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F I S C A L   I M P A C T   R E P O R T

SPONSOR Chandler/Herrera/J. Sanchez **ORIGINAL DATE** 2/21/19 **LAST UPDATED** 3/4/19 **HB** 590

SHORT TITLE Oil and Gas Property Tax Valuations **SB**

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21	FY22	FY23		
	Potentially significant and positive for local property tax beneficiaries in the OGAS counties, since any increase in value would be considered "net new value" and not be reduced by yield control.				Recurring	County, Municipality, School District, Special District revenues
	Because of rate setting procedures would possibly reduce burden on residential and non-residential taxpayers and increase capacity.				Recurring	State and local GO bonds and GO bond capacity.
	Potential shift of tax burden from residential and non-residential taxpayers to OGAS operators.				Recurring	

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		Would require additional effort for assessors in OGAS counties; after an initial effort, continuing effort would also be required			Recurring	Assessors in OGAS counties operating or 1 percent revaluation funds

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals and Natural Resources (EMNRD)
State Land Office (SLO)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 590 adjusts the valuation responsibility assigned to (PTD) the Central Assessment Bureau of TRD's Property Tax Division in favor of allowing local assessors more authority and responsibility. The nature of this reassignment is that TRD/PTD would value any property regulated by the federal energy regulatory commission (FERC). TRD/PTD would continue to use the special method of valuation at Section 7-36-27 NMSA 1978, but the bright line of this assignment would be restricted to the listed property in the method only if the tangible property is regulated by FERC. The reports required of the OGAS operating companies by FERC would then become the basis of the property tax valuation procedure. The former requirement for these companies to provide copies of depreciation schedules is eliminated for TRD.

There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends (June 14, 2019). The provisions are applicable to property tax years beginning January 1, 2020.

FISCAL IMPLICATIONS

This reassignment of valuation responsibility for equipment generally between the wellhead and the master volume meter will possibly result in substantial amounts of property being placed on the property tax rolls. However, this new valuation will be achieved with substantial risk of unfairness and subsequent litigation. The increase in valuation expected in the proposals of this bill may not actually occur.

A number of county assessors in OGAS counties have engaged the services of a specialist OGAS valuation expert who understands where the lines are between property valued pursuant to the ad valorem production equipment tax (Section 7-34-1 through 7-34-20 NMSA 1978), unregulated (and probably unassessed) equipment or gathering lines between the wellhead and the first point of equipment or pipelines regulated by FERC. These contracts have led to substantial assessments with associated liens. A number of these liens have been contested and the case law, is, according to one knowledgeable observer "inconsistent."

Any unassessed equipment identified by a specialist contractor would be considered "net new value", not valuation maintenance. Thus, operating rates subject to yield control would not be adjusted. There would be no decrease in property taxes for other non-residential taxpayers. Yield control reductions are separately calculated for residential and non-residential rates. All of this net new value, if it occurred at all, would be considered non-residential net new value.

Again depending on the timing and magnitude of any assessment increase, there could probably be an increase in state, school district, municipal and county general obligation bond capacity attributed to the net new value. Debt rates are set by dividing the required debt service obligations by the total taxable values. If the total taxable values are increased, then the debt service rates will fall.

These general principles, however, are difficult to apply in practice. What can be said, however, based on the testimony in the counties where specialist contractors have done work, there may well be millions in unvalued, unidentified and unassessed properties.

Countering this view, however, TRD has submitted the following analysis:

> The impact is dependent on how county assessors value certain property, versus how it is valued by the State Assessed Properties Bureau of the Property Tax Division of TRD. It is unknown how the difference in assessment practice will affect the final valuation. However, as per Section 7-36-27(D)(3) NMSA 1978, TRD has a 20% floor in the special method of valuation for oil and gas equipment. The bill could remove this floor and allow counties to apply their typical 12.5% floor, possibly resulting in a negative impact to revenue. Both county treasuries and the state's general obligation bond debt service fund revenues would be affected.

SIGNIFICANT ISSUES

Since this is a largely neglected area of tax law, we shall do a brief "walk-through" of the issues:

TRD/PTD is the sole valuation authority for mines and mineral property (Section 7-36-23); potash (Section 7-36-24); uranium (Section 7-36-25); utilities such as water and wastewater facilities (Sections 7-36-27 and 7-36-28); electricity generation, transmission and distribution (Section 7-36-29); communication systems (Section 7-36-30); railroads (Section 7-36-31); and aircraft (Section 7-36-32).

County assessors are the sole valuation authority for land used for agriculture and livestock (Sections 7-36-20 and 7-36-21, although New Mexico Department of Agriculture/New Mexico State University issues guidelines on land and livestock values); value increases for residential properties (Sections 7-36-21.1 and 7-36-21.2); and manufactured homes (Section 7-36-26).

In contrast, Section 7-36-27 NMSA 1978 assigns a portion of the valuation authority to TRD/PTD and a portion to the assessors. Pipelines are under the authority of PTD (Section 7-36-2(B)(3), while other property, such as gathering lines and meters, are under the authority of the assessor. This mixed assessment authority, with no clear designation of whether certain items are valued by TR/PTD or the assessor, is unique to Section 7-36-27 and has resulted in litigation with "inconsistent" holdings.

The bill, by amending Section 7-36-7 NMA 1978, is intended to clarify that TRD/PTD has valuation authority over property used in interstate commerce—pipeline property, master meters and facilities that are regulated by FERC and all other oil and gas, carbon dioxide and liquid hydrocarbon property is to be valued by the assessors. (Section 7-36-2(A) assigns the county assessors the responsibility for valuation of all property except for that specifically assigned to TRD/PTD).

The assessors will assess the non-FERC regulated oil and gas, carbon dioxide, and liquid hydrocarbon property pursuant to the provisions of Section 7-36-33 NMSA 1978. That statue, like Section 7-36-27 NMSA 1978, provides a cost less depreciation valuation method for valuing all property not valued "under the provisions of Sections 7-36-22 through 7-36-32". The statute provides for recognition of other justifiable factors such as obsolescence and allows TRD/PTD to establish schedules of value for the same or similar kinds of property (Section7-36-33 (E) and (F).

Again, TRD has submitted a countervailing argument:

> To understand the impact of the proposed changes to Section 7-36-2 NMSA 1978, it is necessary to understand the history of centrally assessed property, which is also known as 'state assessed'.
>
> Central assessment was a method developed in the latter half of the 19th century to "address the difficult task of valuing a business … when the property was located in more than one taxing district." It began as a means to address "the fractional parts of railroads," but soon came to be applied to industries that operated "over a geographically large area, such as … telegraph [and] telephone … companies."
>
> By consolidating the duty to value central assessed property in one agency, states were able to use a unit valuation to assess the actual value of the property, including the franchise value or goodwill of the company that could not be "effectively taxed by local assessors." The difficulty that the U.S. Supreme Court had described as "almost insuperable," (i.e.: impossible) became manageable.
>
> Central assessment serves another important interest besides valuing property that covers a large geographic area; central assessment eliminates the unpredictability and bias a county assessor might impose on property in his or her county though the property exists in multiple tax districts. As the Union Pac. Ry. Co court stated: "It seems hardly to admit of a doubt that the object of this scheme was to withdraw the difficult task of assessing fractional parts of a railroad and its property from the hands of local assessors, who could hardly be expected to proceed upon any uniform plan, and each of whom would naturally favor his own particular district."

TRD submits that central assessment promotes fairness in valuation:

> The policy of this State has always been that property tax is imposed fairly. The New Mexico Constitution unambiguously demands fairness in taxation: "… taxes levied upon tangible property shall be in proportion to the value thereof, and taxes shall be equal and uniform upon subjects of taxation of the same class." Further cases expound on this fairness doctrine: "[T]ax laws ought to be construed with fairness, if not liberality, in order to carry out the intention of the legislature and further the important public interests which such statutes subserve." and "[a] tax statute must also be given a fair, unbiased, and reasonable construction, without favor or prejudice to either the taxpayer or the State, to the end that the legislative intent is effectuated and the public interests to be subserved thereby are furthered." This demand for uniformity and equality underlies the Property Tax Code's statutorily scheme for centrally assessed properties.

Central assessment delegates classification and valuation authority to the Department:

> Currently, the Legislature has delegated implementation for most such property to the Department in statute 7-36-2 (B) and (C). The bill proposes to move valuations for some oil and gas equipment to the county assessors. This strikes at the legislative intent of having the State Assessed Division handle such evaluations and would be confusing for some such property to be valued by the state while other parts are not, strictly based on whether it is regulated by a federal commission. For fairness and certainty, it is better to use the method of valuation directed by the legislature and reviewed by the Department.

> Overall, having a central state authority handling assessment and allocation of values to counties removes the possibility and confusion of having different counties use different methods to value the same property. By doing so, it also reduces the possibility of individual counties vested revenue and budgetary considerations improperly affecting those valuations.

TRD also discusses the recent history of this issue:

> Recently, some county assessors whose counties have oil and gas drilling have begun to employ third parties to locate assets that oil and gas companies may not have self-reported to the State Assessed Properties Bureau of TRD. The bureau has a system in place to encourage counties to report any property that would fall under State Assessed authority and was omitted from the tax rolls, and issues omitted assessments every year. In addition, PTD has been performing outreach within the oil and gas community with regards to reporting and this bill may confuse the issue. In this matter, although Robinson[1] approves the use of third parties to locate omitted assets, it specifically does not grant assessors right to value or classify. In addition, the CableOne decision gives the Department sole authority to value centrally assessed property.

TRD believes the proposed legislation creates a patchwork of central assessment practices:

> The Federal Energy Regulatory Commission does not regulate all pipelines. It explicitly does not regulate gathering lines. Gathering lines are defined as "the flowline network and process facilities that transport and control the flow of oil or gas from the wells to a main storage facility, processing plant or shipping point. A gathering system includes many pumps, headers, tanks, regulators, compressors, valves and other associated equipment. The result is that some pipelines in an oil and gas field will be valued by the Department — the FERC regulated pipelines — and other lines —the gathering lines — will be valued by county assessors, even if a gathering lines cross multiple counties.
>
> TRD, state assessors and the oil and gas industry will be subjected to the difficulty in valuation that was "almost insuperable." Permitting multiple valuations by multiple counties, as this proposed bill would allow, may not result in the same tangible property taxed equally and uniformly; it may result in piecemeal valuation — exactly what central assessment is intended to avoid.

ADMINISTRATIVE IMPLICATIONS

One purpose of this bill is apparently to ease some of the burden from the Central Assessment Bureau. Assigning TRD/PTD the responsibility of only FERC regulated property, relieves PTD from the field work of searching out all of the property located in remote areas where drilling and processing are taking place. Without a field audit, the annual renditions of companies must be taken at face value. Note that in the TRD comments, TRD Central Assessment Bureau staff are well aware of this issue and have conducted field inspections and issued assessments for undeclared property.

TECHNICAL ISSUES

Assessors have the authority and the ability to value the property used in the production of oil and gas, carbon dioxide, and liquid hydrocarbons as recognized by the New Mexico Supreme

[1] *Robinson v. Board of County Commissions of Eddy* County, 2015-NMSC-035, ¶ 32.

Court, in *Robinson v. Board of County Commissions of Eddy* County, 2015-NMSC-035, ¶ 32. In that case, the County Commissions challenged the assessor's authority to hire an oil and gas property expert. The Supreme Court unequivocally held that assessors have the authority to hire oil and gas assessment experts:

In the event that an assessor does not wish to value the oil and gas, carbon dioxide, or liquid hydrocarbon property, NMSA 1978, Section 7-36-19 (1973) allows the assessor to contract with PTD for technical assistance in the valuation process.

OTHER SUBSTANTIVE ISSUES

Apparently, the bright line for wellhead property subject to formulaic valuation pursuant to the Ad Valorem Production Equipment statute (Sections 7-34-1 through 7-34-20) is detailed in an NMAC regulation. This bill does not conflict with or impact the Oil and Gas Ad Valorem Production Equipment Tax (OGAVPED) in any way. Currently, nothing in terms of property taxed under Section 7-36-27 NMSA 1978 is the same as the property designated for taxation under OGAVPED. The proposed amendment does not change, expand or add to the designation of property taxed under Section7-36-27 NMSA 1978; the bill merely clarifies the authority between PTD and the assessor to assess the property already identified in Section 7-36-27 NMSA 1978.

Here is what is taxed under the Oil and Gas Ad Valorem Production Equipment Tax:

NMAC 3.18.1.7 DEFINITIONS:

D. **GATHERING:** "Gathering" is the movement of product from the production unit, as that term is defined in Paragraph 3.18.1.7E (1) NMAC, to a central accumulation point or processing or treatment point. This version of Subsection 3.18.1.7D NMAC is applicable to gathering occurring on or after July 15, 1998.

E. **PRODUCTION UNIT:**

(1) For purposes of determining value with respect to production on or after July 15, 1998, a production unit is the wellhead and the equipment associated with the wellhead. Equipment associated with the wellhead consists of all pipe and equipment supporting separation, dehydration, compression, sweetening, product storage, metering and other activities prior to and including the first place of physical measurement.

(a) For oil and condensate, the first place of physical measurement is either the outlet of the initial storage facility or the outlet of the lease automatic custody transfer unit.

(b) For natural gas and carbon dioxide, the first place of physical measurement is the outlet of the custody transfer meter, the allocation meter or the sales meter, whichever occurs first.

(2) For reporting purposes, the department may designate any of the following as a production unit:

(a) property subject to an oil and gas lease on which one or more wells are located;

(b) an area subject to an order for unitization or communitization;

(c) an area subject to a producer's division order;

(d) any producing well;

(e) any other place from which products are severed; or

(f) a proration unit approved by the oil conservation division of the energy, minerals and natural resources department.

Here is what is taxed under PTC Section 7-36-27:

A. All pipelines, tanks, sales meters and plants used in the processing, gathering, transmission, storage, measurement or distribution of oil, natural gas, carbon dioxide or liquid hydrocarbons subject to valuation for property taxation purposes shall be valued in accordance with the provisions of this section.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

According to expert testimony, millions of dollars of OGAS equipment and pipelines would remain off the property tax rolls. On the other hand, the practice of central assessment of OGAS equipment is of long duration and has been sustained through long experience.

LG/sb/al