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Does There Need to Be a Texas Tea Party? Mineral Estate Taxation With Representation

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DOES THERE NEED TO BE A TEXAS TEA PARTY? MINERAL ESTATE TAXATION WITH REPRESENTATION

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The Texas Tax Code sets forth how all taxes in Texas should be levied and against what party or property on which the tax should be levied.[1] In the instance of mineral estate taxation, however, a conflict resides in how the oil and gas terms are defined and how these definitions apply to taxing mineral estates. The courts, however, are in bed with the State in the taxation dilemma.

The application of the tax code to mineral "interests" is quite a mathematical achievement whose methodology cannot be protested.[2] So, as in the urban mineral estate, how does one protest the valuation of one's minerals when quite possibly that valuation falls outside the Texas Tax Code?[3] As usual, the presumption falls on the side of the taxing authority, not the protester.

Texas Property Tax Code specifically sets forth that "all real and tangible personal property . . . is taxable" based on its appraised fair market value.[4] The Texas Property Tax Code also sets forth that mineral interests are classified as real property.[5] The misidentification of property interests causes confusion, and thus Texas is taxing mineral interest owners on ordinary income versus market value, which in this Author's opinion, imposes a double taxation or a surreptitious income tax on the citizens of the State of Texas.

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1. TEX. TAX CODE ANN. (Vernon 2008).
2. *See id.*; GORDON G. PEPPARD, TARRANT APPRAISAL DIST., THE APPRAISAL OF MINERAL INTERESTS (COMPLETED OR PRODUCING) FOR AD-VALOREM TAX PURPOSES IN TEXAS 1 (2009), *available at* http://www.tad.org/ftp_data/DataFiles/Mineral%20Interest%20PA%20Handoutr1.pdf.
3. TEX. TAX CODE ANN. § 11.146 (Vernon 2008).
4. TEX. TAX CODE ANN. § 11.01 (Vernon 2008).
5. TEX. TAX CODE ANN. § 1.04 (Vernon 2008).

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I. Definitions

Anyone who lives in the Barnett Shale areas of North Central Texas has been inundated with terminology that has not been discussed before in an urban setting. The unique technology that has come to light in the last ten years or so has allowed oil and gas exploration in areas never thought possible. Except for those persons residing in rural Wise, Johnson, and Parker Counties that possibly had oil production in the past, most of the people that live in and around Tarrant, Johnson, and Denton Counties are, and rightly so, confused as to the terms they hear through the media, other outlets, or from the grapevine which are inherently misleading.[6]

So, to grasp exactly how the terms in an oil and gas deal are defined and to completely understand the ramifications of the lease and the taxing of your property, consult your attorney.

A. *Surface Estate and Mineral Estate*

In Texas, if an owner of land owns both the "surface" and the "minerals" he owns the land in "fee simple."[7] If the fee simple owner in the land conveys any portion of the "minerals," two estates are immediately created, one being a fee simple in the "surface," the other a fee simple in the "mineral" estate with each carrying the incidents and attributes of an estate in land.[8] The immediate effect of that severance is that the surface estate becomes servient to the mineral estate and is therefore subject to certain rights vested in the mineral estate for which the surface estate cannot interfere.[9]

B. *Oil and Gas Lease*

A common misnomer encountered in the "oil patch" is the term "Oil and Gas Lease" which is not a lease at all; it is a conveyance of a fee simple determinable in all the oil and gas in place with the reverter vesting in the mineral estate owner(s).[10] Most "leases" allow for a certain "royalty" percentage (among other payments[11]) to be paid to the owner of the mineral estate or "Lessor." The lessor only reserves a royalty interest; he does not retain a possessory interest in the oil and gas in place.[12]

6. Tex. R. Evid. 801.
7. Tex. Co. v. Daugherty, 107 Tex. 226, 176 S.W. 717 (1915).
8. Humphreys-Mexia Co. v. Gammon, 113 Tex. 247, 260–61, 254 S.W. 296, 302 (1923).
9. The law regarding these rights is long and tortured and outside the scope of this paper.
10. Stephens County v. Mid-Kansas Oil & Gas Co., 113 Tex. 160, 254 S.W. 290 (1923).
11. Again, the terminology decisions from the courts are many in this regard and are outside the scope of this paper.
12. *See* Natural Gas Pipeline Co. of Am. v. Pool, 124 S.W.3d 188, 194 (Tex. 2003).

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C. *Royalty*

A "royalty" is a cash payment that amounts to the fractional percentage of the gross production the lessor negotiates with the lessee. The royalty is free from all costs of drilling, completing, and operating the well.[13] It must bear its proportionate share of costs incurred subsequent to production such as transportation, dehydration, and compression. For example, my lease consists of a 26.5% royalty. Interestingly enough, the reasons for which will become clearer later, I had to sign a W-4 form and send it along with the lease to my lessee.

D. *Real Property*

As defined in the Texas Property Tax Code § 1.04(2)(d), a mineral estate is real property. Additionally, under subsection (f) so is "an estate or interest . . . or an interest securing payment or performance of an obligation in a property enumerated in Paragraphs (A) through (E) of this subdivision." Thus, a mineral estate is considered real property, but so are a mineral interest and a royalty interest.

In a paper available on our local appraisal district website written by Pritchard and Abbott, Inc., two terms are defined whose definitions illustrate the type of confusion surrounding those terms. The terms are set forth as:

1. **Mineral Rights** is defined as the ownership of the minerals on or under the surface, with the owner having the right to capture or recover and the right to delegate owner rights to another party to recover minerals by negotiating a lease agreement.[14]

The definition is straightforward and concise. It accurately describes fee simple ownership in the mineral ***estate.*** It encompasses certain rights, but it is confusing to say mineral rights when you are discussing the estate.

2. **Mineral Interest** means the ownership of all rights regarding oil, gas, or other minerals as they naturally occur in place, at or below the surface tract of land.[15]

The definition obviously differs from the one above it in one respect—it leaves out the part about delegating rights to another party (lessee) to recover the minerals through a lease. In other words, the term has stripped some attributes of the fee simple mineral estate, but as described, may define a royalty interest.

There is a great difference between the ownership of a mineral estate and the ownership of a royalty interest. There is a great deal of litigation that has occurred and is occurring presently in the division of

13. Boldrick v. BTA Oil Producers, 222 S.W.3d 672 (Tex. App.—Eastland 2007, no pet.).
14. PEPPARD, *supra* note 2, at 1.
15. *Id.*

the mineral estate and whether or not the individual has ownership of the mineral estate bundle of sticks and the interest without any sticks.

E. *Personal Property*

"Personal property" means property that is not real property. "Tangible personal property" means personal property that can be seen, weighed, ***measured***, felt, or otherwise perceived by the senses, but does not include a document or other perceptible object that constitutes evidence of a valuable interest, claim, or right and has negligible or no intrinsic value.

Hopefully, the definitions listed above do not cause more confusion than clarity. The real confusion will be clearer in the following paragraphs.

II. The Taxation

As set forth in the Texas Property Code, all real and personal property within a taxing jurisdiction is *"taxable on its appraised fair market value."* Market Value (fair or otherwise) is defined as:

> the price at which a property would ***transfer for cash*** or its equivalent under prevailing market conditions if:
> (a) Exposed for sale in the ***open market*** with a reasonable time for the seller to find a purchaser;
> (b) Both the seller and the purchaser know of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions on its use; and
> (c) Both the seller and purchaser seek to maximize their gains and neither is in a position to take advantage of the exigencies of the other.[16]

"In its simplest form, Market Value is the price a willing buyer from the open market would pay for your mineral interest in current prevailing market conditions."[17]

Further, the Texas Property Tax Code states that a mineral interest that is valued at less than $500.00 is not taxable.[18]

This Author is taking to task Pritchard & Abbott, Inc. ("P&A") because they provide a document called "*The Appraisal of Mineral Interests (Completed or Producing) For Ad Valorem Tax Purposes in Texas*"[19] to taxing jurisdictions.[20] This paper is an explanation that purports to show how your interest in your minerals is taxed.

16. Tex. Tax Code Ann. § 1.04(7) (Vernon 2008).
17. Peppard, *supra* note 2, at 1.
18. Tex. Tax Code Ann. § 11.146 (Vernon 2008).
19. Peppard, *supra* note 2.
20. *See* Tarrant Appraisal District, www.tad.org (click "Mineral Interest Valuation Details").

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Early in the document it defines mineral interests as real property. Then the document states "mineral interests, ***unlike real estate***, are individual undivided interests in a lease." P & A defined a mineral interest on page 13 of the document as "the ownership of **all** rights regarding oil, gas or other minerals as they naturally occur in place, at or below the surface tract of land."

It seems hard to square that definition to what really happens when one enters into a lease with an oil and gas company. In a simple lease in its simplest form, the mineral interest transforms into a royalty interest. The mineral estate owner upon entering into the lease has ***conveyed*** those rights or that interest to the Lessee in fee simple determinable, with a possibility of reverter in the oil and gas and other minerals in place to the grantor.

The express rights inherent in an oil and gas lease and those conveyed to the lessee are set forth below:[21]

1. The right to explore for oil and gas and other minerals and produce those minerals;
2. The right to use as much of the surface as necessary to produce the minerals;[22]
3. The right to ingress and egress;
4. The right to build roads;
5. The right to use fresh water;
6. The right to house employees;
7. The right to construct facilities;
8. The right to select drill sites;
9. The right to conduct seismic surveys.[23]

The "owner" or lessor cannot do anything in the way of production. He does not have the right to enter the surface to explore for oil and gas and other minerals and to produce those minerals. The mineral owner has conveyed those rights away. So for the document to say that mineral interest is an undivided interest in a lease is incorrect. The correct definition is that the royalty is an undivided interest in the production from the lease. The lessee retains the royalty and the lessee and lessor are not tenants in common with the lessee owning a fractional interest and the lessor owning the remaining fraction.[24] The

21. This is not an all inclusive list.

22. Subject to the Accommodation Doctrine. *E.g.*, Tarrant County Water Control & Improvement Dist. No. One v. Haupt, Inc., 854 S.W.2d 909, 911 (Tex. 1993); Getty Oil Co. v. Jones, 470 S.W.2d 618, 621 (Tex. 1971).

23. Some of the "rights" are subject to contractual negotiations especially in the urban setting. *See, e.g.*, Oryx Energy Co. v. Shelton, 942 S.W.2d 637, 641 (Tex. App.—Tyler 1996, no writ); Macha v. Crouch, 500 S.W.2d 902, 904 (Tex. Civ. App.—Corpus Christi 1973, no writ) ("The holder of an oil and gas lease, in the absence of specific clauses relating to surface use, compensation and damages, has the legal right to use as much of the surface as is reasonably necessary to comply with the terms of the lease and to carry out its purposes.").

24. *See* Natural Gas Pipeline Co. of Am. v. Pool, 124 S.W.3d 188, 194, 196–97 (Tex. 2003).

lessee is strictly a royalty interest owner.[25] The lessee has a possibility of having all the oil and gas in place returned to him, but it is an expectant interest and in this Author's opinion not subject to taxation under the Texas Property Tax Code.

All that being said, the Tax Code has made sure by declaring that §1.04(2)(f) encompasses "any interests securing payment" for any real property is taxable as real property; and that you are taxed on that "interest" even though it is ordinary income and not real property. In this Author's opinion, the Comptroller is stretching the definition, overreaching, and misleading the public in its quest to create state revenue.

A. *The "Uncontestable" Valuation Model*

How does the State formulate the process and the taxing jurisdictions tax royalty interest holders on their interest? First, and most obvious, is by wrongly defining what they are taxing. Secondly, and arguably the most egregious, is the valuation model they purport to use that is by law not contestable and set forth with absolute impunity, and "has been done since 1926." "If your friend jumped off a cliff, would you?" is the only fitting rebuttal that this Author can come up with for statements such as that.

The method used in the valuation of mineral estates is mandated by the State Comptroller. Although great pain is taken to say that the valuation model is not an income tax on prior income, once fleshed out, there is little else that it could be.

The valuation model is comprised of an approach called either the Discounted Cash Flow ("DCF") or the Discounted Net Income ("DNI").[26] The underlying principle is that ***anticipated future income*** from these reserves is allegedly what willing buyers are buying, and willing sellers are selling, which may or may not be true.

The methodology used is "engineering based income" appraisal and not a "real estate," "accounting," or "statistical" method.[27] A "real estate" appraiser is quite confident in using a cash flow model or income approach to valuing a building or multi-story office building. However, that dollar amount may or may not play into the price a willing buyer and willing seller agree upon.[28]

Additionally, pursuant to Texas Property Tax Code § 23.175, the methodology must take into account the average price of the oil or gas from interest from the preceding year.[29] The limit on increase in average price for subsequent years is 150% of the prior year. Interestingly

25. *Id.*

26. PEPPARD, *supra* note 2, at 1–2, 5.

27. *Id.* at 1.

28. This Author could go into capitalization rates and other terms but it is outside the scope of this article.

29. TEX. TAX CODE ANN. § 23.175(a) (Vernon 2008).

enough, your "real property" homestead is subject to only a 10% rise in value from the prior year.[30]

The methodology document used by Pritchard & Abbott states on the first page that the Market Value[31] of a mineral interest[32] in a completed or producing well is *"your net revenue interest's percentage value of the total lease calculated recoverable reserves to be produced in the future, then discounted to present worth."* If this is not a tax on income, why must they use the terms, "your net revenue"?

The State mandated-DCF model purports to say that the market valuation is not an income tax on ***prior annual income*** and is not suppose to represent your prior annual income. The state contends that when the lessor sells his "mineral interest" the lessor is selling his ***Net Revenue Interest***, which is defined as the fractional "ownership" in the lease.

The State then uses the "engineering method" to calculate the future reserves to develop the discounted cash flow model to calculate the value of the mineral estate. Of particular importance here is that the State does not say:

> "We verify the mineral deed conveyances with the grantee or grantor from the deed records of the county in which the conveyance was made to ascertain the value of the interest conveyed between a willing seller and a willing buyer."

The State uses a production profile from the Texas Railroad Commission's Production Database to calculate the "start rate" of production during the prior year. Then the appraiser uses a sophisticated production and plotting software to set forth the decline in the production for that year.[33] Then, the appraiser is bound by the Property Tax Code § 23.175 to calculate the monthly average price for the preceding calendar year multiplied by the Comptroller's Market Condition Factor (CMCF).[34] The appraiser must then ascertain the Lease Operation Expense (LOE). The appraiser must either find the lease operators documentation or use a default average.[35]

The last step the appraiser must arrive at is the discount rate for the time period of valuation by considering factors such as: (1) the cost of money on January 1st and (2) the risk of the property itself (i.e. production rates and declines, technical, economic, and political factors).

The DCF formula is then implicated for valuation and the numbers are plugged in:

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30. *Id.* § 23.23.
31. PEPPARD, *supra* note 2, at 1.
32. *Id.*
33. The presumption is that all production declines in the future. That necessarily begs the question regarding re-entering to conduct fracturing operations to increase production. *Id.*
34. Available from the Texas State Comptroller's Office.
35. Assuredly, it is a guess.

Gross Revenue x Total Lease Royalty Interest Fraction (decimal) x Discount Rate = Year One Discounted Net Revenue.

Thus, you get a taxable "value" of the interest for year one. This calculation continues for each future year until the operating expense becomes greater than the lessee's interest, which should mean that the lease is close to expiring on its own terms because it fails to produce minerals in paying quantities.[36]

B. *The Fallacy of the Method*

Those of us that are old enough to remember the 1980s as something more than the death of disco have dealt with this type of valuation disaster before. The State's oil prices finally collapsed to $11.82 per barrel in July of 1986.[37] This led to a recession in Texas that lasted 17 months and had a devastating effect on state employment.[38] In August 1986, the world oil price dropped below $9 a barrel.[39] The actual low point in Oklahoma was $8.25 in 1986, for good-quality sweet crude.[40] Some shipments of crude changed hands at less than $7 a barrel.[41] The upstream sector of the industry went into a tailspin.[42] Nationwide, marginal wells were being plugged once every 30 minutes. In Oklahoma, it was about eight per day.[43] Out of the 20 biggest S&L failures, 14 were in Texas. Texas S&Ls accounted for more than half that industry's losses.[44] That led Texas into a horrible economic decline that took years to recover.

Nothing was learned by taxing and relying on the future of the energy sector. We are still doing what we did and continue to get the same results. Albert Einstein said it best, "the definition of insanity is doing the same thing over and over again and expecting different results." Why is it mandated by the Comptroller to use a valuation method that relies on volatile market fluctuations of a commodity instead of the value established by willing buyers and sellers? The simple answer is that it does not provide for increased revenue, which we all know bureaucracies thrive upon and which would cease to exist otherwise.

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36. *See* Clifton v. Koontz, 160 Tex. 82, 89–90, 325 S.W.2d 684, 691 (1959).

37. Stephen P.A. Brown & Mine Yucel, FEDERAL RESERVE BANK OF DALLAS, *Do Higher Oil Prices Still Benefit Texas?*, *in* THE FACE OF TEXAS: JOBS, PEOPLE, BUSINESS, CHANGE 34 (2005), *available at* http://www.dallasfed.org/research/pubs/fotexas/fotexas.pdf.

38. *Id.*

39. David Brown, *Crash of '86 Left Permanent Scars*, AAPG EXPLORER, Jan. 2006, *available at* http://www.aapg.org/explorer/2006/01jan/crash.cfm.

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

III. Words Mean Something

One must break down the language the State requires the appraisers to use to understand why Texas mineral owners, specifically those in the urban setting, are getting the shaft and the State is getting the gold mine.

First, the definition of "net revenue interest's ("NRI") percentage" requires some dissection to understand the fallacy of the State's valuation model. The State defines NRI as "the amount of fractional ownership in the lease, typically expressed in decimal form to the hundred thousandths, or six decimal places for mineral interest appraisal and assessment."

This Author believes NRI should mean the lessor's royalty percentage, or the "royalty interest." The definition contains erroneous terms that are in conflict. A lessor does not have a "fractional ownership in the lease." The lessor "reserves" a royalty interest in his mineral estate, which the lessor conveyed to the operator, AND that royalty interest owner is entitled to that specific percentage of gross production or revenue (in cash) on his mineral estate less any transportation, drying, etc., and other express stipulations contained in the lease. The Texas Supreme Court set forth in *Pool* that the lessee and lessor are not tenants in common.

The tax code is quick to point out that "an interest securing payment or performance of an obligation in property enumerated in (a)–(e) of this subdivision" is taxable under the Code as real property. Thus, the State sees the "royalty interest" as taxable "real property."

The law states that when a lessor executes a lease, the lessor conveyed all his rights in the oil and gas in place, with a possibility of reverter of 8/8ths of the minerals, and is only due ***cash*** from the sales of production, thus the reason for the W-4. The lessor is going to give the lessee a 1099 form at the end of the year and that amount is to be reported as ***ordinary income*** and entered in the equation for gross income reported to Uncle Sam on the lessee's tax return. Again, it is this Author's belief that the lessor does not "own" a fractional interest in the lease; the lessor is due cash from his conveyance of the minerals in place as a royalty interest, unless he is a partner with the lessee.[45]

By using the DCF model, the State is basing the mineral estate valuation on the income of the well. The logical conclusion can be nothing else. The State specifically uses the ***gross revenue*** of the well in its calculations.

Pursuant to the tax code, the State is going to tax the mineral owner on his mineral interest's future value based on well revenue, which the

45. That is referred to as a "working interest" which opens up a whole new can of worms that is outside the scope of this article.

mineral owner could sell (but can't[46]) and let Uncle Sam tax you on the income from your royalty interest. This seems to be double taxation on revenue, not fair market value of real property between a willing buyer and willing seller.

IV. Putting it on the Ground

Using the State's model, what would a lot in an urban area realize in income and what could possibly be the taxable estate under the State's theory of taxation?

A. *Urban Lot*

For example use a lot in the Arlington Heights section of Fort Worth called "Blackacre."[47] Typical lots are 50 feet by 150[48] or approximately 7500 square feet or .172176 of an acre. Pursuant to Texas Railroad Commission rules, a pool can consist of 160 acres or 6,969,600 square feet. Using production rates from a well in Tarrant County that produces 2408 Mcf/day or 866,880 Mcf/year at the April spot price on NYMEX on Tuesday April 7, 2009, of $3.565/MMbtu, the well grosses approximately $3,164,112.00 in revenue per year.

Therefore, a royalty consisting of 26.5% means your portion of the well revenue is—(Total lease income) x (.172176 ÷ 160) x 26.5% annually. This is your mineral interest income (NRI) according to the taxing jurisdictions. Or

($3,164,112.00) x (.0010761) x 26.5% = $902.30/year or $75.19/month.

If one was to put that royalty interest on the open market based on future production discounted to present value, what would it bring? The taxing authorities like to say that "in the prevailing market" mineral interests are generally worth three to four times your prior year's annual 12-month income.[49] Therefore, your taxable interest on your mineral estate based on this year's production would be around $3,158.05 based upon the alleged prevailing market theory.[50]

Taking this valuation method a step further, and based on most gas well production, the methodology devised by the State fails to bring in more taxes. Most gas wells decrease in output around 50% in the second year. Thus, tax revenue will fall likewise unless there is a significant rise in natural gas prices for the year, which in the current

46. This Author believes there is very little if any market for an urban lot mineral estate on the "open market" where a mineral estate is supposed to be sold, and thus valued at that price per the definition of market value and for taxing purposes.
47. This Author could not resist.
48. For illustrative purposes only.
49. Peppard, *supra* note 2, at 1.
50. This is a very simplified equation, but shows the extent to which the State will go to get income.

cash market is not predicted anytime soon. So again, the State coffers will suffer accordingly: Déjà vu, 1986.

This very simplistic view does not take into account re-entering the well and re-fracturing for more production. It is simply a basic analysis and truism of a gas well output.

Very recently, there was a news story on a local television station that showed a company paying $5,000.00 for your mineral rights. That is a true test of the fair market value as established by the tax code.

The question might arise, "How would the State (appraisal district) verify under the fair market value appraisal who bought what and for how much?" The same way surface estate appraisers do it—legwork. A real property appraiser is attuned to the market in the area where he or she operates. The appraisal district monitors the official county records, and either ascertains by a phone call to the principals to the transaction or by reviewing the deed itself. Since the transfer of a mineral estate or fraction thereof is considered real property, the conveyance thereof is subject to the statutes of fraud and all other attributes surrounding the sale of real property. The transaction will be in the official county records. The local appraisal districts use this method every five years or so to evaluate ad valorem taxes on surface estates.[51] This is not to say that the appraisal district doesn't increase your taxable value every year by 10% because they can! Unfortunately for the mineral owner, the mineral estate tax is calculated every year whether there has been a conveyance or not.

B. *Larger Acreage*

Since this paper is geared to urban lots versus larger acreages, it is worth delving into the reasons the State has settled on the methodology used today. The same mathematical principles are used "since 1926" to evaluate larger tracts. The only difference is the size of the multiplier. Take the tenth of an acre from our urban lot and start upwards and it is easily seen how the tax rate on the mineral estate increases, but at what point does it reach the point of diminishing returns? 10,000 acres? 100,000 acres? At some point the mineral estate would, at $120 a barrel or $14.00 an MMbtu, be worth more than the whole fee simple estate. The State was generous enough to place provisions in the tax code to prevent that from happening.

Another reason a rural mineral estate is of greater worth, thus higher taxes, is that the rural property is unburdened by city or county regulations that by design inhibit the exploration of oil and gas.

Rightly or wrongly, the city, State, and/or county condemns the mineral owner's right of entering the land for the exploitation of the mineral estate without compensation. The right to use the surface is absolutely necessary for the exploitation of the mineral estate. It is a

51. Again, an oversimplification of real property appraisals.

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reasonable police power in the absolute urban setting, but what about the suburban setting? How far does the ordinance extend into the county?

Additionally, the compelling reason for the servient/dominant estate rule is that the mineral estate is worth ***nothing*** without the absolute right to explore for and extract those minerals.[52]

V. Double Taxation

It has been previously shown that the mineral estate owner of Blackacre in Fort Worth, Texas, will make approximately $902.30 this year more or less at April's rates. In January, the lessor will receive a 1099 from ABC Oil Company showing that amount of income to be reported to Uncle Sam. Once oil or gas leaves the ground at the well head, it becomes personal property not subject to the real property ad valorem tax, thus the reason for the W-4 the lessor signed contemporaneously with the lease.

However, the lessor now has to worry about the county appraisal district bill he or she will get when the well goes into production. As set forth by the State, each year the amount will get progressively smaller due to the declining production curve and price fluctuation. Even with a sharp rise in gas prices, this year's tax is limited to 150% of last year's valuation. All this methodology is based on the price of the commodity, not based on the agreement between what a willing buyer and willing seller decide is profitable for both parties.

The main recurring theme throughout this paper is that the valuation of the real property is based on the cash price of the commodity coming out of the real property, not the fair market value as defined by the tax code. Although the State says the methodology is not contestable, why does the State define the interest as "real property"? It is not real property when you are dealing in cash and revenue. Cash is not real property; neither is the price at which a commodity is sold, or for that matter the commodity itself. The legal status of the commodity changes once it leaves the ground.

True, fair market value appraisal is the value arrived at between a willing buyer and a willing seller. Although the tax code says this is the method by which to value and thus to tax real and personal property, the State relies on a completely different valuation method of taxing mineral interests that have a volatile and unsure valuation that is speculative and in this Author's opinion, an income tax. By placing the revenue of future production value at the heart of the equation, even on the declining production theory, the model is set up for price volatility disaster. The mandated taxing theory is based on the value of the commodity, not the value of the estate, the real property, which is mandated by the Texas Property Tax Code.

52. Operating within the accommodation doctrine.

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One possible explanation why the taxing authorities continually rely on income of the well versus the market value between a willing buyer and willing seller is because the taxing jurisdictions will not put forth the effort to find a willing buyer and seller in the open market to determine the fair market value. As was in the local news recently, if a mineral owner conveyed his royalty interest and his possibility of reverter to another individual via a mineral deed for $5,000.00, does the new mineral owner get to protest his tax rate because the value may possibly be lower than the appraisal district's appraisal? More likely than not, the taxing authority has hard evidence that real property was traded between a willing buyer and willing seller, creating a true fair market value for the estate.

Another, and the most compelling reason for the reliance on value of production, is the increased revenues that a yearly "appraisal" provides. The method increases the amount of revenue due to the State even with a declining production model. The comptroller is charged with taxing and the declining cash flow model does that, whether it is the fair market value or not, inasmuch as the method is not contestable.

VI. Conclusion

There is a plethora of law and statutes that are absolutely adverse to this Author's position. Additionally, there are a lot of you who, after hearing this lecture and reading the paper, believe I should be riding a rather anorexic horse and tilting at windmills.[53]

The purpose of the paper was to: (1) illustrate how the State values your interest, and (2) how the State comes up with its own version of definitions that are not exactly the way the case law sets out the interest. The way the State, for taxing purposes, defines interests allows them to effectuate a tax upon an interest that may or may not be taxable, or may be a surreptitious income tax on the mineral owner.

Another purpose, although not set forth in the paper, is to get the attorney, mineral owner, or CPA to realize what this tax means to the individual who owns a small mineral estate and to help them realize what they can and cannot do about the tax bill that comes in the mail. Unfortunately, pursuant to the code, what "cannot" be done about the tax bill is by far a larger list than the list of what "can" be done.

53. Miguel de Cervantes Saavedra, El ingenioso hidalgo Don Quijote de la Mancha (1904).