attributable and allocable to the operation and maintenance of the transportation system.

7.4.2. *Taxes and Fees.* -- State and Federal taxes, income taxes, severance taxes, and other fees, including royalties.

7.4.3. *Costs of surety.* -- Costs of surety are the costs of securing a letter of credit, or other surety, that the pipeline requires the producer to maintain.

7.4.4. *Fees or costs incurred for storage.* -- This includes storing production in a storage facility, whether on or off the lease, for more than 30 (thirty) days;

7.4.5. *Aggregator or marketer fees.* -- This includes fees paid to another person (including payment to affiliates) to market oil or gas, including purchasing and reselling the oil or gas, or finding or maintaining a market for the well's production;

7.4.6. *Penalties incurred as shipper.* -- These penalties include, but are not limited to:

7.4.6.a. *Over-delivery cash-out penalties.* -- This includes the difference between the price the pipeline pays for over-delivered volumes outside the tolerances and the price received for over-delivered volumes within the tolerances;

7.4.6.b. *Scheduling penalties.* -- This includes penalties incurred for differences between daily volumes delivered into the pipeline and volumes scheduled or nominated at a receipt or delivery point;

7.4.6.c. *Imbalance penalties.* -- This includes penalties incurred (generally on a monthly basis) for differences between volumes delivered into the pipeline and volumes scheduled or nominated at a receipt or delivery point; and

7.4.6.d. *Operational penalties.* -- This includes fees incurred for violation of the pipeline's curtailment or operational orders issued to protect the operational integrity of the pipeline;

7.4.7. *Intra-hub transfer fees.* -- These are fees paid to hub operators for administrative services (e.g., title transfer tracking) necessary to account for the sale of gas within a hub;

7.4.8. *Fees paid to brokers.* -- This includes fees paid to parties who arrange marketing or transportation, if such fees are separately identified from aggregator or marketer fees;

7.4.9. *Fees paid to scheduling service providers.* -- This includes fees paid to parties who provide scheduling services, if such fees are separately identified from aggregator or marketer fees;

7.4.10. *Internal costs.* -- This includes salaries and related costs, rental costs, space costs, office equipment costs, legal fees, attorneys' fees and expenses, and other costs to schedule, nominate, and account for sale or movement of production; and

7.4.11. *Other costs.* -- Depreciation, depletion, extraordinary expenses, ad valorem taxes, capital expenditures, intangible drilling costs, expenditures relating to vehicles or other tangible personal property not permanently used in the production of natural gas or oil shall not be included as operating costs.

§110-1J-8. Default method of valuation.

8.1. When the producer does not file a complete return for a well on or before the August 1 due date of the return, as required by §11-6K-1 of the West Virginia Code, and section heading 9 of this rule, the Tax Commissioner shall use the average industry price of the producing area and strata, multiplied by the amount of production from the well reported to the West Virginia Department of Environmental Protection, to estimate the value of the well.

8.2. When the producer does not report the production of a well to the West Virginia Department of Environmental Protection, the Tax Commissioner shall estimate the appraised value of the well from information available to the Tax Commissioner.

§110-1J-9. Annual property returns.

9.1. On or before August 1 of each year, as required by §11-6K-1 of this Code, the producer shall file the West Virginia Oil and Gas Producer/Operator Return with the State Tax Commissioner, with acknowledgement to the county assessors in the counties where the oil and natural gas property is located. This Return form shall be designed by the State Tax Commissioner so that information pertinent to the valuation of the producing property, and the plugged and abandoned well property shall be reported properly by the producer of oil or gas or both.

9.1.1. Producers shall annually report on a form prescribed by the Tax Commissioner the following information, by well:

9.1.1.a. The identity of the well;

9.1.1.b. The number of MCFs of gas produced;

9.1.1.c. The number of barrels of oil produced;

9.1.1.d. The MCFs of NGLs, including breakdown of type;

9.1.1.e. The amount of gross revenue received;

9.1.1.f. The amount of net revenue received; and

9.1.1.g. The amount of royalties paid.

9.1.2. Actual annual operating costs claimed must be supported by schedules and statements of cost by the producer and will be subject to review and audit, and possible assessment or refund as a result of such audit, by the Tax Department.

9.1.3. The producer must also produce any records or documents that the Commissioner may require proving or verifying the gross proceeds or actual annual operating costs claimed by the producer, including but not limited to:

9.1.3.a. Invoices and receipts;

9.1.3.b. The United States Department of Interior, Office of Natural Revenue Resources Revenue (ONRR) form ONRR-2014, or the proforma form ONRR-2014; and

9.1.3.c. Contracts and Agreements related to costs claimed or gross proceeds received;

9.2. When a producer or operator files annual property tax returns for twenty-five (25) or more wells, the returns and other documents required by this rule shall be filed electronically. A producer or operator that files less than twenty-five (25) annual property tax returns may file the returns electronically.

9.3. Format requirements for electronic filing. -- The requirements and formats for electronic filing are listed in instructions for electronic filing of the form. These formats are available on the State Tax Department's webpage.

§110-1J-10. Annual reports of variables.

10.1. The Tax Commissioner shall, on or before July 1 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 or natural gas related property. Public comments shall be accepted until August 1 of each year with the final results filed in the State Register on or before September 1 of each year.

10.2. The published variables shall include, but not be limited to, information about the components of the capitalization rates and the safe harbor rates.

§110-1J-11. Confidentiality.

11.1. 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 under §11-1A-23 and §11-1C-14 of this code. The information provided is exempt from disclosure under the provisions of §29B-1-4 of this code, and shall be kept, held, and maintained confidential except to the extent the information is needed by the 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.

11.2. Confidentiality of annual industry operating costs information.

11.2.1. Financial information and other data of oil and natural gas producers disclosed to the Tax Commissioner pursuant to reporting annual actual operating costs shall be considered confidential and exempt from disclosure under the provisions of §29B-1-1 et seq., of this code.

11.2.2. Any information disclosed to the Tax Commissioner pursuant to this rule shall have the confidentiality protections given to property tax return information under §11-1A-23 and §11-1C-14 of this code.