

Dave Hardy
Secretary of Revenue



Dale W. Steager
State Tax Commissioner

STATE TAX DEPARTMENT

NOTICE OF WITHDRAW OF IMPORTANT NOTICE TO PRODUCERS OF NATURAL GAS AND OIL FOR PROPERTY TAX YEAR 2021

On or around June 30, 2020, the West Virginia State Tax Department published an *Important Notice to Producers of Natural Gas and Oil for Property Tax Year 2021* (hereinafter, the "2021 TY Notice"). The 2021 TY Notice purported to allow such producers to adjust the gross receipts reported in their upcoming ad valorem property tax returns to approximate the gross receipts the producers would have incurred if they sold oil and gas at the field line point of sale.

After further consideration, it is my determination that the 2021 TY Notice was issued without legal authority, was void, and is ineffective. It is also my determination that it must be withdrawn.

The 2021 TY Notice constitutes a material and substantive change of the application of the Tax Department's legislative rules. Notably, the Supreme Court of Appeals of West Virginia recently concluded that the "average annual industry operating expense" deduction available for oil and gas producers must be calculated using "a singular monetary average." Syl. Pt. 12, *Steager v. Consol Energy*, 242 W. Va. 209, 213, 832 S.E.2d 135, 137 (2019). It further found that the Tax Department excluded "gathering, compressing, processing, and transportation expenses" from the calculation of this singular monetary average, *id.* at 221, 832 S.E.2d at 147, and that this was "a reasonable construction of the" applicable "regulations." *Id.* at 223, 832 S.E.2d at 149.

The Tax Department's 2021 TY Notice materially changed the longstanding and reasonable construction *Consol Energy* affirmed by purporting to allow producers to reduce their gross receipt reporting as if their sales occurred at the field line. Application of the 2021 TY Notice would also substantively and materially affect private and public interests including those of the oil and gas producers, the counties, and the State as a whole.

While certain policy decisions are vested with the Tax Department, material changes to those policies must be implemented by rule-making or by statute. W. Va. Code § 29A-1-2(j), *id.* § 11-3-33 (2020). A rule" is defined by statute to include:

[E]very rule, standard or statement of policy or interpretation of general application and future effect, including the amendment or repeal of the rule, affecting constitutional, statutory or common law rights, privileges or interests, or the procedures available to the public, adopted by an agency

to implement, extend, apply, interpret or make specific the law enforced or administered by it.

Id. § 29A-1-2(j).

All rules must “be promulgated . . . only in accordance with” Article 3 of Chapter 29A of the Code, see *id.* § 29A-3-1, which requires appropriate notice in the State Register, *id.* § 29A-3-4(a), an opportunity for public comment, *id.* § 29A-3-5, and the written consent of the cabinet secretary under which an agency is incorporated. *Id.* § 5F-2-2(a)(13). Substantive changes—like those in the *2021 TY Notice*—must be implemented by legislative rule or by statute because only these have the “force of law.” *Appalachian Power Co. v. State Tax Dep’t of W. Va.*, 195 W. Va. 573, 583, 466 S.E.2d 424, 434 (1995). Both avenues demand a robust process designed to involve public input on material and substantive changes in policy. Additionally, both legislative rules and statutes require the approval of the Legislature and Governor before they become effective. W. Va. Const. art. VII, § 14; W. Va. Code §§ 29A-3-12, 29A-3-13.

The *2021 TY Notice* did not comply with these requirements. Neither legislative rule-making nor statutory procedures were utilized to issue the *2021 TY Notice*. Even the less-robust notice and comment requirements for other rules were not followed. The *2021 TY Notice* is, therefore, “void and ineffective.” *Coordinating Council for Indep. Living, Inc. v. Palmer*, 209 W. Va. 274, 284, 546 S.E.2d 454, 464 (2001). The *2021 TY Notice* was issued without legal authority; and therefore, it must be withdrawn.

Of course, the methodology for calculating oil and gas producers’ ad valorem property tax valuation is subject to the directives of the Legislature. The Tax Department’s longstanding interpretations of applicable regulations may be modified by either a proper legislative rule or by statute. But until such time, the average annual industry operating expense deduction available in West Virginia Code of State Rules §§ 110-1J-4.1 and 110-1J-4.3 (2005) must be calculated in accordance with precedent of the Supreme Court of Appeals of West Virginia. *Consol Energy*, 242 W. Va. at 223-24, 832 S.E.2d at 149-50. According to this precedent, post-production expenses—like “gathering, compressing, processing, and transportation” expenses—are not “directly related” to the “maintenance and production” of oil and gas and therefore, are not included in the average annual industry operating expense deduction. *Id.* at 223, 832 S.E.2d at 149. Inasmuch as *Consol Energy* affirmed the Tax Department’s refusal to allow deductions for post-production expenses, the continued denial of these deductions does not over-value the oil and gas wells in this State.

The *Important Notice to Producers of Natural Gas and Oil for Property Tax Year 2021* issued on or around June 30, 2020, is hereby withdrawn as non-compliant with mandatory rule-making or statutory procedures. It is therefore, void and has no legal effect.

As a result, when determining the value of an oil and gas well for the 2021 Tax Year, the Tax Department will review both the information submitted on the *STC-1235 West Virginia Oil and Gas Producer/Operator Return* for the 2021 Tax Year along with

other sources of data available to the agency. This will include a review of the best information available to determine whether a taxpayer took an impermissible deduction from gross proceeds outside of that allowed for the "average annual industry operating expense." To that end, the Tax Department will also accept any additional information provided by a producer to determine the actual appraised value of a given oil and gas well.

Sincerely yours,



Dale W. Steager
State Tax Commissioner
October 9, 2020