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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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Executive Secretary

April 23, 1987

No. 87/40

TO COUNTY ASSESSORS:

ASSESSMENT OF DRY HOLE WELLS

We have received inquiries from assessors and taxpayers that have alerted us to a problem concerning correct assessment procedures when a new oil well is drilled and turns out to be a dry hole. The practices of which we speak could just as easily have been applied in the case of a gas well, geothermal well, water well and certain mining properties.

What has occurred is that an oil well was drilled to the target depth but no oil was found and when drilling ceased the assessor levied an assessment. Through what we believe was a misinterpretation of the law, the well was appraised for the supplemental roll on the basis of the cost of the well up to the point that drilling was concluded. It was the assessor's belief that the income approach, which would have reflected the dry hole and no value, could not be used in making the supplemental assessment because mineral reserves could only be reassessed on the March 1 lien date. Hence, as mineral reserves cannot be assessed on completion of new construction, the assessor reasoned, then the reserves should not be considered when assessing the new construction of the well for supplemental assessment purposes.

It is the Board's position that such a practice has no support in the constitution, statutes or rules, but is instead a violation of Article XIII Section 1(a) of the Constitution which says that all property shall be assessed at the same percentage of its fair market value. Article XIII A did not in any way alter the provisions of Article XIII pertaining to taxation according to fair market value (State Board of Equalization v. Board of Supervisors, 105 Cal. App. 3d 813; Shellenberger v. Board of Equalization of San Joaquin County, 147 Cal. App. 3d 510). Furthermore, property is not "taxed in proportion to its value" when the assessment is grossly excessive or discriminatory. Such assessments are constructively fraudulent, and relief against them will be granted by the courts. (Mahoney v. City of San Diego, 198 Cal. 388, etc.)

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In summary, the determination of the value of new construction of a new well requires the appraisal of the total unit, well and mineral reserve, prior to the allocation of value between the newly constructed well and the proved mineral reserve. When there are no future benefits anticipated from a newly drilled well, i.e., no new reserves, no alternative uses, no operating benefits, etc., there is little, if any, value attributable to the new construction.

In the event a new well discovers a mineral reserve value less than the cost of drilling (constructing) the well, the ingenuity of the appraiser will be tested in making a reasonable allocation of value between the newly constructed well and the new reserves. The value allocated to the well is subject to supplemental assessment; the new proved reserves will be assessed on the following March 1 lien date in an existing field or as a supplemental assessment if the new reserves represent a "new discovery."

If you have any problems or questions concerning this matter, please call our Technical Services Unit at (916) 445-4982.

Sincerely,



Verne Walton, Chief
Assessment Standards Division

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