State of California

Board of Equalization

Memorandum

To : Mr. Verne Walton

Date March 23, 1988

From : Eric F. Eisenlauer Eric F Eisenlauer

Subject: Mineral Property Declines in Value

This is in response to your memorandum of February 10, 1988 to Mr. Richard H. Ochsner concerning the correctness of the following statement in the 1987 Sierra County Assessment Practices Survey at page 12 under the heading "Operating Mineral Properties":

> Measurement of Declines in Value
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> "When measuring declines in value for the 1984 roll, the county assessor compared the current market value of the entire property including land, improvements, and machinery and equipment to the factored base-year value of the same unit. This was an incorrect procedure. When measuring declines in value, land, and improvements constitute one appraisal unit while machinery and equipment constitute a separate unit (Board Rule 461)."

Quoting from recent assessment practices surveys, you have said the following:

> "Los Angeles County, 1985
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> "The assessor has been recognizing declines in value of mineral rights (Proposition 8) by comparing the current market and Article XIII A values of these rights and enrolling the lessor of the two. This is an erroneous procedure. In determining whether the provisions of Proposition 8 are applicable, the assessor must compare total property values, i.e., the current market value and the Article XIII A value of the land, improvements, and reserves. The separate comparison of the mineral right values is a violation of Board Rule 468.
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> "Santa Barbara County, 1987
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> "Property Tax Rule 468(c)(6) stipulates that value declines shall be recognized when the market value of the appraisal

unit, i.e., land, improvements and reserves, is less than the current taxable value of the same unit. The Santa Barbara County Assessor makes the Proposition 8 comparison on the basis of mineral rights alone. This is an incorrect procedure. In addition, the county assessor uses the lower value as the new base-year value for mineral rights instead of bringing the Article XIII A value forward to again make the appropriate comparison. This is also an incorrect procedure. The method used to recognize declines in the value of oil properties should be revised to conform with the principles expressed in Rule 468.

"Ventura County, 1987

"Property tax rules call for the recognition of declines in value when the market value of the appraisal unit (wells, improvements, and reserves) is less than the indexed base-year value of the same unit. The county assessor correctly recognizes such declines in value in the years that they occur. However, we found several instances where the county assessor mistakenly used the prior year's lower market value of reserves as the indexed base-year value in the following year's calculations.

"The appraiser must maintain Article XIII A values and market values for each property in a given year, for the following year a comparison must again be made between the indexed Article XIII A value and market value. The Proposition 8 value does not become the new base-year value."

"Ray Rothermel believes the comments made in the above three surveys are correct. He believes the comment made in the Sierra Survey is incorrect because mineral properties are appraised as a unit. Since nearly all mineral properties are appraised using the income approach, he believes the unit of appraisal includes everything that contributes to income. This may even occasionally include some personal property which is not separately assessed. This has been the posture taken by the mineral appraisers for the past ten years."

Revenue and Taxation Code section 51(e) defines "real property" for purposes of declines in value as "that appraisal unit which persons in the market place commonly buy and sell as a unit, or which are normally valued separately."

Property Tax Rule 461(d) provides that "[d]eclines in value 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 for the current lien date. Land and improvements constitute an appraisal unit except when measuring declines in value caused by disaster in which case land shall constitute a separate unit. For purposes of this subsection, fixtures and other machinery and equipment classified as improvements constitute a separate appraisal unit."

Property Tax Rule 468(c)(6) concerning oil and gas producing properties provides that "[v]alue declines shall be recognized when the market value of the appraisal unit, i.e., land, improvements and reserves is less than the current taxable value of the same unit."

The question here essentially is what is meant by the word "improvements" in Rule 468(c)(6). That is, does the word "improvements" include fixtures and other equipment and machinery constituting improvements or is such property to be treated separately under Rule 461(d) for purposes of measuring decline in value? To resolve this ambiguity, it is necessary to construe the language in question. In doing so, the same rules of construction applicable to statutes are equally applicable to administrative rules and regulations (58 Cal.Jur.3d, Statutes § 82). The fundamental purpose of statutory construction is to ascertain the intent of the Legislature or in this case to ascertain the intent of the Board in adopting the language Rule 468.

In ascertaining the Board's intent, the language of Rule 468(c) is helpful. It states:

> "The unique nature of oil and gas property interests 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, the valuation of such properties and other real property associated therewith shall be pursuant to the following principles and procedures:"

The foregoing language plainly seems to intend that oil and gas producing properties are to be valued solely by reference to Rule 468 unless otherwise indicated in the rule. Although there are references to other rules in 468(c)(1)-(6), e.g., Rule 460.1, there are no references to Rule 461 or any

subdivision thereof. This is a strong indication that Rule 461 was not intended to apply to oil and gas producing properties. This conclusion is consistent with the general rule of statutory construction that unless repealed expressly or by necessary implication, a special statute dealing expressly with a separate subject constitutes an exception so as to control and take precedence over a conflicting general statute on the same subject. (58 Cal.Jur.3d, Statutes, p. 488.)

At the time the relevant parts of Rule 468 were adopted, Rule 461 provided in pertinent part: "Excluded from improvements are machinery and equipment which in all instances constitute a separate appraisal unit." Soon after the language at issue in Rule 468 was adopted, Rule 461 was amended to delete the above quoted language and to include the language of Rule 461(d) as it now reads. This amendment (specifically the deletion of the words "in all instances") to Rule 461 is consistent with the conclusion that Rule 468 intended a different rule for measuring value declines with respect to oil and gas producing properties and that Rule 461(d) was not applicable to such properties.

Furthermore, the "improvements" used in oil and gas producing properties consist almost exclusively of machinery and equipment (AH 566-19, 20, 200-202). Given the Board's knowledge of this fact, any intention on the part of the Board to apply a Rule 461 decline in value test to oil and gas producing properties would have been inconsistent with the language used, i.e., that the appraisal unit for such properties was "land, improvements and reserves." Under these circumstances, it is extremely unlikely that the Board, in adopting Rule 468(c)(6), could have intended that fixtures and other machinery and equipment constituting improvements used in oil and gas producing properties were to be treated as a separate appraisal unit.

Moreover, your letter says in effect that the mineral appraisers have consistently treated mineral property improvements including fixtures, machinery and equipment as part of a larger appraisal unit for the past ten years. LTA No. 80/9 supports your statement at least with respect to petroleum properties. Such contemporaneous construction of a provision like Rule 468 by the administrative officials charged with its enforcement or interpretation, while not necessarily controlling, is entitled to great weight and is to be followed unless it is clearly erroneous or unauthorized (58 Cal.Jur.3d, Statutes, pp. 573, 574). There is no indication here that the staff's interpretation is clearly erroneous or unauthorized.

Treating fixtures and other machinery and equipment classified as improvements as a separate appraisal unit is apparently based on the conclusion that such items "are normally valued separately" and thus are properly treated as a separate appraisal unit under section 51(e) (Implementation of Proposition 13 "Property Tax Assessment" October 29, 1979, Volume 1, p. 16).

The problem with treating fixtures and other machinery and equipment classified as improvements as a separate appraisal unit as required by Rule 461(d) is that in some instances such property is not in fact "normally valued separately" and is only a part of the "appraisal unit which persons in the market place commonly buy and sell as a unit." To apply section 461(d) in such instances would conflict with section 51(e). Since that is true with respect with many mineral properties (AH 560-82 and AH 566-19, 200-203), applying Rule 461(d) in such cases would appear to be contrary to section 51(e).

For the foregoing reasons, we are of the opinion that Rule 461(d) is not applicable to oil and gas producing properties. We are also of the opinion that Rule 461(d) is not applicable to other mineral producing properties which are appraised in the same way as oil and gas producing properties. As you know, proposed Rule 469 contains language nearly identical to Rule 468(c)(6) and we assume the same approach will be taken with respect to the geothermal rule. In the meantime, however, since Rule 468 is the only rule in effect which specifically addresses value declines for mineral properties, it would not be appropriate to criticize assessors for using Rule 461(d) on mineral properties to which Rule 468 is not applicable. If you have any further questions regarding this matter, please let us know.

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cc: Mr. Gordon P. Adelman
Mr. Robert H. Gustafson