

# THE TAXATION OF MINING

BY JAMES L. WADHAMS, ESQ.

This article could begin with “there is no taxation of mining by the State of Nevada.” The point of that statement would be to gain the reader’s attention, directing them to the fact that the current types of taxation of the activity referred to as mining are the same as any other business activity save and except gaming. The privilege tax on gaming, of course, is a different discussion.

Those individuals and businesses engaged in the exploration for and extraction of minerals in this state will pay sales or use tax on goods they purchase or consume in the state.<sup>1</sup> They will pay a tax on their payroll for unemployment insurance and the modified business tax.<sup>2</sup> They will also pay any corporate or business fees imposed on any other business.<sup>3</sup> On the real property and improvements thereon as well as the personal property they own they will pay the property tax imposed pursuant to NRS 361 at the rate imposed by the county in which the real property is located.<sup>4</sup> On the real property they will pay that same county rate unless one of two things that would make that land a “mine or mining claim” takes place:

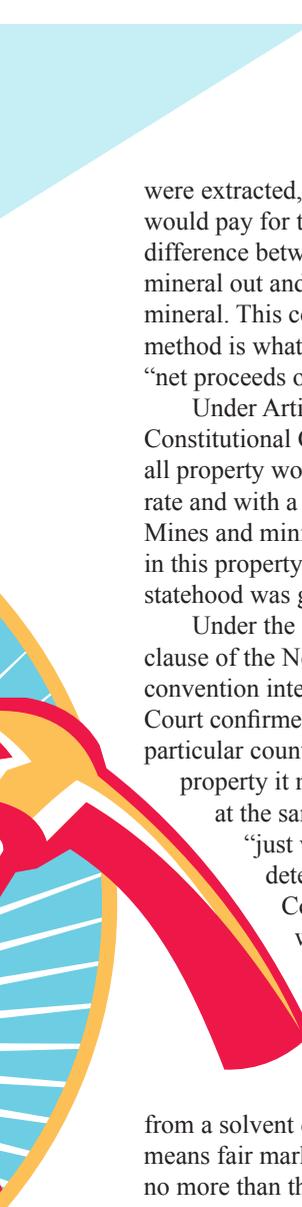
1. If the owner has performed \$100 worth of work on the land, it will be removed from the property tax roll;<sup>5</sup> and,
2. If the owner is extracting a commercially valuable mineral from that land, the owner will be taxed on the value of that property calculated by the commercial market value of the mineral less the cost to extract it.<sup>6</sup> The value resulting from that computation is assessed as what “a willing seller would pay a willing buyer” for that land containing the mineral.<sup>7</sup>

Because of an amendment to the Nevada Constitution in 1989, mineral property is taxed at a rate that is higher than other property in that county.<sup>8</sup> This constitutional amendment (SJR 22) was critical in splitting mineral property from all other property for the purpose of imposing a higher rate of taxation than that applied to all other property in that county.



## The History

When Nevada received the authorization from Congress to petition for statehood, a convention was convened to write a constitution.<sup>9</sup> The Constitutional Convention of 1864 agreed that the financing of government should be accomplished by levying a property tax. The conclusion was that taxpayers should participate based upon their ability to pay and that the amount of property they held was the best measurement of the ability. A great deal of discussion took place on all of the necessary issues of developing a constitution but curiously one of the first questions raised regarding taxation was whether mines and mining claims should be included.<sup>10</sup> Consensus was quickly reached that they should be included but extended discussion took place as to how those claims should be valued. Some suggested that it might be the stock price, the amount of investment, a dollar amount per foot of the excavation, the price obtained for the mineral sold or the value of the land that had been mined. Essentially, the prevailing argument was that unless and until the mineral was extracted and sold, the land was just dirt like any other land, but once minerals



were extracted, the value that someone would pay for that land would be the difference between what it cost to get the mineral out and the price obtained for the mineral. This computation or appraisal method is what is now referred to as the “net proceeds of minerals” method.<sup>11</sup>

Under Article 10, Section 1, the Constitutional Convention agreed that all property would be taxed at the same rate and with a fair market valuation. Mines and mining claims were included in this property tax section from the time statehood was granted.

Under the “uniform and equal” clause of the Nevada Constitution, the convention intended and the Supreme Court confirmed that all property in a particular county, no matter what type of property it might be, must be taxed at the same rate.<sup>12</sup> Similarly, the “just valuation” clause was determined by the Supreme Court to mean “what a willing buyer would pay a willing seller in an open and competitive sale,” or “what a judgment creditor would take in satisfaction of debt from a solvent debtor.”<sup>13</sup> Just valuation means fair market value but it also means no more than that. The court recognized that allowing no more than fair market value would preclude any one from being overtaxed.

As a general principle, Nevada was a “fair market value” state until a shift occurred in 1981. Popular pressure in California gave rise to Proposition 13 that significantly reduced property taxes. This was followed in Nevada by the first passage of Question 6 that would have dramatically reduced property tax in Nevada. The governor and the Legislature responded by enacting what some have called the “tax shift.” At the time of Question 6 the property tax had moved well into the 4 percent range and was pushing the Constitutional maximum of 5 percent in some counties. The decision was made to shift the primary revenue burden from the property tax to the sales tax. Property tax was substantially reduced. The sales tax, which was passed by referendum at 2 percent and could not be amended by the Legislature, was augmented by

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two additional taxes (LSST and SCCRT) on sales raising the aggregate sales tax rate by several percentage points.<sup>14</sup> When this shift occurred, the Legislature adopted new rules for the calculation of values of taxable property. These can be found at NRS 361.227. Land was essentially left at “fair market value” but formulas were adopted for valuing improvements including “replacement cost less depreciation” (at a prescribed rate), capitalized income and so forth. It should be noted that once taxable value is calculated, it must be reduced by 65 percent before the county rate of tax is assessed as set forth in NRS 361.225.

For the mines and mining claims from which minerals were extracted, the constitution specified that the net proceeds method of calculation would be used. The statutory expression of that is found at NRS 362 et seq. NRS 362.120 and specifically describes the method of computation for determining the taxable value of the mineral that was in the ground, i.e., the value of the mine.

In 1987, led by Las Vegas Assemblyman Marvin Sedway, SJR 22 was proposed, passed twice and approved by a vote of the people. This amendment split mineral property (mines and mining claims) out of the “uniform and equal” section of the constitution to allow it to be taxed at a higher rate than

any other property in the county of location. SJR 22 now appears as Subsection 5 of Section 1 of Article 10 of the Nevada Constitution. The effect of this change was a substantial increase in the rate of taxation. Mines and mining claims now could be taxed at 5 percent on 100 percent of their taxable value. This tax on mineral property currently generates a source of property tax revenue that goes directly to the general fund. There are some small pieces of property tax from other sources but the overwhelming majority of property tax revenue comes from this higher rate of tax on mineral property.



## The Tax and its Calculation

As was briefly discussed in the previous section, the method of determining taxable value for this type of property is described in NRS 362.120. It directs the taxpayer to report the value of the mineral that was sold and then identify the costs incurred in that reporting year directly related to the extraction, reduction and refining of the mineral to get it into a commercially usable form. That calculation, referred to as the “net proceeds of minerals,” is the taxable value to which the 5 percent rate is applied. Many people have looked at this computation method as a form of income tax. While it does have similar attributes, it is designed to present a value that “a willing buyer would pay a willing seller” for the property that contained the mineral. It is a property tax.<sup>15</sup> In other words, if I believed that Mr. Smith had an acre of land that contained one ounce of gold, what would I pay for that acre? For reasons that history has proven frequently, the price one could expect to receive in 12 months may be speculative and the costs one might incur over that time might change as well. If one could see the future, there is an argument that one might pay a little less than the difference between what I could sell it for and what it would cost me to get it. The computation described in NRS 362.120 tells the taxpayer to report the sale price of the final mineral and the costs incurred to get it out and the assessor will tax the net value on the assumption that paying more than that value would be a losing proposition. The reports that are filed are



audited upon submission for accuracy and correctness before the tax is certified and an invoice is sent to the taxpayer.<sup>16</sup> If the taxpayer disputes that value, there is resort to the equalization process. Periodically, the State Department of Taxation conducts “field audits” in which they verify source documents.<sup>17</sup>

In the 2011 Legislative

Session, there was extensive discussion about the costs of extraction. While the commentary frequently referred to these costs as “deductions” as if they were similar to the deductions individuals take from their income tax liability, they are costs that any owner of such land would incur to extract something of value. The value of the land to the owner would be no more than that net value. If Nevada had an income tax on businesses (a tax on the income of individuals is prohibited by Article 10, Section 1, Subsection 9 of the Nevada Constitution) the income from that mining activity would be taxed, probably similar to the federal income tax. A state income tax would be in addition to this property tax. Curiously, the Legislature disallowed the cost of sales tax on goods from the computation of value.<sup>18</sup> If one buys an ordinary shovel for \$32.05 including tax, did the shovel cost \$32.05 or did it cost \$29.95? The Legislature also disallowed the cost of health care for the workers as if the cost of employing a worker does not include their health care.<sup>19</sup> One might suggest that providing health care to one’s employees is discretionary, and perhaps it is, but payment of the sales tax on the shovel is obligatory.

The confusion in the discussion of taxes on mining usually stems from confusion in the type of taxation being discussed. Tax on the value of property is ad valorem, and the method of assessing the value is not the same as the tax. One of the primary methods for assessing the value of commercial property is the “capitalized income approach” which takes into account the income a landlord receives from a property.<sup>20</sup> That income is capitalized to estimate what a buyer would pay for that property and that calculation typically becomes a major determinant of the property’s taxable value. The fact that this method uses income to make the calculation of market value does not make this an income tax. A tax on income is something Nevada has not adopted. We do have “activity” taxes like the modified business tax and we do have taxes on sales and uses. Closely akin to the latter are the excise taxes such as cigarette and alcohol taxes.

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## The Future

The future is very speculative indeed. If the world economy stabilizes and that of the United States strengthens as well, the price of gold will drop. If costs of extraction rise rapidly, extraction will slow down or stop. Will taxes be increased or decreased? Unless the constitution is amended to create a separate class of property, not limited by Section 2 of Article 10 to being taxed at 5 percent, the property tax on mines and mining claims is already at the constitutional maximum rate for property. Ironically, there is a proposal currently before the Nevada Legislature (SJR15) to eliminate the effect of Marvin Sedway's amendment by repealing the separate rate currently paid by mine owners. If this measure passes this Legislature and is approved by the voters in 2014, it would put mineral property back in Article 10, Section 1, being taxed at its market value in the ground at a rate no higher than any other property in the county.

As of this writing, the Nevada Supreme Court has directed that the "margins tax" proposed by the teachers will be presented to the Legislature for consideration. If this proposal is adopted by the Legislature or is passed by the voters in November of 2014, mining companies will be obligated to pay that tax just as any other business. ■

- 1 NRS 372
- 2 NRS 363B
- 3 NRS 76.130
- 4 NRS 361
- 5 NRS 362
- 6 NRS 362
- 7 Art. 10, Sec. 1 - "just valuation"
- 8 SJR 22, 1987, 89
- 9 Const. Conv. 1864
- 10 *Id.* @ 222
- 11 NRS 362.120
- 12 *State v. Kruttschnitt*, 4 Nev. 178 (1868), *Sun City Summerlin Community Assn. v. State*, 113 Nev. 835 at 841, 944 P.2d 234 (1997)
- 13 *State v. Virginia & T.R.R.*, 23 Nev. 283, 46 Pac. 723 (1986), cited *State v. Nevada Cent. RR*, 28 Nev. 186 at 207, 81 Pac. 99 (1905)
- 14 NRS 374, NRS 377
- 15 See endnote 13.
- 16 NRS 362.130
- 17 NRS 362.200
- 18 SB493, 76 Regular Session
- 19 IDEM
- 20 NRS 361.277(5)



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