State of California **Board of Equalization**
Legal Division-MIC:82

M e m o r a n d u m

To: Mr. Dick Johnson, MIC:63
Mr. Mark Nisson, MIC:64
Mr. Gary Platz, MIC:60

Date: June 8, 2000

From: Kristine Cazadd
Sr. Tax Counsel

Subject: ***Assessment of Land and Improvements Added to TPZ Land***

This is in response to your inquiry of September 8, 1999 requesting our reconsideration of the attached opinion issued on August 13, 1999, on the following question:

> Where the owner of "timberland" zoned "timberland production" (TPZ) makes improvements to TPZ land which are associated with the cultivation and harvesting of timber, e.g., landfill, culverts, ditches and road paving, are such improvements valued as timberland under Section 434.5, or valued separately under Proposition 13/Article XIIIA of the California Constitution?

The August 13, 1999 opinion stated that the base year or adjusted base year value attributable to *existing, compatible, nonexclusive uses on TPZ land* (Section 435(a)) must be *added to the value of the parcel of TPZ land* on which they are located. As the result of discussions with the Timber Tax Division staff on September 8, 1999, we agreed to reconsider the question in light of language of Section 38109 which requires that immediate harvest values shall be determined in a manner that makes allowances for "*accessibility to point of conversion"*. We also agreed to research the statutory scheme and resolve the apparent inconsistency between Sections 435 and 38109.

Having completed our research and reviewed our findings with the Timber Tax Division, our August 13 opinion is hereby revised. For the reasons hereinafter explained, we now conclude that the values of access roads, culverts, drainage ditches, and other improvements necessary to the growing and harvesting of timber, land and improvements providing "*accessibility to point of conversion*", are included in immediate harvest values. Thus, roads, culverts, drainage ditches, and improvements necessary for timber access are not assessable pursuant to Section 435(a) as *compatible, nonexclusive uses of TPZ land,* except to the extent that they exceed what is necessary to provide that accessibility.

1. **Are the values of access roads, culverts, landfill, ditches, and other improvements necessary for growing and harvesting timber, land and improvements providing "*accessibility to point of conversion*," included in immediate harvest values?**

   Yes.

Section 38109 expressly defines "immediate harvest value" as "*the amount that each species or subclassification of timber would sell for on the stump at a voluntary sale made in the ordinary course of business for purposes of immediate harvest. … Such immediate harvest values shall be expressed in terms of amount to the nearest dollar per thousand board feet, … and shall be determined in a manner which makes reasonable and adequate allowances for age, size, quality, costs of removal, accessibility to the point of conversion, market conditions and all other relevant factors as determined by the board*." (Emphasis added.)

Section 38109 is part of the Timber Yield Tax Law, originally drafted in 1975 and enacted in 1976. In explaining the purpose of the Timber Yield Tax law, the *Analysis of AB 1258 (Warren) as amended March 18, 1976*, by the Senate Committee on Revenue and Taxation, Appendix B (dated 1/7/76), page 4 states,

> "The simplification under the yield tax [system] eliminates the necessity for assessors to conduct costly timber inventories or appraisals, which also are often the subject of disagreement, appeals, litigation and controversy. There is generally ample market evidence to establish harvest values *and to make allowances for variations in logging and hauling costs, species, quality, etc.*, under a yield tax." (Emphasis added.)

The concept of *making allowances for costs* associated with the logging, hauling, etc. of the harvested timber had always included the costs of logging roads that provided accessibility to the harvest site. The basis for this conclusion is that this concept was expressly stated in Property Tax Rule 41, which pre-dated the Timber Yield Tax Law and Section 38109. Adopted in 1968, Rule 41 defined immediate harvest value and specified that consideration be given to all elements of value, such as accessibility and distance to market. It also guided and regulated the assessor in determining the timber to be valued in a given "timber appraisal unit" and in reaching a market value estimate for that unit.

Even after Section 38109 was enacted, Rule 41 remained in effect without amendment, for two reasons. First, much of the pre-existing language in Rule 41 was paraphrased and incorporated into various sections of the Timber Yield Tax Law.[1] Secondly, since Rule 41 set forth relatively broad parameters in defining and valuing subject timber, Section 38109 and other provisions of the Timber Yield Tax Law did not necessitate revision of those parameters. For example, Rule 41(b) had established the following parameters for determining the value of harvested timber.

> *"… Immediate harvest value" is the amount of cash or its equivalent for which timber could be transferred from a willing and informed seller to a willing and informed buyer, both seeking to maximize their incomes, if the timber could be harvested in the forthcoming year. The appraiser must consider all elements of value, such as volume by species, quality, defect, market conditions, volume per acre, size of timber, accessibility, topography, logging conditions, and distance from a processing center capable of utilizing the timber."*

The underlying reasons for including ***accessibility*** to the harvest site as one of the valuation factors that must be considered when establishing immediate harvest values are explained in revised *Assessors' Handbook 551, Forest Property Appraisal*, published by the Board in November 1975 in anticipation of the enactment of the Timber Yield Tax Law, on page 61:

> "The value of stumpage depends strongly on accessibility.[2] It is often necessary to construct and maintain roads and bridges in order to provide access. **The cost of developing new roads or reconstructing old roads and the costs of maintaining roads to harvest the timber are direct charges against the timber stand.** If a timber stand does not have access, an appropriate allowance must be made to provide access. On the other hand, no such deduction should be made for any timber that has access at the time of appraisal. Right-of-way fees for the use of private roads are also property charges in computing stumpage value." (Emphasis added.)

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[1] For example, the language in Rule 41(b) compares closely to the language in Section 38109.

[2] Page 58 of the *Report* defines stumpage value (the commercial value of timber as it stands uncut in the woods) as being synonymous with immediate harvest value when the stand of timber can be harvested within one year.

In a subsequent discussion on estimating stumpage value (by the log-conversion return method of the sales approach), *AH 551* explains on page 73 that the selling price of the harvested timber is "the product plus the total conversion costs." A major item identified in the conversion costs is "*road development*." Pages 75-77 describe how to determine the costs of road development and maintenance. The last paragraph on page 76 distinguishes between *roads that are necessary for the removal of timber* and *roads that exceed what is necessary*.

As an illustration of the term "necessary," AH 551 explains on page 76 that the U.S. Forest Service often requires the building of roads (or charges user fees on road already built) that are "superior to those necessary solely for timber removal." The following advice is provided in such cases:

> "These roads are usually more expensive than those built by a private operator (or on private lands), and their costs may not greatly increase the serviceability of the road for hauling logs. **Some of these additional costs of developing roads for uses other than timber removal should be charged against those uses and not against the timber**." (Emphasis added.)

As enacted, the term, *accessibility,* was not only expressly incorporated into the statutory language of Section 38109, but it was also clarified by the additional words *"to the point of conversion,"* consistent with imposition of the timber yield tax upon harvesting (Section 38115).

Based on the foregoing, the costs of roads and related improvements providing *access necessary to the growing and harvesting of timber* on the harvest site are included in immediate harvest values per Section 38109. On the other hand, the value of roads and related improvements that *exceed* (are "superior to") what is *necessary for access* to the harvest site should be "charged against the site." This latter situation is the purpose of the language in Section 435(a) as discussed below.

2. Does value *attributable to existing, compatible nonexclusive uses,* to be added to TPZ land values under Section 435 (a), include roads, culverts, landfill, ditches, and other improvements necessary for accessibility?

No – except to the extent that they exceed what is necessary for accessibility to the point of conversion.

According to the *Report of the Senate Select Committee on Taxation of Timber and Timberland*, March 17, 1975, pages 96-98, the purpose of enacting the "timberland production zone" (TPZ) statutory scheme was to provide reduced taxation in exchange for long term contractual commitments by timberland owners dedicating their lands to timber growing and harvesting. Thus, Government Code Sections 51101 – 51155 (that codified these provisions) were intended to constitute a strong system of controls, "with regard to the long term commitments and penalties … to prevent the use of the tax system as a shelter for those who are not seriously interested in growing timber for commercial purposes." (Page 98.) These statutes prescribe the details of the TPZ contract terms, <u>one of which is to specify "other uses" of the land that the timberland owner may have while it is zoned TPZ</u> and under contract.

In order to encourage owners to commit their land to growing trees for commercial purposes, this statutory scheme expressly provides three major benefits in connection with a TPZ restriction:

1. All "compatible uses" (quoted below) are allowed;[3]
2. The value of land is reduced based on the existence of the 10-year restriction – (values established by grade per Sections 434-435);
3. The value of "existing, compatible, nonexclusive uses" is added to the value of the land under Section 435(a).

One of the underlying objectives was to allow the timberland owner the right to enjoy other uses of his land, provided that such uses were compatible with timber growing and harvesting,[4] and subject to the requirement that the value of such compatible uses would be an added taxable value of the land. Thus, the purpose of the requirement in Section 435(a) was <u>not</u> to authorize the development of (or to prescribe the valuation of) logging roads

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[3] *Government Code Section 51104 (h) states, a "*compatible use,*" is "any use which does not significantly detract from the use of the property for, or inhibit, growing and harvesting timber, and shall include, but not be limited to, any of the following, unless in a specific instance such a use would be contrary to the preceding definition of compatible use:*

1. Management for watershed.
2. Management for fish and wildlife habitat or hunting and fishing.
3. A *use integrally related to the growing, harvesting and processing of forest products, including but not limited to roads, log landings, and log storage areas*.
4. The erection, construction, alteration, or maintenance of gas, electric, water, or communication transmission facilities.
5. Grazing.
6. A residence or other structure necessary for the management of land zoned as timberland production."

[4] In *Clinton v. County of Santa Cruz* (1981) 119 Cal.App.3d 927, the court explained that because the TPZ restriction on timberland is mandatory, except where the owner requests exclusion, "compatible uses" on timberland provide the owner with the ability to use the land for *some* other purposes. For this reason, the court stated that the term "compatible uses" should be broadly construed. (page 932.)

and improvements necessary to harvesting of the timber on TPZ land, but to provide for the proper assessment of other existing, nonexclusive, compatible uses.

Sections 434 - 435 were enacted in 1976 together with Government Code Sections 51101 et seq., and provided for the assessment of the timberland itself and any "compatible uses" on the timberland - listed under Government Code Sections 51104(h). Sections 434 - 435 therefore authorized a restricted valuation on all types of lands zoned as TPZ, and also mandated assessment of any compatible uses of that timberland, that were apart from or exceeded what was necessary for the growing and harvesting of the timber.

This is evidenced by the recommendation made in the *Report of the Senate Select Committee on Taxation of Timber and Timberland*, March 17, 1975, pages 99-100, which states:

> "Where an owner's use, or permitted use, of their timberland for <u>other than growing trees</u> is noted, such use may have value for purposes of property taxation."
>
> <u>"RECOMMENDATION</u>
>
> It is recommended that additional incremental land value *attributable to uses other than tree growing* be assessed by the local assessor for property taxation purposes. Such procedures would be a movement toward equity between timberland owners and other landowners where both were engaged in similar uses of the land other than tree growing."

Based on the foregoing, the obvious intent of Section 435(a) is to require the separate valuation of *existing, compatible, nonexclusive uses* on TPZ land, which uses are listed in Government Code Section 51104 (h). These uses <u>are not the same</u> as the uses necessary for *accessibility to the point of conversion* on the harvest site. Thus, there is no inconsistency between Section 38109 – requiring the values of roads necessary for ***accessibility to the point of conversion*** to be included in immediate harvest values, and Section 435(a) - requiring the value of *existing, compatible, nonexclusive uses* on TPZ land to be added to the land value. Section 435(a) deals exclusively with *existing, compatible, nonexclusive uses* described in Section 51104 (h). For example, a use described in Section 51104 (h)(3), i.e., "*a use integrally related to the growing, harvesting and processing of forest products, including but not limited to roads, log landings, and log storage areas,* - is obviously different from or superior to roads

necessary for accessibility under Section 38109. As noted above, they either *exceed* what is necessary, or they are distinct from and unrelated to accessibility to the site. Examples of such *existing, compatible, nonexclusive uses* which the Board staff have determined do add value to TPZ land are: building a structure (Annotation No. 830.0010), excavation to clear the land for a residential building site (Annotation No. 840.0143), and cattle grazing.

3. How is the value of *existing, compatible, nonexclusive uses* to be added to the TPZ land per Section 435(a)?

Add the lower of the fair market value or the base year or adjusted base year value of these uses.

Since land zoned as TPZ restricts its use to growing and harvesting timber and to *compatible uses,* (Government Code Section 51115), TPZ land is valued according to its restrictions in use, thus replacing the utilization of agricultural preserves (Williamson Act contracts) on timberland. (Government Code Section 51110(b).) Such TPZ land is valued pursuant to Revenue and Taxation Code Sections 434.5 and 435.[5] There is no provision for valuing TPZ land on any other basis and no provision for valuing the TPZ land according to the present worth of the income it will produce. Consequently, before and after any *existing, compatible,* nonexclusive uses, including any added lands or improvements utilized in the course of such uses, the land continues to be zoned as "timberland production" and is valued as such under Sections 434.5 and 435.

The general valuation requirement in Section 435 (a) requires the assessor to use as the value of each parcel of TPZ land, the appropriate site value pursuant to Section 434.5 (i.e., for either redwood region, pine-mixed conifer region, or whitewood subzone of the redwood region). Additionally, part of subdivision (a) and subdivisions (b) and (c) of Section 435 provide for the valuation of *existing compatible, nonexclusive uses, noncompatible uses,* and *exclusive compatible uses* respectively. The remaining issue therefore, is how these particular *uses* are to be treated for purposes of making added "value adjustments" to any parcel of TPZ land.

First, the latter part of Section 435 (a) requires that the value attributable to any *existing, compatible, nonexclusive uses* shall be added to the Section 434.5 value of the parcel of timberland. This language specifically states that the assessor shall use the appropriate site value of the timberland, "*plus the value, if any, attributable to existing, compatible, nonexclusive uses of the land.*"

[5] Section 434.5 was enacted as part of the same statutory scheme for the property taxation of timber and timberland as discussed above. (Stats.1976, Ch. 176, Rev. & Tax. Code §§431-437 and §§38101-38908.) For timberland, Section 434.5 provided formula per acre values for use in determining the maximum value of timberland within a timberland preserve zone. These per acre values were based on a sustained yield income analysis by species per acre (Property Tax Rule 1021).

In 1981, the staff concluded that the value to be added to the TPZ land each year, under Section 435(a), was the fair market value determined annually (not the Article XIIIA value) of the *existing, compatible, nonexclusive uses*. (See former Annotation No. 830.0010, McManigal Letter 8/14/81.) This was, in large part, because Revenue and Taxation Code Section 52, as added by Stats. 1979, Ch. 242, provided:

> "(b) Notwithstanding any other provision of this division, property restricted to timberland use pursuant to subdivision (j) of Section 3 of Article XIII of the California Constitution shall be valued for property tax purposes pursuant to Article 1.7 (commencing with Section 431) of Chapter 3 of Part 2."

Since Article 1.7 set forth in Section 434.5 a schedule to be used in the valuing of timberland, and Section 435(a) required the assessor to use as the value of each parcel of timberland the appropriate schedule value pursuant to Section 434.5 (plus the value, if any, attributable to existing, compatible, nonexclusive uses of the land), it was concluded that as *existing, compatible, nonexclusive uses* were to be valued pursuant to Article 1.7/Section 435(a), the values attributable thereto should be the fair market values of such uses, as determined annually, not values determined pursuant to the provisions of Article XIIIA.

AB 1488/Stats. 1979, Ch. 242, at the same time included subdivisions (c) and (d) in Section 52:

> (c) Notwithstanding any other provision of this division, property subject to valuation as a golf course pursuant to Section 10 of Article XIII of the California Constitution shall be valued for property tax purposes in accordance with such section.
>
> (d) Notwithstanding the provisions of this division, property subject to valuation pursuant to Section 11 of Article XIII of the California Constitution shall be valued for property tax purposes in accordance with such section.

For similar reasons, the staff concluded that resort to Article XIIIA of the Constitution was not required or necessary in golf course valuation or local government property located outside the government's boundaries valuation.

Thereafter, however, the court of appeal in *Los Angeles Country Club v. Pope* (1985) 175 Cal.App. 3d 278, held that in enacting subdivision (c) of Section 435, the Legislature did not effectively remove golf course property from the provisions of Article XIIIA. In addition, the California Supreme Court in *San Francisco v. San Mateo County* (1995) 10 Cal. 4th 554, held that in enacting subdivision (d) of this section, the Legislature did not remove lands owned by local governments and located outside their boundaries from the provisions of Article XIIIA of the Constitution, even though the subdivision states that property subject to valuation pursuant to Article XIII, Section 11 must be valued for property tax purposes according to that section.

Accordingly, if called upon to construe Section 52(b), we think a court would similarly conclude as the previous courts did, that in enacting the subdivisions of Section 52, including subdivision (b), the Legislature did not remove timberland zoned as TPZ from the provisions of Article XIIIA. This being the case, the value attributable to *existing, compatible, nonexclusive uses* for purposes of Section 435(a), including the values of any added lands or improvements utilized in the course of such uses, should be the fair market values of such uses, or the base year or adjusted base year value of such uses, whichever is lower. As the result, Annotation No. 830.0010 has been withdrawn.

Secondly, Section 435(c) requires that "*any structure on the land being valued*" and "*an area of reasonable size used as a site for approved compatible uses*" must be separately assessed and shall not be valued under the Section 434.5 methodology for TPZ land. Section 435(c) provides that the special valuation provisions of Section 431-437 shall not apply to any structure on the TPZ land or an area of reasonable size used as a site for approved compatible uses; rather, such uses shall be separately assessed. Under this subdivision, an *existing, compatible, exclusive use* is involved, but its purpose is not for growing or harvesting timber. Therefore, a separate appraisal unit for the structure, its related improvements, and any land area of reasonable size used as its site, is "carved out" of the TPZ land. This is quite similar to the language in Section 428, stating that the restricted valuation for agricultural (Williamson Act contract) land does not apply to any residence of agricultural laborer housing or to an area of reasonable size used as a site, thereby "carving out" the structure and its site for separate assessment. For such structures and for areas used as sites for approved compatible uses, an Article XIIIA base year or factored base year value (or new base year value if there is new construction or a change in ownership), or the current fair market value of such structures and areas should be used, whichever is lower.

Thirdly, Section 435(b) requires the assessor to value the existence of any mines, minerals, quarries, hydrocarbons or geothermal resources in or upon TPZ land. These are not identified in Government Code Section 51104(h) as "compatible uses," and in many cases they would not be; but they too, as unique properties, are valued separately as their own "appraisal unit" under other provisions of law, specifically, Property Tax Rules 468 or 469.

4. <u>What is the basis for valuing improvements to TPZ land under subdivision (a) rather than subdivision (c) in Section 435?</u>

Facts indicating that the criterion in either subdivision (a) or (c) is met.

By way of clarification, there is one further issue regarding the valuation of TPZ land. The question is whether the values of paved roads, culverts and/or asphalt burms would qualify under the TPZ valuation of subdivision (a) of Section 435 if classified as land under Property Tax Rule 121, *Land*, or if classified as improvements under Property Tax Rule 122, *Improvements*, they would be subject to separate assessment under subdivision (c)? For the reasons stated above, the answer to this question does not depend on the classification of these improvements under Rules 121 or 122, but on whether they are beyond what is necessary for ***accessibility to the point of conversion***, meeting the criteria of subdivision (a). To be within the criterion of subdivision (c), these improvements must be built for the purpose of providing ingress and egress to any structure approved for compatible use on the land, in addition to exceeding what is necessary for ***accessibility***.

The distinguishing factor under Section 435 is whether a use on TPZ land is an *existing, compatible, nonexclusive use* or an *existing, compatible, exclusive use*, not simply an improvement's classification. A paved road and related improvements that exceed what is necessary to provide *access* to the timber on the harvest site must be valued under subdivision (a) at the lower of its fair market value or base year or adjusted base year value, and "charged against the site" as noted above. On the other hand, a road built on TPZ land for the sole purpose of ingress and egress to the owner's home is part of "*an area of reasonable size used as a site for approved compatible uses*," and is valued as part of the separate appraisal unit carved out for the home and its site, under subdivision (c). Like the home and the site on which the home is located, the driveway valued per subdivision (c) receives an Article XIIIA base year value as a component of that separate appraisal, since it also is an existing, compatible, exclusive use of the site. In such case, the base year or adjusted base year value, or the current fair market value of the driveway should be used, whichever is lower.

KEC:tr
prop/prec/timbertx/00/05kec

Attachment: Cazadd Memo, 8/13/99

cc: Mr. David Gau, MIC:64
Mr. Stanley Siu, MIC:61
Ms. Hadley Alger, MIC:64
Mr. Charlie Knudsen, MIC:62

Annotation – Timberland

830.00XX Existing, Compatible, Nonexclusive Uses

Revenue and Taxation Code Section 435(a) requires that the value attributable to existing, compatible, nonexclusive uses, including compatible uses listed in Government Code Section 51104(h), on TPZ land are the fair market values of such uses, including the values of any added lands or improvements (Property Tax Rule 124) utilized in the course of such uses, or the base year or adjusted base year value of such uses, including such values of any added lands or improvements, whichever is lower, as determined annually.

However, the values of roads and other improvements providing *access necessary to the growing and harvesting of timber* on the site are included in immediate harvest values per Section 38109. Only the value of roads and other improvements that are *unrelated to* or *exceed* ("superior to") what is *necessary for access* to the timber on the site is to be added to the TPZ land value under Section 435(a). **C 6/XX/00.**