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## Tennessee

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## TENNESSEE



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*Introduction of Oil and Gas Development*

This article provides an update of the developments in the oil and gas law in the State of Tennessee from August 1, 2017 through July 31, 2018. This article focuses on major legislative and regulatory enactments as well as developments in the common law.

*I. Judicial Developments**A. The Coal Creek Company v. Anderson County, Tennessee*

In *The Coal Creek Company v. Anderson County, Tennessee, et al*, the Court of Appeals of Tennessee considered “whether a tax on certain property containing oil and gas deposits constitutes an unlawful additional severance tax.”<sup>1</sup> The Coal Creek Company (“Coal Creek”) appealed certain tax assessments received from several Tennessee county property assessors. After administrative proceedings and appeals, Coal Creek filed suit in Knox County Chancery Court, seeking review of those administrative proceedings and appeals. Following a bench trial, the Knox County Chancery Court dismissed Coal Creek’s complaint, and Coal Creek appealed to the Court of Appeals of Tennessee.<sup>2</sup>

Coal Creek owned real property in fee, which contained oil and gas, in Anderson, Campbell and Morgan Counties.<sup>3</sup> The fee property was subject to oil and gas leases, for which Coal Creek received royalty payments.<sup>4</sup> Beginning in 2009, the counties re-classified the Coal Creek Property from farm property to industrial or commercial property, which increased the tax rate from 25% to 40%.<sup>5</sup> The Tennessee Division of Property Assessments assisted the counties in determining the mineral valuations, by using an income approach.<sup>6</sup> The income approach is “designed to determine the value of income-producing property by reducing to present value the anticipated future net earnings stream of the property.”<sup>7</sup> Additionally, the “income approach begins with a calculation of gross income. This gross income figure is then reduced by expenses. The resulting net income figure

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1. *The Coal Creek Company v. Anderson County, Tennessee*, 546 S.W.3d 87, 89 (Tenn. Ct. App. 2017).

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.* at 89-90.

7. *Id.* at 98 (citing *Seaton v. State Bd. of Equalization*, No. E1998-00880-COA-R3-CV, 2000 WL 852123, at \*1 (Tenn. Ct. App. June 28, 2000)).

is then capitalized at an appropriate rate to arrive at the value of the income-producing property.”<sup>8</sup>

On appeal, Coal Creek argued “that the tax assessments on its mineral interest constitute an unlawful additional severance tax above what is provided for exclusively by Tenn. Code Ann. § 60-1-301.”<sup>9</sup> Additionally, Coal Creek argued that “the Board of Equalization’s failure to promulgate and abide by guidelines as contemplated by Tenn. Code Ann § 67-5-801 precludes the ‘layering’ of taxes on Coal Creek’s property according to different uses.”<sup>10</sup> The court began by discussing the re-classification of the property by stating that “[i]t is undisputed that Coal Creek’s property contains oil and gas deposits which, when extracted, produce income for the company. It is a logical and unsurprising proposition that a property producing a stream of income . . . is more valuable than an otherwise comparable property that cannot provide any such income stream.”<sup>11</sup> Further, the court stated that “it is clear from the record that Coal Creek’s property is not merely farm land, however long previously it had been classified solely as such.”<sup>12</sup>

Next, the court moved to the issue of the tax assessments. The court stated that the “tax assessments at issue are on oil and gas remaining in the ground. A severance tax, by contrast, taxes those minerals that are extracted.”<sup>13</sup> Additionally, the court stated that “[a]ccounting for and taxing the value of the oil and gas deposits on Coal Creek’s property is not identical to imposing an unlawful additional severance tax.”<sup>14</sup> Further, the “evidence in the record reflects that the income approach is a viable and widely accepted means of arriving at value, depending upon the circumstances, [and] Tennessee case law also supports this proposition.”<sup>15</sup> Finally, the court stated that “Coal Creek asserts that the Assessors did not correctly perform an income approach appraisal method because no reliable studies are available to establish the oil and gas reserves. Nevertheless, again, in our judgment, this does not relieve Coal Creek from being subject to taxation of its mineral interest.”<sup>16</sup> Therefore, the court held that “the

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8. *Id.*

9. *Id.* at 100.

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.* at 100-101.

16. *Id.* at 101.

taxes assessed upon Coal Creek's property relative to oil and gas remaining in the ground are property taxes, not a severance tax."<sup>17</sup>

## *II. Legislative and Regulatory Developments*

During the relevant time period of this update, there were no notable Legislative and Regulatory Developments involving the oil and gas industry.

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17. *Id.* at 89.