ATTORNEY ADVERTISING

The Marcellus Shale:

Natural Gas Leasing

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Will My Property Taxes Go Up If I Sign a Gas Lease?

By: Gary M. Schuster, Esq. and Penny Thelman

Landowners may be concerned that the discovery or recovery of natural gas on their property will result in an increase in the assessed value of their property with a resulting increase in property taxes. In New York, this concern is unfounded. The gas company, and not the landowner, is charged for the real property taxes associated with the value of the natural gas produced from your land.

Although gas leasing activity may be new in the eastern part of New York, gas drilling and production has existed near Lake Erie since the 1970's. Due to this long history, New York has very thorough and well-established regulations governing the levying of real property taxes associated with the production of natural gas. The value of the gas production is separately assessed from the other interests in the real property and the resulting tax assessment is levied directly against the gas company rather than the land owner.

In instances where the land receives an exemption, such as for agricultural, forestry or non-profit purposes, the production of gas on such land will not jeopardize the exemption for the entire exempt property. Instead, only the portion of the land that is directly used for gas recovery, processing and transportation will lose its exemption, and be assessed based on its use for gas production. The remainder of the land will still enjoy its tax exemption.

One factor that landowners may not be aware of is the benefit to their community resulting from the new tax revenues arising from gas production. The gas company will pay significant sums to the local tax authority (as a real property tax) for the value of gas produced.

The chart below gives an example of how gas production is separately taxed, apart from the land, and may bring additional tax revenues to a municipality.

(Continued on page 2)

DEFINITIONS

Equalization Rate (ER) - The unique factor for each town, calculated to arrive at assessed value upon which taxes are based.

Assessed Value (AV) - This is the amount to which the local tax rates are applied, after equalization.

Annual Production (AP) - Gas produced or extracted from a single well in a one-year period; data provided by gas producer/lessee to NYS ORPS (Office of Real Property Services)

Unit of Production Value (UPV) - Factor to be determined by NYS for Marcellus Shale play each year, expressed as dollar amt per "mcf" (1000 cubic ft) of gas; includes valuation/depreciation for physical capital on site

Unit of Production (UP) - This is the value of well production for an individual w ell; data provided by NYS ORPS to local tax assessor where well is located.

mcf = 1,000 cubic feet

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Hypothetical Well located in the Town of Delaware, Sullivan County			
Estimated Annual Production (AP) of 365,000 mcf of gas (1,000 mcf/day)			
Estimated Unit Production Value (UPV) is $7.90 per mcf			
Estimated Value of well is $2,883,500 per year (before applying Equalization Rate)			
2008 Property Tax Equalization Rate for Town of Delaware is 0.505			
Est. 2008 Assessed Value (AV) of Well ($2,883,500 x 0.505) $1,456,167	2008 Tax rate per $1,000 of AV	Est. AV of Well (in 1,000's of $'s)	Est. Property Tax dollars Paid by Gas Company
Town of Delaware	$8.60754	1,456.167	$12,534.00
County of Sullivan	$8.99414	1,456.167	$13,096.00
School (Delaware Valley or Sullivan West)	$22.42206	1,456.167	$32,650.00
Est. Total Property Tax Paid by Gas Company for One 1,000 mcf[1] well			**$58,280.00**
Note: An average home uses 84 mcf of natural gas per year. A well producing 1,000 mcf per day, would provide energy to over 4,300 homes per year! Source: Natural Gas Supply Association (www.ngsa.org)			

Assume that a single well on your property produces one million cubic feet (1,000 mcf) of gas per day. This is a reasonable average rate of production for the Marcellus Shale region based on information from other states and similar formations (data from Independent Oil and Gas Association of New York, 2008). That production translates into an Annual Production Rate of 365,000 mcf.

The Annual Production Rate is then multiplied by the Unit of Production Value (UPV). The UPV is determined by New York State on an annual basis. As a realistic hypothetical UPV rate we will use $7.90 per mcf. The Annual Production Rate of 365,000 mcf multiplied by the UPV of $7.90 comes to $2,833,500, which amount is referred to as the "Unit of Production" or the annual value, for assessment purposes, of this one producing well.

The tax assessor takes the Unit of Production of $2,833,500 and multiplies that by the equalization rate for the applicable Town. For illustration purposes, the Town of Delaware in Sullivan County had an equalization rate in 2008 of 50.05%. So the Assessed Value for the one hypothetical well is $1,456,167. Remember, this is the Assessed Value of the gas being produced, not the real property assessed value to you - the landowner.

Using the 2008 tax rates shown in the table above, the one well with an Assessed Value of $1.45 million would generate approximately $12,500 in taxes for the Town, $13,100 for the County and $32,650 for the School. With the gas company paying property tax on the value of the gas, the landowner has no increase in his real property tax assessment and no increase in real property taxes associated with the natural gas production.

Note:
A landowner will be liable to pay **income taxes** for payments received by the landowner pursuant to a gas lease including, but not limited to, bonus or lease signing payments and royalty payments which result from natural gas being produced on the property. It is highly advisable to consult with a qualified accountant and attorney prior to signing a lease, but in any event prior to filing your tax return.

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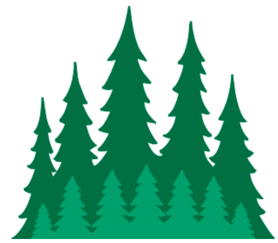
Hunting & Gas Production:The Big Boom?
Watch for the hunting article in our next newsletter!

Forest Ownership and Gas Drilling

By: Jackie Henry



Landowners with forested land participating in the Forest Management Program, for tax abatement purposes, should be cognizant of the tax penalties for converting the use of all or a portion of their forested land in an untimely manner for gas drilling purpose.

For those landowners who own several acres of woodland but are not currently participating in a forestry management program, it is important to know the basics of forest management. Forest management includes a range of human interventions, including conservation and economic activities, such as extraction of timber, planting and replanting of various species and cutting roads and pathways through forests.

Maple Sugaring

Maple sugaring is a rich part of New York's identity and heritage. With the growing demand for pure maple products, maple syrup production can provide an annual income to forest owners without the need for commercial timbering. Did you know that maple trees are tapped when they are at least 30 years old - a diameter of 10 inches or more? It takes about 40 gallons of sap to make one gallon of maple syrup, but what a sweet experience! Further maple resource information can be found at www.nysmaple.com

"New York is the nation's second largest maple-producing state, according to the State Agriculture Department. In 2008, with 1.5 million taps in service, Empire State sugar houses boiled up 322,000 gallons of maple syrup, a 44 percent increase over 2007. The value of New York's 2007 maple syrup yield was $7.5 million, with an average per-gallon price of $33.50."
Source-The Daily News - March 28, 2009

Q: If I own forest land, can I still lease my property for gas drilling?

A: It does not appear that there are any general State regulations pertaining to forest management on private lands that would affect the ability of landowners to lease their land for drilling for gas in the Marcellus Shale formation. However, landowners whose property is committed to the production of forest crops under Section 480-a of the Real Property Tax Law (RPTL) may be subject to penalty for conversion of forested acreage to another use (i.e., well pads, etc.), depending on the when the mineral rights agreement was signed in relation to their commitment under the RPTL.

Example:

The commitment is a rolling 10-year commitment on the part of the landowner. To get the exemption for 2009, the property is committed to the production of forest crops from 2009 to 2018; to get the exemption for 2010, the commitment is extended through 2019, and so on. If any committed acreage is converted to another use that precludes the production of forest crops, the penalty is three (3) times the tax reduction received on the converted acreage, for a maximum of 10 years. As an example, if a landowner commits 100 acres to the program, and after 7 years converts 10 acres to well pads, the penalty would be three (3) times the amount that his taxes were reduced on those 10 acres over the previous seven years. He would continue to be eligible to receive the exemption on the remaining 90 acres. If after another 12 years he converted an additional 5 acres to pasture land, the penalty would be three (3) times the amount that his taxes were reduced over the previous 10 years, and he would continue to be eligible to receive the exemption on the remaining 85 acres.
(Source: Email from Robert Messenger, Senior Forester, NYSDEC, dated 10/29/08)

Additional Resources:
www.catskillforest.org
www.cce.cornell.edu/arc
www.ForestConnect.info
www.dec.ny.gov
www.nyfoa.org

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BREAKING NEWS!

"A Generic Environmental Impact Statement (GEIS) provides a comprehensive review of the potential environmental impacts of oil and gas drilling and production and how they are mitigated. The Department is preparing a supplemental GEIS to assess issues unique to horizontal drilling and high-volume hydraulic fracturing of the Marcellus and other low permeability reservoirs. "

- Source: http://www.dec.ny.gov/energy/46288.html

It is currently anticipated that the DEC's draft GEIS will be issued in the summer of 2009. In the meantime, some gas companies are hedging their bets by continuing to apply for drilling permits for test wells. As recently as March 12, 2009, Chesapeake Appalachia, L.L.C. applied for drilling permits in Delaware County.

"Chesapeake is the largest leasehold owner in the Marcellus Shale play. The company expects to end 2009 as the most active driller and the largest producer of natural gas from the play. Chesapeake is currently producing approximately 30 mmcfe net per day (45 mmcfe gross operated) from the play and anticipates reaching approximately 100 mmcfe net per day (220 mmcfe gross operated) by year-end 2009. The company has achieved attractive drilling results in the play to date, including two recent wells that began producing at rates above 6 and 7 mmcfe per day, respectively, and is planning to significantly increase its Marcellus drilling activity during 2009 and 2010.

Chesapeake is currently drilling with 11 operated rigs and anticipates operating an average of approximately 14 rigs in 2009 and 28 rigs in 2010 to drill approximately 85 net wells in 2009 and 160 net wells in 2010 to further develop its 1.3 million net acres of Marcellus leasehold. During 2009 and 2010, 75% of Chesapeake's drilling costs in the Marcellus, or approximately $650 million, will be paid for by its joint venture partner StatoilHydro."

-Source: http://www.chk.com/ **(June 2009)**