STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced	**2/25/99**	Bill No:	**SB 933**
Tax:	**Property**	Author:	**Poochigian**
Board Position:		Related Bills:	

BILL SUMMARY:

This bill would provide a new construction exclusion for "structures" improved or replaced when complying with federal, state, and local regulations on underground storage tanks.

ANALYSIS:

Current Law:

The assessed value of a property is generally the market value of a property at the time of purchase adjusted annually by a maximum of 2 percent for inflation. The law requires that when "new construction" occurs, the total assessed value of the property must be increased by an amount equal to the value added by the new construction. When new construction replaces existing improvements, the value attributable to those pre-existing improvements is deducted from the property's assessed value prior to adding the value for the replacement.

When an underground storage tank is replaced, the assessed value of the old tank is subtracted from the property's assessed value and the market value of the new tank is added to the property's assessed value. Where a structure (such as the island canopy at a service station) must be replaced in connection with removing the tank, then the value of the old and replacement structure are similarly treated. With respect to upgrading, rather than replacing, a tank or structure, the property's assessed value of the tank or structure would be increased by the value added by the improvements.

Proposed Law:

This bill would provide that where a "structure" must be improved or replaced to comply with federal, state, and local regulations on underground storage tanks, new construction does not mean the construction or reconstruction performed for the purpose of normal maintenance and repair of that portion of the improvement or replacement made by a property owner to meet compliance standards.

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In General:

Property Tax System. Article XIII, §1 of the California Constitution provides that all property is taxable, at the same percentage of "fair market value," unless specifically exempted, or authorized for exemption, within the Constitution.

Article XIIIA, §2 of the California Constitution defines "fair market value" as the assessor's opinion of value for the 1975-76 tax bill, or, thereafter, the appraised value of property when purchased, newly constructed, or a change in ownership has occurred. This value is generally referred to as the "base year value". Barring actual physical new construction or a change in ownership, annual adjustments to the base year value are limited to 2% or the rate of inflation, whichever is less. Article XIIIA, §2 provides for certain exclusions from the meaning of "change in ownership" and "newly constructed" as approved by voters via constitutional amendments.

New Construction. With respect to any new construction the law requires the assessor to determine the added value upon completion. The value is established as the base year value for those specific improvements and is added to the property's existing base year value. When new construction replaces existing improvements, the value attributable to those preexisting improvements is deducted from the property's existing base year. (R&T Code §71) New construction under Rule 463 is defined, in part, to mean:

1. Any addition to real property, whether land or improvements (including fixtures), since the last lien date.

2. Any alteration of land or improvements (including fixtures) or portion thereof since the lien date which constitutes a major rehabilitation thereof or which changes the way it was used.

3. Any rehabilitation, renovation, or modernization which converts an improvement or portion thereof or fixture to the substantial equivalent of a new improvement or fixture is a major rehabilitation of such improvement or fixture, or part thereof.

New Construction Exclusions. Revenue and Taxation Code §70(c), §70(d), §74, §74.3, §74.5 and §74.6 exclude certain specified improvements made to real property from the definition of new construction. These provisions relate to seismic safety improvements, fire prevention or suppression improvements, accessibility improvements for disabled persons, and improvements reconstructed after disaster. Constitutional authorization exists for these specific types of improvements as provided in Article XIIIA, §2 of the Constitution. Consequently, while these improvements may increase the value of the property, the additional value is exempt from taxation.

Improvements: Fixtures and Structures. The law requires that assessed values be maintained separately for "land" and "improvements." The law further categorizes improvements by their type. Revenue and Taxation Code §105 defines "improvements"

as “all buildings, structures, fixtures, and fences erected on or affixed to the land.” With respect to this bill, underground storage tanks are classified as fixtures. There are several reasons why a “fixture” classification is important:

- **Differing definitions of "new construction."** With respect to fixtures, Property Tax Rule 463(b)(5) provides that new construction includes ”any substantial physical rehabilitation, renovation or modernization of any fixture which converts it to the substantial equivalent of a new fixture or any substitution of a new fixture. Substantial equivalency shall be ascertained by comparing the productive capacity, normally expressed in units per hour, of the rehabilitated fixture to its original productive capacity.”

- **Fixtures are their own "appraisal unit" when measuring declines in value.** They are given special assessment treatment under Rule 461(d) in that, unlike land and other types of improvements that generally increase in value by 2% each year, the assessed value of fixtures is generally decreased each year to account for depreciation.

- **Fixtures not included in a change in ownership or in a structure are not subject to supplemental assessments.** Under §75.15, this means that the value of newly installed or improved fixtures are not subject to property tax until the following tax year. Other types of fixtures that are a part of buildings and structures are subject to property taxation from the moment they are complete. Under §75.5, fixtures that are normally valued as a separate appraisal unit from a structure and are not included in a change in ownership are exempt from supplemental assessment.

Classification of Service Station Improvements. Service station improvements are made of many components. Assessors must identify and categorize each component consistent with existing law. In general, components such as signs, hoists, and tanks are classified as “fixtures” if they directly augment the service station trade. This classification is consistent with Property Tax Rule 463(c) defines "fixture" as "an improvement whose use or purpose directly applies to or augments the process or function of a trade, industry, or profession." As such, these improvements are properly categorized as fixtures, and replacement constitutes new construction.

The following table is a generalized listing of property typically found in connection with service stations and their appropriate categorization as proposed by industry.[1] As technological advancements are made and other changes occur in this industry, these general categorizations may need to be modified.

[1] Categorization recommendation supplied by the Western States Petroleum Association Marketing Property Task Force.

CLASSIFICATION OF SERVICE STATION IMPROVEMENTS	
Structures	**Fixtures**
Buildings	Island Curbing
Curbing	Signs
Paving	Hoists
Restrooms	Compressors
Walls	Air & Water Wells
Fencing	Dispensers/Pumps
Yard Lighting	*Tanks* & Related Equipment
Landscaping	
Island Canopy	

Background:

The following information is taken from a California Environmental Protection Agency's News Release dated December 3, 1998.

Owners and operators of USTs across the United States had until December 22, 1998 to comply with federal and state requirements to upgrade or replace tanks and piping installed before 1984 when California's UST program and more stringent tank requirements came into effect. This deadline was initially established by the U.S. Environmental Protection Agency 10 years ago to allow tank owners sufficient time to comply with the upgrade requirements. In California, State law prohibits the delivery of petroleum products to USTs after January 1, 1999 if those USTs have not been upgraded or replaced by the December 1998 deadline.

Local agencies regulate approximately 61,000 tanks throughout California. Of those, 55,000 are petroleum tanks and 6,000 are hazardous substance tanks. It is estimated that approximately 29,000 USTs still need to be removed, replaced or upgraded. Although most of these tanks contain petroleum products, the impact to the public will be minimal as the majority of the tanks that have yet to comply with the law are located at trucking and transportation companies, hospitals, marinas, airports, and federal, state and local agencies.

In addition to being denied gasoline delivery, owners who miss the December 22,1998 deadline will be subject to fines. If a petroleum release is discovered on the property after this deadline, owners who have not upgraded may be ineligible to receive reimbursement for cleanup costs from the State Water Resources Control Board Cleanup Fund.

Upgrades may include retrofitting an existing tank and piping with internal lining, corrosion protection, spill containment, overfill prevention equipment, striker plates and automatic pump shutdown capabilities. Replacing the tank with a new secondary tank system can also satisfy the requirement. Non-petroleum hazardous substances tank systems, like those containing waste oil or chemicals, may not be retrofitted. They must be replaced with secondary containment (double-walled) tank systems.

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Upgrade work can still be done after the December 22, 1998 deadline without penalty if the tanks are emptied, temporarily closed and properly sealed prior to the deadline. Tank owners may then choose to replace, upgrade or permanently close the tanks during the temporary closure period.

COMMENTS:

1. **Sponsor and Purpose.** This measure is sponsored by the author in an effort to ensure that property tax assessments are not increased when property owners are forced to purchase or upgrade underground storage tanks to meet laws and regulations imposed by government.

2. **Should Fulfilling A Governmental Regulation Result in Higher Property Taxes?** Proponents reason that it is unfair that property owners must pay more property taxes as a consequence of making improvements to their property as required by law. The property owner is financially impacted twice: first, by the initial outlay to pay for the improvements and, second, by the annual incremental cost because the assessed value of the property has increased. Some service station owners have closed their businesses because it was too costly to comply with the underground storage tank requirements.

3. **This Bill Exempts Structures. Tanks Would Still Be Subject To Reassessment.** As noted above, "structures" and "fixtures" are treated differently for property tax purposes. An underground storage tank is a fixture. As currently drafted, this bill excludes "structures," but not the tank itself, from the definition of new construction. Presumably, the author intends to exclude the improvement or the replacement of the tank from the definition of new construction. Suggested amendments are offered below.

4. **How Should "Rebuilt" Gas Stations Be Treated?** If it is also the author's intent to exclude "structures" from new construction, then this raises various implementation questions. Further amendments would be beneficial. Should the new construction be limited only where there was reconstruction of a substantially equivalent structure? Some gas stations did minimal tank work which would have only slightly disrupted the site or surrounding structures. In other cases, gas stations have undergone major renovations or complete rebuilding at the time the underground storage tank work took place. These gas stations have reopened and expanded their previous facilities with other retail establishments, such as fast-food outlets and mini-marts. Would these properties be eligible for a partial or complete new construction exclusion?

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5. **Is This Legislation Too Late For Those Property Owners Who Complied With The Law?** The new construction exclusion would apply prospectively. Presumably this bill would therefore apply to 1) future changes in underground tank laws and requirements and 2) those owners who did not meet the December 22, 1998 deadline but who have emptied and, temporarily or permanently, closed their tanks and will receive governmental approval to replace or upgrade their tanks at a later date. There was more than ten years of advance notification and education of the December 22, 1998 deadline. The U.S. EPA has been warning that they would not (and did not) extend the deadline because it would have been unfair to those underground storage tank owners who had already complied.

6. **Suggested Amendments.** The following amendments to Section 70 are suggested if the author intends to limit this bill to apply only to underground storage tanks.

> (e) Notwithstanding the provisions of (a) and (b), ~~W~~ where a ~~structure~~ tank must be improved, upgraded, or replaced to comply with federal, state, and local regulations on underground storage tanks, "newly constructed" and "new construction" does not mean ~~the construction or reconstruction performed for the purpose of normal maintenance and repair of that portion of~~ the improvement or replacement of a tank ~~made by a property owner or~~ [2] to meet compliance standards.

The following amendments are suggested if the author intends to exclude both tanks and substantially equivalent replacement structures from the definition of new construction.

> (e) (1) Notwithstanding the provisions of (a) and (b), ~~W~~ where a ~~structure~~ tank must be improved, upgraded, or replaced to comply with federal, state, and local regulations on underground storage tanks, "newly constructed" and "new construction" does not mean ~~the construction or reconstruction performed for the purpose of normal maintenance and repair of that portion of~~ the improvement or replacement of a tank ~~made by a property owner~~ to meet compliance standards.
>
> (2) Notwithstanding the provisions of (a) and (b), where a structure was reconstructed, or portion thereof, as a consequence of completing work on an underground storage tank to comply with federal, state, and local regulations on these tanks, timely reconstruction of the structure shall be considered to have been performed for the purpose of normal maintenance and repair where the structure, or portion thereof, after reconstruction is substantially equivalent to the prior structure.

COST ESTIMATE:

The costs associated with this measure would be absorbable.

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[2] Many gas stations are leased from the actual property owner. To ensure these improvements are excluded regardless of whether the property is leased or owned, this phrase is deleted.

REVENUE ESTIMATE:

Background, Methodology, and Assumptions

State law and regulations required that underground storage tanks (UST's) storing petroleum and other hazardous chemicals that were installed before 1984 were to be removed, replaced or upgraded by December 22, 1998 to reduce the risk of hazardous material releases into the environment. The upgrade deadline was established by the U.S. Environmental Protection Agency in Fall 1988 and became a state requirement soon after. A petroleum UST that was not upgraded by the deadline cannot be used to receive product after January 1, 1999.

Information from the counties shows that probably all of the upgrades and replacements that will be done were completed by the deadline. It is likely that the remaining UST's that were installed before 1984 and were not removed, replaced, or upgraded by the deadline will be removed or abandoned.

Revenue Summary

It does not appear that there is any revenue effect from the new construction exclusion for underground storage tanks that are required to be improved or replaced to comply with federal, state, and local regulations.

Qualifying Remarks

The revenue estimate of this bill has been prepared assuming that the author intended to ensure only that replaced or upgraded "tanks" are not treated as new construction.

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