

## Memorandum

**To:** Honorable Jerome E. Horton, Chairman  
Honorable Michelle Steel, Vice Chair  
Honorable Betty T. Yee, First District  
Senator George Runner, Second District  
Honorable John Chiang, State Controller

**Date:** August 28, 2013

**From:** Randy M. Ferris   
Chief Counsel

**Subject:** **Board Meeting, September 10, 2013**  
**Chief Counsel Matters – Item J – Rulemaking**  
**Request for Authorization to Repeal and Initiate Rulemaking to Readopt Property Tax Rule 474, *Petroleum Refining Properties***

We request your approval to repeal and initiate the rulemaking process to readopt Property Tax Rule<sup>1</sup> 474, *Petroleum Refining Properties* (Rule 474).<sup>2</sup> These actions are in response to the August 5, 2013, California Supreme Court decision in *Western States Petroleum Association v. Board of Equalization* (August 5, 2013, S200475) \_\_ Cal.4th \_\_ (hereafter *WSPA*). In that case, the Supreme Court held that Rule 474 is substantively valid, but procedurally invalid under the Administrative Procedure Act (APA).

The Board adopted Rule 474 on September 27, 2006,<sup>3</sup> to provide that, consistent with California Constitution article XIII, section 1,<sup>4</sup> article XIII A (which contains Proposition 13 as amended by Proposition 8), Revenue and Taxation Code<sup>5</sup> section 51, and Rules 461 and 324, refinery property consisting of land, improvements and fixtures is rebuttably presumed to be a single appraisal unit in determining Proposition 8 declines in value below the Proposition 13 adjusted base year value for property tax valuation purposes.

The Supreme Court held that the adoption of Rule 474 did not exceed the Board's rulemaking authority because the rule is consistent with applicable constitutional and statutory provisions as well as the long-standing valuation principle that the proper appraisal unit is the collection of assets that people in the marketplace normally buy and sell as a single unit. Notably, it opined that Rule 474 comports with economic reality in determining declines in value when

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<sup>1</sup> All references to Property Tax Rules or Rules are to sections of title 18 of the California Code of Regulations.

<sup>2</sup> We also note the Los Angeles County Assessor's Office has requested, in a letter dated August 20, 2013, that the Board initiate rulemaking regarding Rule 474. (The letter is attached.)

<sup>3</sup> The Board readopted Rule 474 on August 14, 2007, after amendment to the Initial Statement of Reasons.

<sup>4</sup> This section states that all property is taxable and shall be assessed at the same percentage of fair market value unless otherwise provided by the California Constitution or the laws of the United States.

<sup>5</sup> All further statutory references are to the Revenue and Taxation Code unless otherwise indicated.

land and fixtures are actually bought and sold as a single unit. Specifically, in the last paragraph of part III.B. of the opinion, the Supreme Court stated:

. . . To account for fixture depreciation separately when land and fixtures are actually bought and sold as a single unit would allow the owner to claim a reduction in real property value that is economically fictitious, resulting in a tax windfall. Neither California Constitution article XIII A nor section 51 nor traditional appraisal practices require the unit of appraisal to be defined in a manner that maximizes the depreciation of fixtures in contravention of economic reality. To the contrary, the law and consistent practice have long required appraisal of real property in the declining value context to reflect its "full cash value" – that is, the value "property would bring if exposed for sale in the open market." (§§ 51(a)(2), 110.) Rule 474 is consistent with this principle.

Nevertheless, the Supreme Court affirmed the Court of Appeal’s judgment invalidating Rule 474 on procedural grounds, finding that the Board failed to provide an adequate assessment of the Rule’s economic impact during the rulemaking process as required by the APA. In particular, the Supreme Court held that Rule 474 is procedurally deficient because the Board did not make a reasoned estimate of all cost impacts of the rule on affected parties.

Therefore, Board Staff requests the Board’s authorization to repeal Rule 474 under California Code of Regulations, title 1, section (Rule) 100 without the normal notice and public hearing process. This change to the California Code of Regulations is specifically authorized by Rule 100, subdivision (a)(3) because the change merely deletes a provision that has been held invalid in a final judgment entered by a California court of competent jurisdiction. Board Staff also requests the Board’s authorization to initiate the rulemaking process to readopt Rule 474 following the notice and public hearing process under the APA. As part of that process, staff will reassess the economic impact of Rule 474 on affected businesses in accordance with the APA and WSPA. Then, staff will make a determination in the Notice of Proposed Regulatory Action published by the Office of Administrative Law as to whether Rule 474 will or will not have a "significant, statewide adverse economic impact on business," and staff will include the factual basis for that determination in the Initial Statement of Reasons, which will be posted on the Board’s website. Finally, because the Supreme Court held that Rule 474 was substantively valid, the text of Rule 474 will remain unchanged, and is attached.

If you need more information or have any questions, please contact Robert Tucker, Assistant Chief Counsel, at (916) 322-0437 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

**STATE BOARD OF EQUALIZATION**



BOARD APPROVED

At the 9/10/13 Board Meeting

Joann Richmond for  
Joann Richmond, Chief  
Board Proceedings Division

Approved:

Cynthia Bridges  
Cynthia Bridges  
Executive Director

Attachments: August 20, 2013, Letter from Los Angeles County Assessor’s Office  
Text of Rule 474

cc: Mr. Robert Tucker MIC:82  
Mr. David Gau MIC:63  
Mr. Richard Moon MIC:82  
Mr. Bradley Heller MIC:82  
Mr. Dean Kinnee MIC:64  
Mr. Todd Gilman MIC:70



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**SHARON MOLLER**  
CHIEF DEPUTY ASSESSOR

August 20, 2013

Chairman Jerome E. Horton  
Fourth District  
State Board of Equalization  
450 N Street, MIC: 72  
Sacramento, CA 95814

Dear Chairman Horton:

**Request for Rulemaking, Property Tax Rule 474**

The Los Angeles County Assessor's Office respectfully requests that the Board of Equalization initiate rulemaking to address the problem with the economic impact statement for Property Tax Rule 474 identified by the California Supreme Court in its opinion in *Western States Petroleum Assn. v. Board of Equalization* 2013 Cal. LEXIS 6646, ("WSPA").

The Court affirmed in *WSPA*, on a very positive note, that the policy enacted in Rule 474 and adopted by your Board of requiring the performance of "decline-in-value" appraisals of oil refineries on a unit basis was substantively valid. The Court reasoned that the Rule was consistent with applicable constitutional and statutory provisions, and that for valuation purposes the proper appraisal unit is the collection of assets that persons in the marketplace normally buy and sell as a single unit.

Unfortunately, the Court also confirmed that Rule 474 was invalid because it found that the Rule's economic impact statement required by the pertinent procedural law did not adequately estimate all cost impacts on affected parties.

Assessors with oil refinery properties in their jurisdiction now face a difficult dilemma. The Supreme Court affirmed the substantive policy of Rule 474 as satisfying the applicable legal principles such as the requirement of full cash value assessments. Assessors, however, are required to follow specific provisions of law including your Board's rules, or potentially expose their County to potential liability for taxpayer attorneys' fees. (Rev. & Tax. code § 538.)

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With Rule 474 confirmed invalid on procedural grounds, an argument could potentially be advanced that the regulatory provision now applicable to refinery properties is Property Tax Rule 461(e), which requires the separate assessment of fixtures for decline-in-value appraisals. This development would have a significant adverse impact on the County of Los Angeles. Our county has six major refineries in its jurisdiction with a combined annual assessment of approximately \$9 billion. If the pertinent measure for refinery decline-in-value analysis were the artificial separation of fixtures from land and improvements as required by Rule 461(e), the impact on refinery assessed values would be substantial and negative.

Local assessors should not be put to a Hobson's choice. On the one hand, an assessor risks exposure for attorneys' fees if he or she were to follow the sound policy direction of what has been declared a procedurally invalid rule. On the other, to follow Rule 461(e) in contravention to what has been stated to be consistent with applicable constitutional and statutory provisions risks the potential loss of significant tax revenues to their county and the State.

We respectfully request your Board to initiate a rulemaking proceeding to reenact Rule 474 in a manner that satisfies the procedural concerns of the *WSPA* Court. My Office stands ready to advocate in support of that result, and to provide expert testimony in the rulemaking process.

Thank you for your consideration of this request.

Sincerely,



SHARON MOLLER

BD

c: Members, State Board of Equalization  
Cynthia Bridges, Executive Director  
Randy Ferris, Chief Counsel  
David Gau, Deputy Director, Property and Special Taxes Department  
Dean Kinnee, Chief, County-Assessed Properties Division

## **RULE 474. PETROLEUM REFINING PROPERTIES.**

**(a)** The provisions of this rule apply to the valuation of the real property, personal property, and fixtures used for the refining of petroleum.

### **(b) GENERAL.**

(1) The unique nature of property used for the refining of petroleum requires the application of specialized appraisal techniques designed to satisfy the requirements of article XIII, section 1, and article XIII A, section 2, of the California Constitution. To this end, petroleum refineries and other real and personal property associated therewith shall be valued pursuant to the principles and procedures set forth in this section.

(2) Notwithstanding any other provision in this section, any appropriate valuation method described in section 3 of title 18 of this code may be applied in the event of a change in ownership in a petroleum refining property.

### **(c) DEFINITIONS.** For the purposes of this section:

(1) "Petroleum refining property" means any industrial plant, including real property, personal property, and fixtures, used for the refining of petroleum, as identified in Standard Industrial Classification (SIC) System Codes 2911 and 2992, or North American Industry Classification System (NAICS) Codes 32411 and 324191.

(2) "Appraisal unit" consists of the real and personal property that persons in the marketplace commonly buy and sell as a unit.

### **(d) DECLINES IN VALUE.** For the purposes of this section:

(1) Declines in value of petroleum refining properties will be determined by comparing the current lien date full value of the appraisal unit to the indexed base year full value of the same unit.

(2) The land, improvements, and fixtures and other machinery and equipment classified as improvements for a petroleum refining property are rebuttably presumed to constitute a single appraisal unit, except when measuring declines in value caused by disaster, in which case land shall constitute a separate unit.

(3) In rebutting this presumption, the assessor may consider evidence that:

(A) The land and improvements including fixtures and other machinery and equipment classified as improvements are not under common ownership or control and do not typically transfer in the marketplace as one economic unit; or,

(B) When the fixtures and other machinery and equipment classified as improvements are not functionally and physically integrated with the realty and do not operate together as one economic unit.

Authority Cited: Section 15606(c), Government Code  
Reference: Article XIII, Section 1, and Article XIII A, Section 2, California Constitution  
Sections 51 and 110.1, Revenue and Taxation Code