

**STATE OF TENNESSEE  
OFFICE OF THE ATTORNEY GENERAL**

December 2, 2014

Opinion No. 14-103

Taxation of Mineral Interests

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**QUESTIONS**

1. Does the taxation of mineral interests using a valuation process based on the income derived from such property during the prior year constitute a tax on a type of income other than income derived from stocks and bonds that are not taxed ad valorem?

2. Does the taxation of mineral interests using a valuation process based on the income derived from such property and the amount of minerals removed from the property during the prior year constitute an additional severance tax on gas and oil production in violation of Tenn. Code Ann. § 60-1-301?

**OPINIONS**

1. No. Determining the value of real property by using the income approach is a commonly-used, appropriate method for valuing income-producing property for purposes of ad valorem taxation. The use of this approach does not result in the assessment of an income tax.

2. No. Use of the income approach to value mineral interests likewise does not result in the assessment of an unauthorized severance tax.

**ANALYSIS**

The goal in valuing property for ad valorem tax purposes is to determine “the sound, intrinsic and immediate value of the property for purposes of sale between a willing seller and a willing buyer.” Tenn. Att’y Gen. Op. 79-509 (Dec. 4, 1979). “Generally speaking, there are three approaches (or methods) used by appraisers to determine the value of property—the market approach, the income approach, and the cost approach.” Tenn. Att’y Gen. Op. 79-44 (Feb. 1, 1979). “Usually, these three approaches are used and are correlated to reach a determination of value.” *Id.*

The income approach to valuation is “essential to appraisal processes.” Tenn. Att’y Gen. Op. 77-41 (Feb. 18, 1977). The income approach is “based on the premise that ‘the value of a property is equivalent to the present worth of the net income it may be expected to produce during a normal term of ownership or over its remaining

economic life.” Tenn. Att’y Gen. Op. 79-509 (Dec. 4, 1979) (quoting *State of Tennessee Assessment Manual*, at 31). This approach “is commonly used and appropriate to value income-producing real property.” *Spring Hill, L.P. v. State Bd. of Equalization*, No. M2001-02683-COA-R3-CV, 2003 WL 23099679, at \*9 (Tenn. Ct. App. Dec. 31, 2003) (no perm. app. filed).

The use of the income approach to value property does not convert the tax subsequently imposed into an income tax. *See, e.g., First Am. Nat’l Bank of Knoxville v. Olsen*, 751 S.W.2d 417, 421-22 (Tenn. 1987) (although the amount of excise tax is measured by net earnings that does not convert it into an income tax); *Kankakee County Bd. of Review*, 544 N.E.2d 762, 772 (Ill. 1989) (recognizing distinction between income tax upon revenue and consideration of same revenue when calculating fair market value of property for ad valorem tax purposes). The use of the income approach results in the assessment of a property tax, and the consideration of the property’s income in this process does not change the basic nature of the tax being assessed. *Cf. Corn v. Fort*, 170 Tenn. 377, 389, 95 S.W.2d 620, 624 (1936) (holding that “a privilege [franchise] tax is not converted into a property tax” despite the fact that both taxes are “measured by the value of property”).

In accordance with these principles, it is entirely appropriate for an assessor to use the income approach when valuing mineral interests. To the extent that this interest in real property is generating income, the assessor can and should consider the income in valuing the property. Property containing particularly productive mineral resources will generate more income and possess greater value than a less productive property. The use of the income approach to value such a mineral interest does not result in the imposition of an income tax or severance tax.

HERBERT H. SLATERY III  
Attorney General and Reporter

ANDRÉE SOPHIA BLUMSTEIN  
Solicitor General

MARY ELLEN KNACK  
Senior Counsel

Requested by:

The Honorable Ken Yager  
State Senator  
G19 War Memorial Building  
Nashville Tennessee 37243