PROPOSED REGULATION FOR COMMENT

REGULATION NO. ____________

Issued: October 17, 2016

PROPOSED REGULATION SETTING METHOD OF VALUATION FOR POSSESSORY INTERESTS IN RESERVATION LAND

Preamble: The value of a possessory interest to be taxed under P.O.L.C § 6-2-3 must reflect the fair market value of the interest. The value must include the "value of the taxpayer's Possessory Interest in Reservation Land," P.O.L.C. § 6-2-4.B. Section 6-2-4 provides that the value of a possessory interest shall be computed as provided in the chapter "or by any other method adopted by the Tax Administration Division (Division) which accurately reflects the fair market value of the possessory interest which is subject to taxation." Although Section 6-2-4(B) further provides that values would be equal to the values set out in the New Mexico Property Tax Code, NMSA 1978, Sections 7-36-15 to 33 (as amended), these New Mexico Tax Code sections do not have a method for valuation of Possessory Interests in Reservation Land that are less than fee simple interests. Accordingly, the Division is proposing to adopt the following regulation for valuing Possessory Interests in Reservation Land.

The regulation is proposed to be retroactive to January 1, 2010.

The Division believes it is important to adopt a valuation method for possessory interests that will be familiar to taxpayers and is similar to those used in other taxing jurisdictions. The Division refers Taxpayers to the method of valuing possessory interests in lands adopted by the State of California. *See* Cal Rev. & Tax. Code § 107; California State Board of Equalization, Assessor's Handbook, § 105, Assessment of Taxable Possessory Interests (2015). In addition to California, other states with federal or tribal tax exempt landholdings, and the District of Columbia, have adopted regulations valuing possessory interests using the Direct Income Approach as proposed by this regulation. Because of the unique nature of tribal trust land and the Pueblo's tax code, this regulation is similar, but not identical, to the valuation methods used in other state jurisdictions.

The Division has issued individual rulings to Taxpayers who had not reported or paid taxes on possessory interests held under rights of way or leases. This proposed regulation is consistent with those individual rulings and is intended to provide a general statement applicable to all Taxpayers of the valuation methods to be used for their Possessory Interests in Reservation Land.

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The Division also draws taxpayer's attention to the new BIA leasing and right of way regulations which provide that leases and rights of way for tribal land are not subject to state taxation on the underlying possessory interest in land, permanent improvements or activity occurring on the leased land. See e.g. 25 C.F.R. §162.017.

Proposed Regulation

1. Definitions:

   a. "Possessor" means any person, as defined in P.O.L.C. § 6-1-2, who has a Possessory Interest in Reservation Land.

   b. "Possessory Interest in Reservation Land" is (as defined in P.O.L.C. § 6-1-2 for possessory interest) any nonexempt interest in real property within the Pueblo of Laguna Reservation, including but not limited to:

      i. interests held in fee simple;
      ii. interests held under lease or sublease;
      iii. interests held under an easement or right of way; and
      iv. interests held under a use or business agreement.

   c. "Reservation Land" includes all lands subject to the jurisdiction of the Pueblo, including all land held by the United States in trust for the Pueblo and all lands within the exterior boundaries of the Pueblo of Laguna Reservation or Pueblo of Laguna Grant, regardless of whether the lands are owned in fee, held in trust by the Unites States for the Pueblo, or otherwise held.

   d. The "Term of Possession" is the remaining amount of time that the Possessor has the right to occupy or use Reservation Land as set out in the document granting the possessor the right to utilize the land. It includes automatic rights of renewal, but not rights of renewal that are not automatic.

   e. "Contract Rent" is the amount of money or other consideration paid, required to be paid in the granting document or the value of a comparable possessory interest, for a Possessory Interest in Reservation Land for the remaining Term of Possession as set forth in Section 3.a below. If a lump sum payment is made at the beginning of a term, then the Contract Rent for the remaining Term of Possession shall be determined as set forth in Section 3.b below.

   f. "Fair Market Value" is the value of the possessory interest determined using the Direct Income Approach of valuation set out in this regulation. The Fair Market Value is not diminished by any obligation of the Possessor to pay rent or retire debt secured by the Possessory Interest in Reservation Land.

2. Rights to Be Valued.

   The rights to be valued in a Possessory Interest in Reservation Land include all rights to use or occupy real property held by the Possessor, including non-exclusive rights to occupy or utilize the land or subsurface for specific purposes as set out in rights of way, easements, permits, licenses, leases, land use agreements, or any other document granting a right to use or occupy Reservation Land as granted or approved by the Pueblo of Laguna or Secretary of the Interior. The rights to be valued shall not include construction maintenance easements of less than eleven (11) months.

3. Direct Income Approach Method of Valuation.

   a. Valuations of taxable Possessory Interests in Reservation Land shall use the appraisal method known as the Direct Income Approach as set out in this regulation to determine the value to be taxed. A taxable Possessory Interest is valued by discounting the Contract Rent by the applicable discount rate in Section 3.c below for the remaining Term of Possession. The Contract Rent shall be derived by direct or comparable valuation.

      i. Direct Valuation - The Contract Rent shall be as set forth in the granting document for the remaining Term of Possession.

      ii. Comparable Valuation - This method shall be used for those leases or rights of way for which the direct valuation of Contract Rent is based on leases or rights of way that no longer reflect the fair market value for use of Pueblo land . In those cases, the Division shall specifically notify the Taxpayer of reassessment using comparable valuation and provide evidence of comparable use, protecting the confidentiality of the comparable possessor, that will be used to determine the comparable Contract Rent. This subsection is intended to provide a fair and equitable assessment of taxes for similar uses of Pueblo land.

   b. Lump sum payments.

      i. If the Contract Rent was paid in advance without reference in the legal documents to an allocation of payment for any of the Years of Possession, the lump sum payment shall be allocated equally to each of the years for which the payment grants the Possessor rights to use or occupy the land.

      ii. If the legal document references or sets out an allocated value of lump sum payment for certain periods within the Term of Possession, the value as indicated in the legal document for the remaining years shall be used.

   c. Discount Rate. The discount rate shall be eight percent (8%), except that for utilities subject to regulation by the New Mexico Public Regulation Commission (PRC), the discount rate shall be the approved rate of return allowed by the PRC for Taxpayer capital improvements. The PRC discount rate is available upon written request to the Division and documentation of such approved rate of return.

4. Assessment Of Tax On Possessory Interest in Reservation Land.

   The Fair Market Value of a Possessory Interest in Reservation Land for purposes of P.O.L.C. §6-2-4 shall be determined by taking the Contract Rent for the remaining Term of Possession, and discounting it by 8% (or, if applicable, the regulated rate of return as determined by PRC for the Taxpayer). The Taxpayer shall pay the possessory interest tax of 5%, or any amended rate of possessory interest tax set out in the Tax Code, on the Fair Market Value. The Division shall use this method for valuing Taxpayer's possessory interests and shall provide the valuation to the Taxpayer for inclusion in its reporting in accordance with P.O.L.C. § 6-2-5.

5. Examples of Application of Direct Income Approach.

   a. The Direct Income Approach may be calculated as follows for each year:

      Contract Rent for remaining Term of Possession
      Contract Rent discounted by 8% = Fair Market Value

      Fair Market Value X 5% = Possessory Interest Tax due for that year.

   b. Example for lump sum with evenly-allocated annualized payments (§ 3.b.i):

      i. A business lease provides for a lump sum payment at the beginning of the term of $1 million for a 10 year term, and 8 years remain in the lease term.

         - $800,000 discounted by 8% over the 8 year term = $574,664
         - $574,664 X .05 tax rate = $28,733 tax due

   c. Example of Contract Rent paid by regulated utility for comparable property (§ 3.a.ii). A regulated utility has a 20 year right to occupy the land and paid $500,000 for that right. In the 10th year, another possessor paid $2,000,000 for a comparable type of use for a 20 year period. The utility's regulated rate of return is 10%. The Division will notify the Possessor of the revised assessment, comparable use and payment.

      - Contract Rent = $1,000,000 (10 remaining years at comparable rate of $100,000/yr)
      - Discounted by 10% for Fair Market Value of: $614,456
      - $614,456 x .05 tax rate = $30,722 tax due

   d. Example for annual payments with an escalator (§ 3.b.ii):

      i. A business lease provides for an annual lease payment of $50,000 to be escalated by 2.5% every year for a ten year period, and five years remain in the lease term. The contract rent is the sum of the annual payments for each of the remaining years at the escalated amount for each year.. The discount rate is then applied to arrive at Fair Market Value.

         - Year 6-10 Contract Rent: $297,353
         - Discounted by 8% for Fair Market Value of: $236,549.26
         - $236,549.26 X .05 tax rate = $11,828 tax due

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6. Retroactive.

This regulation setting out the method for valuing possessory interests in land shall be retroactive to **January 1, 2010**.