



STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

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July 17, 2007

No. 2007/032  
Revised

TO COUNTY ASSESSORS, COUNTY COUNSELS,  
AND OTHER INTERESTED PARTIES:

NOTICE OF PROPOSED REGULATORY ACTION  
BY THE  
STATE BOARD OF EQUALIZATION

PROPOSED ADOPTION OF  
PROPERTY TAX RULE 474 -- *PETROLEUM REFINING PROPERTIES*

On September 27, 2006, the State Board of Equalization held a public hearing and adopted proposed Property Tax Rule 474, *Petroleum Refining Properties*. The Office of Administrative Law (OAL) issued its Decision of Disapproval of Regulatory Action dated June 8, 2007, solely based on the finding that "the Initial Statement of Reasons failed to provide the public with the rationale for the determination by the agency that the provisions in section 474 are needed to carry out the purpose for which it is proposed." In response, the Board of Equalization has submitted the initial statement of reasons to the 15-day file, recommending that changes be made to the statement to more fully explain the proposed rule's purpose and necessity consistent with the OAL decision. No substantive changes to the proposed rule have been made; however, a statutory reference to Revenue and Taxation Code section 53.5 was determined to be irrelevant and removed.

Enclosed are the revised versions of the initial statement of reasons and proposed Rule 474.

In accordance with Government Code section 11346.8, subdivisions (c) and (d), and section 11347.1, the revised initial statement of this rule is being placed in the rulemaking file and mailed today to interested parties who commented orally or in writing, or who asked to be informed of such revisions. If you wish to review the rulemaking file, it is available for your inspection at the State Board of Equalization, 450 N Street, Sacramento, California. The proposed rule will be placed on the agenda for the August 14, 2007 Board meeting for the Board's consideration.

TO COUNTY ASSESSORS,  
COUNTY COUNSELS, AND  
OTHER INTERESTED PARTIES

2

July 17, 2007

Questions regarding the substance of the proposed rule should be directed to: Mr. Robert Lambert, Acting Assistant Chief Counsel, at P.O. Box 942879, 450 N Street, MIC:82, Sacramento, CA 94279-0082; E-mail: [Robert.Lambert@boe.ca.gov](mailto:Robert.Lambert@boe.ca.gov); Telephone: 916-324-6593; Fax: 916-323-3387.

Requests to present testimony and bring witnesses to the public hearing, and inquiries concerning the proposed administrative action should be directed to: Ms. Diane Olson, Regulations Coordinator, P.O. Box 942879, 450 N Street, MIC:80, Sacramento, CA 94279-0080; E-mail: [Diane.Olson@boe.ca.gov](mailto:Diane.Olson@boe.ca.gov); Telephone: 916-322-9569; Fax: 916-324-2597. Written comments must be submitted to Ms. Olson by August 1, 2007.

Sincerely,

Gary Evans, Assistant Chief  
Board Proceedings Division

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Enclosure

**INITIAL STATEMENT OF REASONS  
NON-CONTROLLING SUMMARY**

**Property Tax Rule 474  
Petroleum Refining Properties**

**Specific Purpose**

~~\_\_\_\_\_ The purpose of the proposed rule is to implement and make specific the requirements for valuation of real property, personal property, and fixtures used to refine petroleum.~~

**Factual Basis**

~~\_\_\_\_\_ Section 1 of article XIII of the California Constitution provides that, unless otherwise provided by the California Constitution or the laws of the United States, all property is taxable and all assessed property is taxed in proportion to its full value. Subdivision (b) of section 2 of article XIII A of the California Constitution requires that the base year value of assessed property may not increase annually by more than the inflation factor prescribed in that subdivision.~~

~~\_\_\_\_\_ Section 51 of the Revenue and Taxation Code implements these provisions by establishing methods for adjusting the base year values of assessed real property. Subdivision (d) of section 51 provides that "real property" means "that appraisal unit that person in the marketplace commonly buy and sell as a unit, or that is normally valued separately."~~

~~\_\_\_\_\_ The Board of Equalization proposes to adopt Rule 474 to clarify and make specific certain specialized appraisal techniques for the valuation of real property, personal property, and fixtures used to refine petroleum.~~

~~\_\_\_\_\_ Proposed Rule 474 will (1) define "petroleum refining property;" and (2) establish a rebuttable presumption for purposes of recognizing declines in value that fixtures and machinery and equipment classified as improvements for a petroleum refining property are part of the same appraisal unit as the land and structures. The presumption must be overcome before fixtures are treated as a separate appraisal unit for declines in value, except when measuring declines in value caused by disaster, in which case land constitutes a separate appraisal unit.~~

**Proposed Property Tax Rule 474**

Proposed Rule 474<sup>1</sup> will (1) define “petroleum refining property;” and (2) establish a rebuttable presumption for purposes of recognizing declines in value that fixtures and machinery and equipment classified as improvements for a petroleum refining property are part of the same appraisal unit as the land and structures. The presumption must be overcome before fixtures are treated as a separate appraisal unit for declines in value, except when measuring declines in value caused by disaster, in which case land constitutes a separate appraisal unit.

**Specific Purpose; Necessity; Factual Basis**

General purpose. In general, the purpose of the proposed rule is to implement and make specific the requirements for valuation of real property, personal property, and fixtures used to refine petroleum. More specifically, the purpose of the proposed Property Tax Rule 474 is to clarify and implement the requirements under article XIII, section 1, and article XIII A, section 2, of the California Constitution for the valuation of real property, personal property, and fixtures used to refine petroleum. The proposed rule is necessary in order to require that assessors value petroleum refinery property properly for fair market value/decline in value purposes, as explained and for the reasons set forth below:

Summary of Necessity. As explained in more detail below, Rule 461, subdivision (e) provides the general rule that, in appraisals conducted for the purpose of determining whether or not there has been a decline in value in real property upon which improvements, fixtures, and machinery are located, the fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit. This rule is premised upon the normal market situation, applicable to most types of property, where the land and improvements are most commonly sold separately from the fixtures and machinery. Accordingly, when applied to the appraisal of most types of real property, Rule 461, subdivision (e) will result in accurate fair market valuations of both the land and improvements and the fixtures and machinery.

It has long been recognized, however, that Rule 461, subdivision (e) will not produce accurate fair market valuations in all situations. In some exceptional cases involving special types of properties, the normal market situation involves the sale of land, improvements, fixtures and machinery as a single economic unit. In these types of cases, in order to be consistent with the marketplace, the land, improvements, fixtures, and machinery should be valued as a single appraisal unit to determine whether or not there has been a decline in value. Because petroleum refinery properties sell most commonly as a single economic unit – including land, improvements, fixtures, and machinery, the application of the “general rule” of Rule 461, subdivision (e) to petroleum

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<sup>1</sup> All references to proposed Property Tax Rule or proposed Rule are to the rule proposed for inclusion in title 18 of the California Code of Regulations.

refinery properties is inappropriate; and, in fact, will lead to appraisals that are not consistent with fair market value when calculating declines in value for such properties.

In order to address the special characteristics of such properties, Proposed Rule 474: (1) defines the petroleum refining property appraisal unit that normally will be used to determine "full cash value" under article XIII A, section 2; and (2) establishes a rebuttable presumption that fixtures and machinery and equipment classified as improvements, for a petroleum refining property, are part of the same appraisal unit as the land for purposes of recognizing declines in value. This presumption may be overcome by showing that the land and fixtures in a specific petroleum refining property do not operate together as a single economic unit. In the case of declines in value caused by disaster, however, land and fixtures would constitute separate appraisal units. Proposed Rule 474 thereby clarifies how the value of petroleum refining properties should be determined when there has been a decline in value.

Fair market valuation and declines in value. Section 1 of article XIII of the California Constitution states that, unless otherwise provided by the California Constitution or the laws of the United States, all property is taxable and shall be assessed at the same percentage of fair market value. Article XIII A (which contains Proposition 13 as amended by Proposition 8) of the California Constitution requires that all real property be valued at its factored base year value (Proposition 13 value), which is a property's fair market value as of the date of a change in ownership or completion of new construction adjusted annually to reflect an inflation factor of no more than 2 percent, or the property's fair market value at the lien date (Proposition 8 value), whichever is lower. (See Rev. & Tax. Code, § 51, subd. (a).)<sup>2</sup> Proposition 8 amended Proposition 13 to provide a temporary reduction in assessed value where the property has experienced a decline in fair market value to an amount below Proposition 13 value. (*County of Orange v. Renee M Bezaire* (2004) 117 Cal.App.4th 121.)

The determination of whether or not there has been a decline in value of petroleum refining property is currently governed by section 51 and Rule 461, subdivision (e), which provide the general decline in value principles for use in implementing article XIII, section 1 and article XIII A, section 2, of the California Constitution. Under these provisions:

In determining the extent of a potential decline in value, the assessor must look to the net change in value of the appraisal unit which is commonly bought and sold in the market place, or which is normally valued separately . . . . This means that land and improvements are ordinarily treated as a unit, [footnote omitted] and that a taxpayer cannot claim a net decline in full cash value terms of an improvement due to depreciation [i.e. decline in value], without also including any appreciation in the value of the land. If the building depreciation is offset by the increase in land value, then no reduction in assessment occurs. Fixtures, however, are

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<sup>2</sup> All section references are to the Revenue and Taxation Code unless otherwise specified.

normally appraised separately, thus owners may claim a decline based on depreciation of the fixture without regard to the value of the surrounding land or improvements. (Emphasis added.)<sup>3</sup>

Section 51, subdivision (d) defines an "appraisal unit" alternatively as: (1) that which "persons in the marketplace commonly buy and sell as a unit" or (2) that which is "normally valued separately." The second alternative was adopted in recognition of the fact that fixtures and other machinery and equipment classified as improvements are normally valued separately in the marketplace.

After the passage of Proposition 8, the Board amended Rule 461 to state that fixtures and other machinery and equipment classified as improvements should be treated as a separate appraisal unit. Accordingly, Rule 461, subdivision (e) presently provides that fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit. The Board adopted the language of Rule 461, subdivision (e) on January 25, 1979, and it has remained unchanged since that time. Given such separate appraisal units, no offsetting of land and improvement value vis-à-vis fixture and machinery value can take place, having the effect of isolating fixture and machinery declines in value from land and improvement increases in value. Under such a rule, any fixture and machinery declines in value (from depreciation or any other cause) are immediately recognized for property tax purposes as Proposition 8 value reductions, despite increases in land and improvement value. While this is entirely appropriate and, in fact, mandatory, where the market indicates the existence of two separate appraisal units – one for land and improvements and one for fixtures and machinery – it is inappropriate where the market indicates that, in fact, the two categories of property commonly sell as a single unit.

The appraisal of property at fair market (or full cash) value means the price at which a property, "if exposed for sale in the open market with a reasonable time for the seller to find a purchaser, would transfer for cash or its equivalent under prevailing market conditions between parties who have knowledge of the uses to the property may be put...." (Rule 2, subd. (a) (Emphasis added); see also Rev. & Tax. Code, § 110, subd. (a).) Thus, the price at which property would transfer in the open market is the fundamental principle in defining fair market value. Consequently, for property tax purposes, the unit of property that commonly must be appraised is the one normally dealt with in the market. According to the Board's Assessors' Handbook (AH) 501, Basic Appraisal, p. 10-11, "The identification of the property to be appraised is an integral part of the appraisal process. Part of the process of identifying the property is identifying the 'appraisal unit' .... The proper unit to be valued is the unit that people in the market typically buy and sell. For example, single family homes are sold as a combination of land and buildings .... The combination of land and buildings, therefore, comprises the appraisal unit [for single family homes], and the appraisal of this type of property must reflect the value of this unit." Subdivision (b) of Rule 324 similarly provides that, "An

<sup>3</sup> Implementation of Proposition 13, Volume 1, Property Tax Assessment, Assembly Revenue and Taxation Committee, October 29, 1979, page 13.

appraisal unit of property is a collection of assets that functions together, and that persons in the marketplace commonly buy and sell as a single unit or that is normally valued in the marketplace separately from other property, or that is specifically designated as such by law." (Emphasis added.)

Existing exceptions to Rule 461, subdivision (e). While the general decline in value rule is adequate for properties that can be valued and which sell in the marketplace as separate appraisal units, the Board has adopted special rules for property that, like petroleum refining property, is of a type that is not adequately addressed by the general rule. These types of properties include oil and gas, mining, and geothermal properties, which are governed by Property Tax Rules 468, 469, and 473, respectively. In contrast to present Rule 461, Rules 468, 469, and 473 provide, as an exception to the general rule of decline in value appraisals, that fixtures and other machinery and equipment classified as improvements do not constitute a separate appraisal unit. These rules were promulgated in recognition of the unique nature of these properties, and to provide specialized appraisal techniques required to satisfy the requirements of article XIII, section 1, and article XIII A, section 2, of the California Constitution.

Petroleum refineries. The general decline in value rule set forth in Rule 461, subdivision (e), has been interpreted by some as applying to the valuation of petroleum refinery property. Such application, however, has been criticized as being inconsistent both with market practices and the constitutional requirement of fair market valuation. Unlike the usual case for most other types of property, in the sale and purchase of petroleum refinery property, land, improvements, and fixtures are commonly bought and sold as a single economic unit; in fact, it appears that the sale of refinery property almost always includes all three categories of property. This is because all the parts of the refinery must operate together to produce the finished product. Refineries are different from other heavily fixturized manufacturing industries in that up to 80 percent of their values are contained in the fixtures. In addition, because the land and fixtures are so integrated, it is difficult to physically separate the fixtures from the land. Furthermore, the land and fixtures are so economically integrated that, in an open market transaction, a buyer would not purchase the land or fixtures separately.

Thus, application of the "general rule" set forth in Rule 461, subdivision (e) to refinery property is inconsistent with the constitutional requirement of fair market valuation in that such regulatory provision might be interpreted as mandating two separate appraisal units while the petroleum refinery market evidences a single appraisal unit, one that encompasses land and improvements, as well as fixtures and other machinery and equipment classified as improvements. The general rule would be valid for petroleum refinery property only if persons in the marketplace commonly bought and sold refinery land/improvements, on the one hand, and fixtures/machinery, on the other, as separate units; or if such types of property were normally valued separately.<sup>4</sup> But refinery land, improvements, and fixtures and other machinery and equipment classified

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<sup>4</sup> Of course, if two types of property are not bought and sold separately, then generally there is no reason (or basis upon which) to value them separately.

as improvements are commonly bought, sold, and valued as a single unit in the marketplace. Thus, application of the general decline in value rule to petroleum refining property may, under appropriate facts, violate the California Constitution's requirement that property be valued at fair market value. (Cal. Const., art. XIII, § 1 and art. XIII A, § 2.) Proposed Rule 474 corrects this misinterpretation of Rule 461 and section 51.5

Conclusion. In conclusion, Proposed Rule 474 is necessary since the current statutory and regulatory scheme does not adequately address the decline in value of petroleum refining property. Similar to properties governed by Rules 468, 469, and 473, petroleum refineries normally would not separately sell their land apart from their fixtures.

Proposed Rule 474, thus, is necessary with respect to appraising the declines in value of petroleum refineries because the application of the "general rule" in Rule 461, subdivision (e), to such refineries is inappropriate and will lead to inaccurate valuations. Proposed Rule 474: (1) defines the petroleum refining property appraisal unit that normally will be used to determine "full cash value" under article XIII A, section 2; and (2) establishes a rebuttable presumption that fixtures and machinery and equipment classified as improvements, for a petroleum refining property, are part of the same appraisal unit as the land for purposes of recognizing declines in value. This presumption may be overcome by showing that the land and fixtures in a specific petroleum refining property do not operate together as a single economic unit. In the case of declines in value caused by disaster, however, land and fixtures would constitute separate appraisal units. Proposed Rule 474 thereby clarifies how the value of petroleum refining properties should be determined when there has been a decline in value.