

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF MONTANA,)	
)	DOCKET NO.: PT-1999-24
Appellant,)	
)	
-vs-)	
)	
FERDIG OIL COMPANY,)	FACTUAL BACKGROUND,
)	CONCLUSIONS OF LAW,
Respondent.)	ORDER and OPPORTUNITY
)	<u>FOR JUDICIAL REVIEW</u>

The above-entitled appeal was heard on August 2, 2000, in the City of Shelby, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was given as required by law.

The taxpayer, represented by Charles Jansky, president, and Curtis Dahlgaard, vice president, presented testimony in opposition to the Department of Revenue appeal. The Department of Revenue (DOR), represented by Charles Pankratz, Region 2 leader, and Kevin Watterud, appraiser, presented testimony in support of its appeal. Testimony was presented and exhibits were received. The Board then took the appeal under advisement; and the Board having fully considered the testimony, exhibits and all things and matters presented to it by all parties, finds and concludes as follows:

FACTUAL BACKGROUND

1. Due, proper and sufficient notice was given of this matter, the hearing, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. The property which is the subject of this appeal is described as follows:

Personal property identified as oil field storage tanks located in Toole County, State of Montana (Assessor number: 000G751517)

3. The taxpayer appealed to the Toole County Tax Appeal Board on November 22, 1999, citing the following reason for appeal:

All personal property (stock tanks/ gas shacks) not returned to personal property using acquired year/acquired cost basis as specified by 1999 legislature.

4. In its January 28, 2000 decision, the county board approved the appeal, stating:

Please be advised that the Toole County Tax Appeal Board has met and arrived at a decision regarding the above-referenced appeal, which was heard on January 27, 2000.

The Toole County Tax Appeal Board finds that the Montana Department of Revenue is in error in taxing the storage tanks as they currently are and must revert the storage tanks back to Class eight property as specified in Section 15-6-138 (c), MCA (1999). SB 487 in the 1999 Legislative Session added paragraph c

to Section 15-6-138, MCA (1999). Oilfield storage tanks are included in this paragraph, and thus must be taxed as Class eight property. Your appeal for reclassification is approved and the Department of Revenue is directed to make those changes. . .

5. The DOR then appealed that decision to this Board on February 25, 2000, stating: "The nature of the proof adduced at the hearing was insufficient, from a factual and a legal standpoint, to support the Board's decision."

DOR'S CONTENTIONS

Mr. Pankratz testified that the DOR appealed to this Board because the county board decision was "rather vague. I believe they felt that they had written specifically to the particular issues that they'd heard, but, as I read their decision, it would have been my opinion that we had already done what they'd asked. . . I wanted some further explanation." (DOR Exhibit A, a copy of the Toole County Tax Appeal Board decision dated January 28, 2000).

DOR Exhibit B is a copy of the 1999 assessment notice to Ferdig Oil. This document lists the legal description, property class code, quantity, 1998 and 1990 market value, the taxable percentage and the taxable value of personal property subject to taxpayer under the ownership of Ferdig Oil. Mr. Pankratz noted that this document shows that the DOR has classified the subject

personal property as Class 8 with a taxable percentage of six percent. Therefore, he contended, the DOR has already complied with the directive of the Toole County Tax Appeal Board. Thus, the issue before this Board is **not** a classification issue; rather, it is a valuation issue.

DOR Exhibit D is a copy of DOR policy regarding the valuation and assessment of oilfield buildings and tanks, dated October 18, 1996. In pertinent part, this policy directs DOR employees that *"This procedure establishes guidelines for completing the valuation and assessment of oilfield buildings and tanks. Beginning with the 1998 tax year, oil field storage tanks (class code 3310) and buildings (permanent and movable) shall be considered real property. These improvements will be appraised and assessed as Class 4 commercial property."*

Mr. Pankratz' testimony was that, in 1999, the Montana Legislature met and, "because of some lobbying", revised Montana code pertaining to the valuation of oilfield buildings and tanks.

SB487, codified in Section 15-6-138 (c), MCA, provided that *"all oil and gas production machinery, fixtures, equipment, including pumping units, oil field storage tanks, water storage tanks, water disposal injection pumps, gas compressor and dehydrator units, communication towers, gas metering shacks treaters, gas separators, water flood units, gas boosters, and*

similar equipment that is skidable, portable, or movable, tools that are not exempt under 15-6-201 (1) (r), and supplies except those included in class five" was to be classified as class eight property and taxed at six percent for tax years beginning after December 31, 1997.

Mr. Pankratz stated that SB184 was also passed by the 1999 legislative session, "which was a major change in assessment of real estate and affected almost all properties statewide. Compared to this particular law change, SB487, had minimal impact." (SB184 concerned the "phasing in" of increased valuations as a result of the 1997 statewide reappraisal of property).

According to Mr. Pankratz, implementation of SB487 (Section 15-6-138 (c), MCA) was "put on the back burner in view of the massive undertaking of implementation of SB184." Sometime in the latter part of 1999, DOR staff was still receiving instruction on how to implement SB487 in an equitable manner among all affected taxpayers. The decision was made at that time that, if "individual comprehensive field reviews had been done on properties last year (in 1998), and depreciation levels had been correctly determined to arrive at market value, the same depreciation levels could be used this year when entering the properties onto BEVS." (Business Equipment Valuation System. Taxpayer's Exhibit 5, August 27, 1999 memorandum to all regional DOR offices from administrative staff in Helena). Mr. Pankratz explained that, according to the August 27,

1999 directive, "we would use the CAMA (computer assisted mass appraisal) system to arrive at a market value, a replacement cost new less depreciation and then that CAMA system market value would be transferred to the business equipment valuation system and be used to set the market value for storage tanks and gas shacks. . . . I don't believe that the administrative rule was changed other than that, based on Department personnel interpretation, that the first line (of ARM 42.21.138 (1), oil and gas field machinery shall be valued using the cost approach to market value, provided us enough authority to value the oil and gas storage tanks and the gas shacks."

The DOR did not use the taxpayer's acquired cost in its valuation and, therefore, did not apply trending factors specified in ARM 42.21.138 (3).

Mr. Pankratz stated that the DOR used the cost approach (replacement cost new less depreciation) in valuing the subject personal property. "We (the DOR) used the CAMA system, which has tank values incorporated into their cost tables. CAMA is generally for land and improvements valuation. . . ." According to Mr. Pankraz, the DOR consulted pages 45-46, part 4, under replacement cost, of the Montana Appraisal Manual, to determine replacement cost new. That value was "tempered based on new information that we got about what these tanks are really worth, Fort Benton, tank

manufacturers. . . we did this informal review and we found that our tank values, under replacement cost, were rather high. We didn't have the ability to change the cost tables because there are other properties that we valued with the same cost tables but we did have an opportunity to adjust the depreciation. The tanks needed considerably more depreciation to get them to the final replacement cost new less depreciation value which we have determined to be market value. . . we attempted, because we had people in the field, we had people going out with the actual oil and gas producers, we made every attempt that we could arrive at a market value that was appropriate based on the conditions of these tanks and within our capacity. Our business equipment valuation system applies a percent good at the lowest possible rate of 27 percent for the year in question, salvage value. We needed to use depreciation levels lower than that. The depreciation levels that we are using, in many cases, are ten percent good because of the replacement cost new being higher than it should have been. We overrode the depreciation. . ." (Charles Pankratz testimony, State Tax Appeal Board hearing, August 2, 2000).

TAXPAYER'S CONTENTIONS

The properties at issue in this appeal are: all properties that had **oil field storage tanks** classified as real property in

1998 and returned to personal property in 1999. This specifically includes all new properties acquired by Ferdig in 1998 and first rendered as of 1 January 1999 by Ferdig (properties 84-88 listed in Attachment (6) [Svare, Dix Mont State, Flesch, Kalbar, and Great Northern]). (Taxpayer's Exhibit one, page three).

The taxpayer is unsure of a dollar amount to request: *"because for the year 1999 there was so much flying back and forth that at the end of the day we don't know, because the tanks were mixed in with other things, we don't actually what the final tank numbers were in all cases, all we got was a lump of money we owed on a property, you couldn't break it out among the tanks so I can't say exactly what the tax would have been versus what we paid. That was not information that we got."* (Charles Jansky testimony, State Tax Appeal Board hearing, August 2, 2000).

Mr. Jansky argued that the DOR established the market value of the subject personal property using real property criteria. Once that was determined, the subject property *"was certainly taxed as Class 8 personal property. So, in that sense, I think that the Toole CTAB's decision maybe wasn't completely clear. It basically said the taxpayer won, so assess the property as if it were personal property. Well, the fact of the matter is, the State did."*

The taxpayer's position is contained in Taxpayer's

Exhibit 1 (Statement of Position): "For tax year 1999 Ferdig believed that **oil field storage tanks** were not properly returned to the category of personal property by the Montana Department of Revenue (DOR) in accordance with the legislative mandate of SB487. As a result, Ferdig's **oil field storage tanks** were grossly over valued in 1999 and Ferdig was excessively taxed by the DOR. Ferdig filed a timely appeal with the Toole County Tax Appeal Board and this appeal was heard on 27 January 2000. The result of the appeal was that Ferdig's position was sustained. The DOR appealed the Toole County Tax Appeal Board's findings and that has resulted in the matter now being heard before the State Tax Appeal Board.

Background:

Prior to 1997 all oil and gas field machinery and equipment (wellheads, pump jacks, water separators, pumps, **oil field storage tanks**, injection pumps, gas compressors, etc.) were categorized as mining machinery which made such items of machinery and equipment Class eight personal property per 15-6-138 (1) (b) MCA.

15-6-138. Class eight property - description- taxable percentage. (1) Class eight property includes:

(b) all mining machinery, fixtures, equipment, tools that are not exempt under 15-6-201 (1) (r), and supplies except those included in class five;

The method of valuing and depreciating this oil and gas field machinery and equipment was (and remains) outlined in ARM 42.21.138 (1) as follows:

"Oil and gas field machinery and equipment shall be valued using the cost approach to market value. The taxpayer must provide to the department the acquired cost, the year acquired, and an itemized description of each piece of machinery and equipment. The acquired cost will be trended to current replacement cost and then depreciated according to the scheduled mentioned in (2)."

In 1996 the DOR decided that since **oil field storage tanks** were not specifically listed under the definition of "**all mining machinery, fixtures, equipment,**" they (the DOR) had the latitude to administratively reclassify **oil field storage tanks** from class eight personal property to class 4 commercial property and that is what they did, starting for the 1998 tax year. Attachment (3), provided by DOR representative Kevin Watterud during the hearing before the Toole County Tax Appeal Board, concisely sets forth this administrative change in the treatment of **oil field storage tanks**, moving them from the BEVS (Business Equipment Valuation System -

generally used for personal property) to the CAMAS (Computer Assisted Mass Appraisal System -generally used for real property).

The effect of this reclassification in 1998 was, in Ferdig's case, to increase the taxable value of the **oil field storage tanks** by a factor of approximately ten. As Ferdig's situation was by no means unique, there was a considerable amount of industry objection to the entire process. This resulted in some modifications to the valuation by the DOR but the bottom line is that Ferdig's **oil field storage tanks** wound up with an artificial market value in 1998 significantly higher than their acquired costs. The taxpayer did not appeal in 1998 because "most of the time, on one, or two, or three, or five properties, life's too short to fight about it and we had more things to do and there was some give and take back and forth and, at the end of the day, we accepted it for 1998 and went on about our business." (Charles Jansky testimony, State Tax Appeal Board hearing, August 2, 2000).

In 1999, the Montana legislature was made aware of the inconsistencies regarding the administrative reclassification of **Oil field storage tanks** (and certain other items of oilfield equipment and machinery) from personal property to real property. As DOR spokespersons were unable to provide any rational basis for having made the reclassification, the legislature (with virtually no dissent) passed SB487 [(attachment (1))]. SB487 was intended to do nothing more than legislatively correct an overreach of administrative discretion by the DOR. To accomplish this, SB487 specifically listed **oil field storage tanks** (and certain other items of oilfield equipment) as class eight personal property in a new paragraph (c) to Section 1 of 15-6-138, MCA as follows:

15-6-138. Class eight property - description - taxable percentage. (1) Class eight property includes: (c) all oil and gas production machinery, fixtures, equipment, including pumping units, oil field storage tanks, water storage tanks, water disposal injection pumps, gas compressor and dehydrator units, communication towers, gas metering shacks, treaters, gas separators, water flood units, gas boosters, and similar equipment that is skidable, portable, or movable, tools that are not exempt under 15-6-201 (1) (r), and supplies except those included in class five.

SB489 (sic) also provided (Section 3) that the act applied retroactively to tax years beginning after December 31, 1998.

The legislative intent was unambiguous: Starting in the

1999 calendar year, **oil field storage tanks** were again to be categorized as "oil and gas field machinery and equipment" and were to be valued on the basis of acquired year/acquired cost per ARM 42.21.138 (1) [Attachment (2)]. This is not only what the plain language of the law stated, but was also consistent with the understanding of the legislative sponsor of the bill (Senator Glen Rosch) and the primary author of the bill (Mr. Patrick Montalban on behalf of the Northern Montana Oil and Gas Association.)

Analysis of DOR's Implementation of SB489: (sic)

Instead of reverting back to the original method of valuing the **oil field storage tanks** (acquired year/acquired cost per ARM 42.21.138 (1)), however, the DOR made another administrative decision, this time to value the reclassified equipment "**utiliz(ing) the current appraised value to ascertain the original installed cost and year of installation for these tanks and buildings.**" This decision is outlined in Attachment 4, a DOR Memorandum dated 6 August 1999, with the offered justification being that doing it any other way would have required "**a considerable amount of time and work. . . .**"

Cutting to the chase, this means that in Ferdig's particular case the **oil field storage tanks** got returned to personal property at values far higher (by a factor of five) than even their original acquired cost. We believe this procedure was wrong; we believe it was contrary to the specific intentions of the legislation as explained by Mr. Montalban and Senator Rouch; and we believe that at least in Ferdig's case it would have required less time for the DOR to have "done it right" than to have followed the course actually taken. Indeed, it can be noted from Attachment (5), a DOR memorandum of 27 August, 1999, that the problems of adapting the CAMAS valuation to the BEVS depreciation schedule was akin to shoving a square peg in a round hole: it didn't fit very well . . .

Proposed method of resolution:

In all instances, the DOR has already furnished all items of cost on each of the involved properties. Thus, the only work necessary will be to return the value of the **oil field storage tanks** to their acquired cost basis as originally reported by Ferdig. Attachment (6) contains a summation of all of the acquired cost/acquired year information on all of Ferdig's **oil field storage**

tanks and is consistent with that previously furnished the DOR going back over twenty years.

Illustration of Error:

Attachment (6) is a listing of values assigned by the DOR for all of Ferdig's **oil and gas storage tanks** as of 1 January 2000. We believe the values assigned by the DOR for 2000 are identical to those used by the DOR in 1999 although no similar rendition was provided by the DOR for 1999. Attachment (6) also shows the variation between the acquired year/acquired cost used by Ferdig and the values assigned by the DOR. As can be noted, the total value assigned by the DOR for Ferdig's stock tanks is over five times the acquired cost of Ferdig's **oil field storage tanks** (\$647,900 vs. \$125,580) without even considering depreciation.

Action requested by STAB:

Direct the DOR to value all of Ferdig's oil field storage tanks utilizing the acquired year/acquired cost method (ARM 42.21.138 (1)).

BOARD'S DISCUSSION

The Board finds that the taxpayer has satisfactorily demonstrated that the valuation methodology employed by the DOR in valuing the subject personal property was inappropriate.

ARM 42.21.138 (1) provides that "oil and gas field machinery and equipment shall be valued using the cost approach to market value. The taxpayer must provide to the department the acquired cost, the year acquired, and an itemized description of each piece of machinery and equipment. The acquired cost will be trended to current replacement cost and then depreciated according to the scheduled mentioned in (2). (Emphasis supplied.)

Mr. Pankratz acknowledged that the use of CAMA, primarily

used for real estate valuation, has overstated the replacement cost new of these tanks.

When questioned as to his opinion regarding the appropriate valuation methodology to be used for the subject storage tanks, he testified: *"I would say, based on my knowledge and my experience with the Department of Revenue, generally, that would fall right in the acquired year/acquired cost category. For future years, we will be using acquired year/acquired cost. We've finally settled that issue and, also came to the understanding that the law change requires us to put oil storage tanks and gas shacks into the category of class eight and then rely on the acquired year/acquired cost methodology for the future. So, in the future we will be doing that. We've learned our lesson for 2000. . . We had equalized it, but did we follow the strict administrative rule? Probably not."*

CONCLUSIONS OF LAW

1. The State Tax Appeal Board has jurisdiction over this matter. **Section 15-2-301, MCA, Appeal of county tax appeal board decisions.** (4) In connection with any appeal under this section, the state board is not bound by common law and statutory rules of evidence or rules of discovery and may affirm, reverse, or modify any decision.

2. **Section 15-6-138, MCA.** Class eight property - description - taxable percentage. (1) Class eight property includes: (c) all oil

and gas production machinery, fixtures, equipment, including pumping units, oil field storage tanks, water storage tanks, water disposal injection pumps, gas compressor and dehydrator units, communication towers, gas metering shacks, treaters, gas separators, water flood units, gas boosters, and similar equipment that is skidable, portable, or movable, tools that are not exempt under 15-6-201 (1) (r), and supplies except those included in class five.

3. **ARM 42.21.138 (1)** Oil and gas field machinery and equipment shall be valued using the cost approach to market value. The taxpayer must provide to the department the acquired cost, the year acquired, and an itemized description of each piece of machinery and equipment. The acquired cost will be trended to current replacement cost and then depreciated according to the scheduled mentioned in (2).

4. It is true, as a general rule, that the appraisal of the Department of Revenue is presumed to be correct and that the taxpayer must overcome this presumption. The Department of Revenue should, however, bear a certain burden of providing documented evidence to support its assessed values. (Western Airlines, Inc., v. Catherine Michunovich et al., 149 Mont. 347, 428 P.2d 3, (1967)). The Board finds that the DOR did not satisfactorily meet its burden, through substantial and credible evidence, in opposition to the taxpayer's contentions.

ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject personal property shall be entered on the tax rolls of Toole County at values consistent with the use of the taxpayer's acquired cost and acquired year with the application of appropriate trending methodologies prescribed in ARM 42.21.138 (3). The appeal of the DOR is hereby denied.

Dated this 21st of August, 2000.

BY ORDER OF THE
STATE TAX APPEAL BOARD

GREGORY A. THORNQUIST, Chairman

(S E A L)

JAN BROWN, Member

JEREANN NELSON, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 21st day of August, 2000, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

Attn: Charles Jansky
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