POSSESSORY INTEREST TAX REGULATIONS

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1.201. **TITLE**
This chapter is called the Possessory Interest Tax Regulations.

1.202. **RESERVED**

1.203. **RESERVED**

1.204. **TERMS AND USAGE**
Subject to the definitions contained in the Tax Administration Regulations and subsequent paragraphs of this chapter, and unless the context otherwise requires, in this chapter the following terms are used for the meanings given--

A."Chapter" means these regulations and the Possessory Interest Tax.

B. "Operator" means any person engaged in the severance of products from a production unit.

C. "Tax" means the Possessory Interest Tax.

1.205. **RESERVED**

1.206. **RATE OF TAX.**
The tax is presently imposed at the rate of three percent (3%) on the value of a possessory interest.

1.207. **NOTICE OF ASSESSMENT**
A notice of assessment and demand for payment will be sent to the owners of an interest in a lease. Each owner will be billed in proportion to its interest on the assessment date. In addition, as the primarily responsible party, the operator of an oil and gas lease shall be sent assessments for taxes and penalties owed by working interest holders, but shall not be sent assessments for amounts owed by holders of overriding royalty interests, unless:

A. Required information has not been provided or is insufficient to describe the overriding royalty interest; or

B. In accordance with the provisions of 24 NNC §207.

1.210. **RESERVED**

1.211. **RESERVED**

1.212. **RESERVED**

1.213. **RESERVED**

1.220. **RESERVED**

1.221. **PRIMARY RESPONSIBILITY**
Consistent with 24 NNC §207, owners will be liable for tax assessed in proportion to their interests in a lease on the assessment date. Operators of oil and gas leases shall be primarily responsible for paying taxes, interest, and penalties owed by working interest holders and shall have standing to appeal those assessments.

1.222. **INTEREST DEFINED**
Interest includes the interest of any grantee, lessee, permittee, assignee, sublessee, franchisee, or transferee, whether of the whole interest in a lease or less than the whole, including the interests of parties to a joint venture or operating agreement as provided in this paragraph. The ownership and interests of the parties to a joint

venture, franchise, or operating agreement will be determined in light of the terms of the agreement, on the basis of the parties' respective participation in income or profits, assets, and management of the venture or operation, as those factors bear upon the property rights conferred under the agreement.

1.223. **RESERVED**

1.224. **RESERVED**

1.225. **RESERVED**

1.226. **RESERVED**

1.230. **RESERVED**

1.231. **DISCRETION AS TO METHOD**

The value of possessory interests will be determined by one or more of the following methods or by any method adopted by the Commission which accurately reflects fair market value. Fair market value is determined by using standard appraisal methods which include the income, cost, and comparable sales approach.

1.232. **RESERVED**

1.233. **RESERVED**

1.234. **COAL**

The following regulations shall apply to valuation of possessory interests that relate to coal mines and/or coal reserves using the present value of net income approach.

A. Allowable expenses include all expenses which are necessary for the production of income over the discount period. Allowable expenses include but are not limited to the following categories of expenses.
   1. Direct mining costs. The Commission will allow direct mining costs relating to overburden removal, coal removal, coal crushing and conveying, and mine office.
   2. Division and Corporate General & Administration (G & A). The Commission will allow that portion of the G & A allocated to the mine site.
   3. Selling Expenses.
   4. Insurance.
   5. Reclamation Costs.
   6. Compliance with Laws & Regulations.
   7. Taxes and Fees.
   8. Royalties.
   9. Income Taxes.

B. Non-allowable costs.
   1. Interest expenses.
   2. Depletion allowance.
   3. Amortization costs.
   4. Depreciation for book or tax purposes.

C. Such expenses and costs enumerated in A. and B. above are subject to review by the appraiser as to the reasonableness and accuracy. Should the appraiser determine that the expenses and costs submitted by the taxpayer do not meet the test of reasonableness and accuracy, then the appraiser shall use such expenses and costs that in his or her opinion accurately result in fair market value.

D. Treatment of personal property. Personal property is considered taxable and will be included in the fair market value of taxable property.
E. Coal production schedule. Average production for the three calendar years immediately preceding the assessment date shall be considered in conjunction with a forecast to project future production for the life of reserves or twenty-five years, whichever is less. The production schedule will be utilized in conjunction with price and operating cost data to determine future net income and/or cash flow. The production schedule may be adjusted based on information provided by the taxpayer.
F. Price and operating cost. Average price per ton and allowable operating cost for the three calendar years immediately preceding the assessment date shall be projected for the life of the lease including any renewals, or for the life of reserves or twenty-five years, whichever is less. The price and operating cost data will be utilized in conjunction with the coal production schedule to determine future net income. The price and operating cost may be adjusted based on information provided by the taxpayer.
G. Replacement capital. Actual average replacement cost per ton for the three calendar years immediately preceding the assessment date shall be projected for the life of the lease including any renewals, or for the life of reserves or twenty-five years, whichever is less. The replacement capital will be factored into the price/operating cost data to determine future net income and/or cash flow. The replacement capital may be adjusted based on information provided by the taxpayer.
H. Non-producing coal mines. Reserves relating to non-producing mines shall be valued if the reserves can be mined economically in the future. Coal that cannot be mined at a profit in the future will not be considered a reserve. If the mine is shut down permanently, it will be valued at salvage.
I. Discount rate. The Commission will develop the discount rate annually in consultation with state taxing jurisdictions and valuation consultants. Taxpayer input will be considered.
J. Residual value. Mines that continue to operate with only a slight chance for profit in the future will be valued at residual value or slightly greater than salvage. Residual value includes maximum amounts of physical, functional, or economic depreciation. Temporarily shutdown mines will be valued at a residual value.
K. A mine sale. The sales comparison approach for the mine unit itself will be used where 50% or more of the mine has been sold within the last two years of the assessment date, which is January 1 of the tax year. The appraiser will grant the sales comparison approach value primary weight within one year of the assessment date.

1.235. **BUSINESS SITE LEASES**

The following regulations shall apply to valuation of possessory interests that relate to business site leases. The Office of the Navajo Tax Commission will determine which approach most accurately reflects fair market value.

A. Allowable expenses include all expenses which are necessary for the production of income over the discount period. Allowable expenses include but are not limited to the following categories:
    1. Direct cash operating expenses relating to the operations of the enterprise.
    2. General and administration (G & A). The Office of the Navajo Tax Commission will allow that portion of the G & A allocated to the business lease.
    3. Taxes and fees.
    4. Lease payments.
    5. Income taxes.

6. Sustaining capital for replacement and environmental.

B. Non-allowable costs:
   1. Interest expenses.
   2. Depletion allowance.
   3. Amortization costs.
   4. Depreciation for book or tax purposes.

C. Such expenses and costs enumerated in A. and B. above are subject to review by the appraiser as to the reasonableness and accuracy. Should the appraiser determine that the expenses and costs submitted by the taxpayer do not meet the test of reasonableness and accuracy, then the appraiser shall use such expenses and costs that in his or her opinion accurately result in fair market value.

D. Treatment of personal property. Personal property not owned by the Navajo Nation is considered taxable and will be included in the fair market value of taxable property.

E. Projected cash flow. The gross receipts realized for the three calendar years of operation immediately preceding the assessment date shall be considered in conjunction with a forecast of future income. Projected cash flow may be adjusted based on information provided by the taxpayer.

F. Replacement capital. Actual average replacement capital for the three calendar years of operation immediately preceding the assessment date shall be projected for the life of the lease. The replacement capital may be adjusted based on information provided by the taxpayer.

G. Discount rate. The Office of the Navajo Tax Commission will develop the discount rate annually.

1.236. **ELECTRIC POWER GENERATION – VALUATION**

The Office of the Navajo Tax Commission shall appraise annually using the sales comparison approach, the depreciated historical cost method or the income approach. Functional and economic obsolescence will be applied when appropriate.

A. Definitions
   1. "Electric power generation" means electric power generating plant including all the property located on the Navajo Nation used for the generation of electric power not owned by the Navajo Nation.
   2. "Book value or net book value" means the amount carried on the corporate accounting records for physical assets or capitalized items or the original or acquisition cost less physical depreciation for age or wear and tear.
   3. "Obsolescence" means depreciation for functional or economic factors or factors which impair the function of the plant or impair the desirability of the plant.
   4. "Cash flow" means gross income, less operating costs, income taxes, replacement and environmental capital expenditures. Interest, depreciation, depletion and amortization are not allowable costs for cash flow.
   5. "Replacement capital expenditures" means those necessary to maintain production levels versus expansion capital, which increases production levels.
   6. "Environmental capital expenditures" means those mandated for protection of the environment such as those required by the Clean Air Act.
   7. "Discounting" means converting periodic income into a present value.
   8. "Construction work in progress" means property included in the construction work in progress account before it is booked or included in the book value.
   9. "Materials and supplies" means all property included in the account or accounts for this type of property.

10. "Going-concern value" means the value of an enterprise as an operating business including intangibles.
11. "Residual value" means a value, which contains maximum amounts of depreciation for a unit that continues to operate with probable future cash flow losses.

B. Income Approach Procedures
   1. The income approach will not be considered as a primary valuation method until tax year 2004. The income approach can be used for calculating obsolescence for the cost approach.
   2. For tax year 2004 and thereafter, the decision to use the income approach will be made by the Office of Navajo Tax Commission.

C. Cost Approach Procedures
   1. The cost approach shall include all assets not owned by the Navajo Nation. Moveable buildings and structures, personal property, materials and supplies, intangibles, and that portion of construction work in progress not owned by the Navajo Nation are taxable.
   2. Book value and net book value including applicable obsolescence will determine the cost approach value.
   3. Obsolescence will be based on the income approach or discounted cash flow, a loss in production, or any other technique deemed appropriate by the Office of the Navajo Tax Commission.

D. Sales Comparison Procedure
   1. If the entire electric power generating plant is sold or more than 50% interest is sold, the sale will be used as a primary determinant of value for two years, after that, it will receive minor consideration or no consideration as an indicator of value based on appraisal judgment.
   2. Comparable sales of other similar plants may be used as indicators of value.
   3. Minority interest sales will not be utilized as a primary indicator unless a controlling interest is acquired.

E. Determination of Value
   1. For the tax years 2001, 2002, and 2003, the depreciated book value or net book value plus materials and supplies, intangibles, and construction work in progress will be the basis of value, unless a controlling interest sale occurs.
   2. In the event of a permanent shutdown of the power plant, salvage value will be determinative of value. Salvage value will be based on 5% of original or acquisition cost.
   3. In the event that the unit is operating but continues to incur cash flow losses with probable continued losses into the future, the residual value based on 20% of the original or acquisition cost will be determinative of value.

1.240. **RESERVED**

1.241. **FILING OF DECLARATIONS**

The declaration required to be filed under this chapter is the Possessory Interest Tax Declaration, Form 200.

A. Declaration required. The declaration will report ownership of interests in leases and must be filed for each assessment date by every owner, even those whose interest(s) is (are) exempt from the tax. A declaration must be filed by every interest owner for informational purposes regardless of value of interest.

B. Form and instructions. Forms and instructions will be mailed to any person making a written request. A declaration may be filed on a clear copy of the official form.
C. Time and place for filing. The declarations for coal leases, oil and gas leases, and rights-of way are due on or before April 1st of each year. The declarations for business site leases are due on or before May 15th of each year. They must be filed with the Office of the Navajo Tax Commission.

1.242. **RESERVED**

1.243. **RESERVED**

1.244. **RESERVED**

1.245. **OTHER DECLARATION REQUIREMENTS**
Information declarations may be required from any person the Office of the Navajo Tax Commission deems necessary for the proper and efficient administration of this tax. For instance, an operator of any oil and gas property who is not the owner of the entire working interest in the lease will be required to file a Form 245, an information declaration regarding the ownership of the lease, as well as other information such as well data, and the value, volume, and kind of production.

1.246. **RESERVED**

1.247. **RESERVED**

1.248. **RESERVED**

1.249. **RESERVED**

1.260. **RESERVED**

1.261. **EFFECTIVE DATE**
This chapter is effective as of the date of adoption by the Navajo Tax Commission in accordance with the Tax Administration Regulations and will apply to all assessment dates on or after the effective date.

1.262. **RESERVED**

1.263. **RESERVED**