

OPINIONS OF THE ATTORNEY GENERAL

VOLUME NO. 42

OPINION NO. 5

OIL AND GAS - Net proceeds not to be included within assessed value of lots in rural special improvement districts;

RURAL SPECIAL IMPROVEMENT DISTRICTS - Assessed value of lots not to include oil and gas net proceeds;

TAXATION AND REVENUE - Assessments for rural special improvement districts not to reflect oil and gas net proceeds;

MONTANA CODE ANNOTATED - Sections 7-12-2151, 7-12-2151(1)(b), 15-23-101(4), 15-23-501, 15-23-603, 15-23-607(4);

MONTANA LAWS OF 1985 - Chapter 657, section 2; chapter 665, section 10.

HELD: Oil and gas net proceeds and royalty interests should not be included within the assessed value of land benefited from a rural special improvement district for purposes of

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assessment of costs under section  
7-12-2151(1)(b), MCA.

29 January 1987

Daniel L. Schwarz  
Powder River County Attorney  
Powder River County Courthouse  
Broadus MT 59317

Dear Mr. Schwarz:

You have asked my opinion concerning the following question:

Are net proceeds and royalties on oil and gas interests subject to rural special improvement district levies?

You have indicated to this office that a rural special improvement district has been created in your county on land which overlies the Belle Creek oil field. Statutes which establish how costs of rural improvements may be defrayed indicate four alternate manners of assessment. The method which is relevant to your inquiry is set forth in section 7-12-2151(1)(b), MCA:

Each lot, tract, or parcel of land assessed in the district may be assessed with that part of the whole cost of the improvement based upon the assessed value of the benefited lots or pieces of land within said district, if the board determines such assessment to be equitable in proportion to and not exceeding the benefits received from the improvement by the lot, tract, or parcel.

The question is whether oil and gas net proceeds should be included in the valuation of the property for purposes of assessment of costs.

The method of assessment of costs based on valuation of lots was added to section 7-12-2151 by the 1985 Legislature, 1985 Mont. Laws, ch. 665, § 10. The 1985 Legislature similarly amended the assessment of costs provision for nonrural special improvement districts. 1985 Mont. Laws, ch. 657, § 2. The legislative history of these acts does not reflect whether valuation of lots benefited should reflect mineral or oil and gas deposits. Implicit in the language of section 7-12-2151, MCA, is the recognition that the assessed

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value of the realty should be determinative of the allocation of improvement costs. The underlying rationale of this method of assessment of costs is that more valuable lots or land should bear a proportionately higher share of improvements provided.

Taxing statutes must be strictly construed in favor of the property owner. Burlington Northern, Inc. v. Flathead County, 176 Mont. 9, 575 P.2d 912 (1978); Swartz v. Berg, 147 Mont. 178, 411 P.2d 736 (1966). This axiom of construction has been particularly applied to the area of special assessments by local governments. See Leroy v. Rapid City, 193 N.W.2d 598 (S.D. 1972). The governing statute must be carefully scrutinized and, where any doubt exists as to a mode of assessment, the doubt should be resolved against the existence of the assessment power. 14 E. McQuillin, Municipal Corporations § 38.07, at 50-51 (3d ed. 1970). The statute here speaks of the "assessed value of the benefited lots." § 7-12-2151(1)(b), MCA. In the absence of an express legislative mandate that this value of realty includes net proceeds from oil and gas, it is difficult to thus construe the statute.

As a general principle, it is true that "[m]inerals, being tangible substances, may be treated in law as corporeal property, and until separated from the soil are part of the realty within which they lie." Marnett Oil & Gas Co. v. Musey, 232 S.W. 867, 869 (Tex. 1921). However, a proceeds tax is a tax on minerals produced. When oil and gas have been produced, it is personal property. 1 H. Williams & C. Meyers, Oil and Gas Law § 212 (1985). See also Anderson v. Beech Aircraft Corp., 699 P.2d 1023, 1028 (Kan. 1985); Young v. Young, 709 P.2d 1254, 1257 (Wyo. 1985). "Courts are unanimous that royalty which has accrued from production and severance of petroleum products constitutes personal property." R. Hemingway, The Law of Oil and Gas § 2.5, at 53 (2d ed. 1983). Montana case law is in accord. Voyta v. Clonts, 134 Mont. 156, 328 P.2d 655 (1958) (oil remaining in the ground before recovery is part of land but becomes personal property when recovered); Rist v. Toole Co., 117 Mont. 426, 159 P.2d 340 (1945) (severed royalty interest is not separately taxable as real estate because once oil is recovered it becomes personal property). Cf. § 15-23-501, MCA ("and the annual net proceeds of all mines and mining claims shall be taxed as other personal property").

Thus the oil and gas net proceeds and royalty interests at issue are personal property for purposes of taxation. Personal property flowing, but severed, from a

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particular lot should not add to its valuation as realty.

The surface owner of property overlying oil and gas deposits is frequently not the owner of the underlying mineral interests. As a matter of course, the right of entry to search for subsurface minerals is often transferred, leased, or sold. Similarly, royalty interests to the sale of oil and gas deposits are often transferred. In either case, the proceeds of oil and gas are frequently realized by parties distinct from the surface owner.

The tax on oil and gas net proceeds is a tax upon the sale of product yielded from wells. § 15-23-603, MCA. By statute, the produced oil and gas is centrally assessed property, § 15-23-101(4), MCA, for which the operator or producer is liable for the payment of taxes. § 15-23-607(4), MCA. The producer benefits from the sale and is taxed accordingly.

If one assumed net proceeds were included within the valuation of land for purposes of section 7-12-2151, MCA, the inequitable result would occur whereby a surface owner would bear a greater tax burden for proceeds realized by a second party. The valuation would reflect an asset not possessed by the taxed party.

THEREFORE, IT IS MY OPINION:

Oil and gas net proceeds and royalty interests should not be included within the assessed value of land benefited from a rural special improvement district for purposes of assessment of costs under section 7-12-2151(1)(b), MCA.

Very truly yours,

MIKE GREELY  
Attorney General