

Oil and Gas Drilling and New York's Real Property Tax

1. The *ad valorem* basis of the property tax
 - a. Definitions, court interpretations
 - (i) RPTL Section 305 – “uniform percentage of value”
 - (ii) “value” means “market value” (Foss v. City of Rochester, 1985)
 - (iii) “current use” of property relevant (New Country Club of Garden City v. Board of Assessors, 1991)
 - b. Separate assessments of oil/gas rights
 - (i) Allowable (see 4 Op. Counsel SBEA No. 77; 7 Op. Counsel SBEA No. 220)
 - (ii) Not advisable due to problems with enforcement of the tax (see ORPTS “Advice” memo)
2. The NYS Oil/Gas Program
 - a. Basic structure
 - (i) Enacted in 1981 as Sections 590-597 of the Real Property Tax Law
 - (ii) Set up as specialized part of property tax, with revenue going to local governments
 - (iii) Not a severance tax (23 of the other states have severance taxes)
 - (iv) “Unit of production values” set by state, based on production and other economic data submitted by producers and regional delineations set by DEC
 - (v) “Unit” includes the well, the underground oil/gas, and all rights of extraction, plus applicable equipment, but not the land value
 - (vi) Values determined from capitalizing an average future net income stream for the region in question
 - (vii) Assessment is determined as (unit of production value) x (production) x (applicable equalization rate)
3. The Marcellus Shale
 - a. No extraction has taken place yet; no permits have been issued by DEC
 - b. Timing of extraction and related economic considerations unknown at present
 - c. Environmental and other issues have been raised
 - d. Should production begin, DEC would likely designate a new region, which would have its own unit of production value
 - e. It is always possible that other/additional approaches, such as a state severance tax, could be taken, but this would require action by the State Legislature
 - f. As far as property assessments are concerned (at the present time) the statutes and case law already discussed should be kept in mind
 - g. Assessors should be aware of guidance issued by ORPTS legal staff concerning determination of land assessments

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OIL AND GAS

We have recently received questions concerning the treatment of short-term leases of the rights to search for and extract natural gas. The particular questions concern leases for five-year periods. These leases can be for as much as \$5,000 per acre, a price far in excess of what land similar to the leased land had sold for previously. The leases also contain a royalty payment if gas is extracted.

The first point for assessors to be aware of is that these leases are speculative. They are premised upon the use of horizontal drilling and high-volume hydraulic fracturing drilling in the Marcellus Shale. At present the Department of Environmental Conservation has not issued permits for this type of drilling.

While it is possible to separately assess oil and gas rights (4 Op.Counsel SBEA No. 77; 7 Op. Counsel SBEA No. 20), we strongly recommend against doing so in these situations. Separate assessment would require entry on an assessment roll of a lease of short duration. Should the lease appear as a parcel and taxes not be paid, the normal enforcement process would take place. Given the length of time involved in foreclosure, the foreclosing authority would necessarily be foreclosing against the remaining term of the lease, which could be quite short. There may be little value remaining at that point.

Separately assessing the lease would of course require the assessor to determine what the value of the lease is. A one-time payment for these rights does not establish the value of the lease itself. Similarly, it would be unsound appraisal practice to assume that this one-time payment establishes the value of the land subject to the lease in an open market transaction. It would be even more unsound to assume these payments establish the market value of other properties.

Assessors in the affected areas should closely monitor land sales to see if these leases are having any effect on sales prices. Even if an assessor determines that the possibility of extracting gas has come to permeate a market, as with any other factor the assessor would also have to consider whether this factor has any effect on the value of particular parcels.

Finally, we remind local officials that there is already a program in place to incorporate oil and gas production into the local property tax. Officials in the affected areas may wish to familiarize themselves with the oil and gas units of production program as described elsewhere on this website www.orps.state.ny.us/sas/oil_gas. These provisions are applicable when oil or gas is actually extracted.