British Columbia Legal Update

By
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INTRODUCTION

I wish to express my appreciation to the CPTA Western Chapter Executive for asking me to participate as a member of this Panel.

The following is a brief overview of a cross-section of topical issues in British Columbia property assessment and taxation which may be of interest to the Western Chapter.

1. Parking Site Tax

Perhaps the highest profile development in 2006 is the introduction of the parking site tax. In 2005 the *Greater Vancouver Transportation Authority Act* was amended to allow the GVTA (Translink) to levy the new tax, as a means of discouraging vehicle use and raising revenue for transportation infrastructure projections, on non-residential properties in the lower mainland. BC Assessment, responsible for preparing the parking tax assessments on behalf of the GVTA, issued the first round of assessments in January. Appeals of the assessments were filed with BC Assessment by January 31 and are in the process of being heard by review panels. Further appeals lie to the Property Assessment Appeal Board.

The tax was initially set at $1.02 per square metre, less than the $1.43 per square metre permitted under the Act. It applies to all land used or useable for parking. This includes existing outdoor parking sites and parkades, as well as land available for parking or used to access parking, including driveways, lanes and turnarounds. It does not apply to GVTA land (including park and rides), ferry terminals, residential parking, parking for car dealership or rental inventory, tractor trailer storage areas, campsites, vehicle impound lots, service and fuel bays at gas stations and repair shops, and properties that are otherwise exempt from property taxes. Exterior parking lots are measured from exterior curb to exterior curb, while parkades are measured from interior wall to interior wall. Assessments provide for partial exemptions, split classification and allocation of common areas.

It is reported that Translink has estimated that the tax base resulting from the first round of review panel appeals would, at the current $1.02 per square metre rate, generate taxes of approximately $25 million, exceeding the approximately $20 million originally budgeted. Translink has announced that , in light of this, the tax rate will be adjusted so that the $20 million anticipated will be collected in 2006, a roughly 20% reduction in taxes across the tax base. Translink has also resolved to look at alternatives means of raising revenues for public transportation infrastructure, going forward.

2. Case Update: Court of Appeal Ruling on Tenants' Interests and Appeal Rights

Morguard Investments Ltd. et al v. Assessor of Area #12 – Coquitlam, 2006 BCCA 26

On January 23 the Court of Appeal upheld the B.C. Supreme Court decision allowing Hudson's Bay Company and Zellers Inc. to bring a stated case appeal from a settlement between the Assessor and the landlord of the 2001 through 2003 assessments of Coquitlam Centre shopping centre, in which Hudson's Bay and Zellers are anchor tenants.

By way of background, individual tenants in shopping centres do not receive separate assessments. Instead, the landlord receives an assessment of the entire premises, and tenants pay their pro-rate share of property taxes based on the provisions of the lease which may or may not be directly related to the assessment of the entire shopping centre.

Here, the Board accepted recommendations with respect to the value of the Coquitlam Centre in a decision issued in July, 2003. Hudson's Bay and Zellers had not participated in the appeals or settlement discussions. Dissatisfied with unanticipated increases in their property taxes resulting from the settlements, the tenants required the Board to state a case upon receiving a copy of the Board's decision in December, 2003. The assessor challenged the Board's jurisdiction to state the case at the tenants' behest, on the basis they were not "persons affected by a decision of the Board on appeal" under section 65 of the *Assessment Act*. The assessor believed that tenants in a shopping centre, who are not separately assessed for their interests, and whose liability for taxes arise under the lease, are not "affected" in the sense required, because they have no direct interest in the assessment or taxation of the shopping centre. The tenants argued that it is for the Court, not the Board, to decide this threshold question, and that the tenants are "persons affected" by the Board's decision on the assessment appeals (here, the acceptance of the settlement between the assessor and the landlord).

The Board found that the Court must determine this question, and filed the Stated Case with the Court under section 65. The assessor and tenants sought directions from the Court with respect to whether it is for the Board or for the Court to decide this question, and in any event, whether the tenants are "persons affected by the Board's decision". The assessor argued that tenants are in a fundamentally different position than taxing authorities and landlords, whose direct interests in the assessment and taxation of a shopping centre are plainly recognized by the *Assessment Act*. To be in

a position to appeal by stated case, tenants must participate in the appeal process and be entitled to receive a copy of the Board's decision. The assessor argued that to permit tenants who receive Board decisions some months after their release to state cases would seriously undermine the finality and certainty of assessment cycles.

In its September 30, 2004 decision, the B.C. Supreme Court ruled that whether or not a person is "affected" by a decision of the Board is a threshold question the Board must decide before stating a case. As to whether Hudson's Bay and Zellers are "affected" in the sense required to state a case, the Chambers Judge found that, in the circumstances at hand, tenants, whose liability to pay property taxes are directly related to changes in the assessments, are "persons affected by the Board's decision", and are entitled to pursue the stated case appeal despite not having been involved before the Board. The assessor appealed the latter finding.

The Court of Appeal unanimously upheld the Chambers Judge's decision, ruling that in the modern commercial context, many leases require tenants to pay, or reimburse the landlord, for property taxes as a specific "add-on" to normal rent, and so have an interest in the assessment of the premises. The Court also observed that "the openness of the process and the full availability of rights of appeal may be as important legislative objectives as efficient and finality in the statutory assessment scheme".

The decision confirms the broad rights of appeal available to tenants under section 65 of the Act, whether or not they participate in a landlord's appeal. Practically speaking, it encourages landlords to ensure that tenants (or at least those responsible for the majority of taxes) are invited to participate in appeals or kept apprised of settlement negotiations and recommendations made to the Board. The merits of the stated case appeal (whether the Board acted properly in approving the settlement recommendations) are scheduled to be heard in late April, 2006 in B.C. Supreme Court.

3. Cable Television Commissioner's Rates Appeals

Shaw Cablesystems BC Ltd. et al v. Assessment Commissioner – PAABBC Decision No. 20050391 (September 20, 2005)

Linear structures, including pipelines, power lines, fibre optic cable, television cable and the like, are assessed based on rates for improvements established from industry costs in British Columbia, prescribed as Commissioner's rates. These rates are established annually for each type of linear

structure, according to criteria set out in section 21(1)(a) of the B.C. *Assessment Act*. Values must be based on average current costs of constructing improvements of similar construction and installation difficulty in B.C. The Commissioner may account for physical depreciation and functional disutility in the rates.

Here, Shaw Cablesystems and four other cable providers appealed the 2004 and 2005 Commissioner's rates prescribing the value of their cable systems to the Board. The Appellants challenged, among other things, the methodology the Commissioner used to determine physical depreciation, the relevance of currency exchange rates in establishing costs, the use of a single rate for all cable companies, and the sufficiency of industry cost investigation in determining the rates.

In its decision, the Board:

- first, interpreted section 21 as requiring an allowance only for pure physical depreciation, *without consideration for functional obsolescence and accidental damage*, despite the Appellants' evidence of these factors. The Board rejected both the Commissioner's 40% rate of depreciation for the cable system improvements, which was based on competing expert opinions, and the Appellants' calculations, which included the depreciation factors the Board found irrelevant, settling on pure physical depreciation in the range of 45% to 50%. Significantly, the Board observed that depreciation should not be based on competing expert opinions as the basis for life expectancy of cable where, as here, there was actual empirical and statistical evidence available to verify the age of much of the cable and the replacement rate of the cable based on failure;

- second, found that the Commissioner's rates failed to account for $18,000,000 in currency exchange which ought to have been deducted from the value of assets for the 2005 rate. The Board rejected the Commissioner's argument that because this information was unknown as the time the rates were set, it was not an error to omit the deduction in setting the rate;

- third, found there was insufficient evidence to criticize the Commissioner's use of a single rate for all cable companies (dismissing this ground of appeal), and

- finally, found that, in order to determine the "average current cost" of cable systems in B.C. as the basis for the rates, the Commissioner ought to have looked beyond specific cost data from national CRTC statistics and Shaw itself in setting the rate. The Board ruled that even though Shaw might comprise 90% of the cable service market, since the cost of systems used by various smaller cable systems might be quite diverse and driven by factors like geographical limitations and level of service expectations, the balance of the service providers might be saddled with an inappropriately arbitrary rate that does not relate to the actual cost of their systems.

The Board ordered the Commissioner to revise the 2004 and 2005 rates to reflect these deficiencies and to take into consideration agreements reached by the parties during the appeal on distribution plant system cost, individual subscriber drop cost, and the multiplier used with drop cost to establish total drop cost to value the systems.

This decision, which was not appealed by stated case, is important for several reasons:

- first, it marks the first interpretation by the Board of section 21 of the Act since it was amended to permit an allowance in the rates for "the decline in cost of constructing or installing a similar improvement of the same or similar functional utility", where "functional utility" is defined as the ability of an improvement to meet market standards. In the author's view, a question is raised whether the Board's ruling on pure physical depreciation gives sufficient meaning to this statutory allowance, and

- second, it clarifies the responsibility of the Commissioner to investigate industry costs in establishing rates, even where they apply principally to a dominant member of the industry, to achieve fairness and uniformity in the application of those rates across the class.

4. Pipeline Classification

Greater Vancouver Sewerage & Drainage District et al v. Assessor of Area #08 – North Shore / Squamish Valley – PAABBC Decision No. 20052174 (February 1, 2006)

The utilities class (class 2) includes property used for the "*business of transportation, transmission or distribution by pipeline*". The recent Court of Appeal decision in *Burlington Resources Canada Ltd. v.*

Assessor of Area #27 – Peace River (2005), 37 B.C.L.R. (4th) 151 (C.A.) established that Burlington's inter-facility natural gas piping must be classified light industry (class 5), not class 2 because Burlington is not in the business of transportation, transmission or distribution by pipeline, but instead the preparation of natural gas for market and the use of the pipeline was not a utilities class use.

Here, the Appellants argued that the *Burlington* decision, together with amendments to the words of class 2 and the definition of "pipeline corporation", effectively constrain the "business of transportation, transmission or distribution by pipeline" to pipeline use relating to gas or petroleum, so that their water and sewer pipelines do not fall into the utilities class. The Board disagreed, finding that:

- the *Burlington* decision does not constrain the scope of pipeline use that qualifies for utility classification. *Burlington* stands for the proposition that the Board may, absent expert evidence to the contrary, rely on its technical expertise to determine if a pipeline use qualifies for class 2. This is a question of fact that does not preclude classification of sewage and water piping as utility;

- the definition of "pipeline corporation" (used in the context of valuation) is irrelevant to the definition of "pipeline" for classification. Fundamentally, classification is based on use, not ownership, and

- sewer and water piping falls within the scope of the heading "utilities" in Class 2.

In addition to clarifying the interpretation of class 2, as a practical matter, the Board's decision ensures that the pipeline category of the utilities tax base includes municipal infrastructure, which is beneficial to gas and oil pipeline owners with infrastructure in municipal tax bases.

5. Case Update – Pending B.C. Supreme Court Decision on Valuing Lease Restrictions

Western Stevedoring Co. Ltd. v. Vancouver Port Authority and Assessor of Area #08 – North Shore / Squamish Valley 2005 PAABBC 0019

The assessment community, and particularly occupiers under Crown lease, await the decision of the B.C. Supreme Court in the *Western Stevedoring* case, which was heard in late January. The decision, touching on the relevance of restrictive use clauses in Crown leases, could have broad implications

for the assessment of occupiers of port properties in the lower mainland, and for occupiers of Crown lands under leases with restrictive uses clauses generally.

At the heart of the issue is section 19(5) of the *Assessment Act* which requires the assessor, in determining actual value of land and improvements, to include in the list of factors considered any restriction placed on the use of the land and improvements by the owner of the fee. This section comes into play in assessing the value of land occupied under port leases. Under its lease, Western Stevedoring must use the premises in a first class manner as a forest products terminal. Western Stevedoring believed that the Assessor had not taken this into consideration in valuing Western's property.

Before the Board, the assessor and Western Stevedoring advocated fundamentally different approaches for valuing the upland leased premises. Using the direct comparison approach, the assessor valued the leased lands (other than the berth corridor) at between $94 and $100 million, but to maintain equity, recommended values of between $37 and $52 million. Western Stevedoring valued the lands at $19 million by applying a 10% rental factor (capitalization rate) to the lease income, to take into consideration the restriction on use of the property contained in the lease, less a special purchaser/lessee adjustment reflecting the present value of synergies realized from operating both terminals and achieving cost reductions. The assessor characterized the purpose clause in the lease as akin to a zoning regime restricting the property to waterfront industrial marine use, and selecting comparables with marine uses. The assessor rejected Western Stevedoring's rental factor approach on the basis that the rent paid to the Vancouver Port Authority cannot be considered economic or market rent, and that the rental factor or capitalization rate was not derived from market sales, and in any event, capitalization of rent does not equate to a fee simple value, but only a leasehold interest. Western Stevedoring rejected the Assessor's comparables on the basis that, not being port property transactions, none were subject to the unique mandate of the *Canada Marine Act* which enshrines the use of port properties as port properties, creating different and incomparable markets for port properties on the one hand, and urban properties on the other.

Ruling in favour of Western Stevedoring, the Board found that it must be guided in valuing the property by the requirement under section 19(5) to account for the lease restriction in use. The Board found that, unlike most valuation exercises, highest and best use of the port land is not

necessarily a factor in its valuation. Where, as here, the Crown has restricted the use of occupied port land, the highest and best use is the restricted use under the lease.

In its search for a proxy to market value, the Board rejected the assessor's direct comparison approach on the basis that none of the comparables were suitable in use for a break bulk terminal (the restricted use of the subject lands), and it was not sufficient for the purpose of accounting for restrictions on use under the lease under section 19(5), to base comparisons on marine industrial uses, which are less specific and less restrictive than break bulk terminal use. Nor, did the Board find, could the comparables have been assembled, due to their characteristics, for the purpose of constructing a break bulk terminal. The Board preferred Western Stevedoring's rent capitalization approach as a proxy for market information, for several reasons. First, the Board dismissed the assessor's concern that the approach was not based on market evidence because, in the Board's view, there is no market for this type of property. Second, the Board found that since the property was leased for the use to which it is restricted and lengthy sophisticated negotiations on rent akin to any market rent negotiation had occurred, the Board was satisfied that the lease rent represented fair market rent. Third, although not drawn from market sales, the Board was satisfied that Western Stevedoring's 10% rental factor (taken from the high end of the range for the Crown lease industrial market), represented the greater economic risk in a break bulk terminal. Rejecting Western Stevedoring's adjustment for cost reduction synergies as a "value to owner", the Board found the actual value of the leased upland to be $26.6 million.

On appeal to the B.C. Supreme Court, the assessor, the City of North Vancouver and the District of North Vancouver argued that while section 19(5) refers to restriction in use as a factor to be considered in valuing an occupier's interest, the Board erred in finding that the restrictive use was the highest and best use, and therefore dictated the actual (market) value of the property. The assessor also argued that in accepting the capitalization of rent as a proxy for value, the Board erred by valuing only the leased fee interest instead of the entire fee simple interest. The Respondent argued that the Act specifically requires the restrictive use be taken into consideration and where, as here, no credible market evidence exists, the restrictive use establishes the highest and best use. The Respondent also argued that the Act specifically requires the assessment and taxation of the interest of the occupier, here a leasehold interest.

It is anticipated the Court will deliver its decision in the next several months. Meanwhile, given the significance of the valuation questions raised by this appeal and the very public profile of the case, it remains an open question whether legislation will ultimately be introduced to address the unique issues raised by port land valuation.

6. Cost Approach

Pacific Newspaper Group Inc. v. Assessor of Area #14 – Surrey / White Rock, PAABBC Decision No. 20050284 (October 4, 2005) (stated case pending)

The role of the cost approach in valuing special purpose property continues to receive attention as a result of the recent Board decision concerning the proper method to value the printing and distribution facility for the Vancouver Sun and Province newspapers.

Round 1: The 2000 and 2001 assessments of the printing facility were the subject of a previous Board decision which was overturned by the B.C. Supreme Court and Court of Appeal. In that case, the Board found that the facility was so specialized that nobody besides the current owner would have any use for it other than in its current use, and the current use was the highest and best use. Relying on the seminal Privy Council decision in *Montreal v. Sun Life Assurance Co.* and Supreme Court of Canada decision in *Ontario v. Office Specialty*, both of which approved the valuation of special purpose facilities using the replacement cost approach based on the current use, the Board upheld the approximately $40 million assessment of the printing facility. The Board rejected the owner's argument that use of the cost approach reflected value to owner, and the owner's position that the facility should be valued at approximately $25 million, a value agreed between the parties to reflect the value of the facility in another use.

In what some considered a surprising turn, the B.C. Supreme Court overturned the Board's decision, rejecting the assessor's use of the cost approach as reflecting value to owner. The Court (upheld by the Court of Appeal), reasoned that the *Sun Life* and *Office Specialty* (and subsequent B.C. Court of Appeal *Crown Forest*) decisions, although in principle blessing use of the cost approach for special use properties, did so in circumstances where there was evidence of a potential market besides the current owner for the property in its current use. The Court found that since there was no evidence of any potential market for the printing facility besides the current owner, and since the parties had agreed on the value of the facility in another use, the Court must distinguish the *Sun Life* and *Office Specialty* decisions and order the assessor to revalue the printing facility based on the agreed-upon

alternate (lesser) use. The assessor's application for leave to appeal the Court of Appeal decision to the Supreme Court of Canada was (as usual) denied.

Round 2: Returning to the Board for the next iteration of the case, the owners appealed the 2002 through 2005 assessments, asking the Board to apply the Court of Appeal's decision from 2000 and 2001 assessments to reject the assessor's application of the cost approach. This time, the Board took note of what it considered distinguishing factors that set the case apart from the Court of Appeal decision rejecting the cost approach, and instead applied the *Sun Life* and *Office Specialty* decisions, confirming the assessment based on the current highest and best use and replacement cost approach. The Board found that, this time, there was evidence that the printing facility, while unlikely to sell to another buyer who would use it as a printing facility on a stand-alone basis, could nevertheless be (and had indeed in the past twice been) sold as part of a going-concern (eg. through a share purchase and sale of the entire business). With evidence of a potential market for the current use besides the current owner in hand, and recognizing both that this type of facility would not sell based on capitalization of its income stream and that sales of this type of facility rarely occur, the Board was satisfied that any concerns of valuing the facility to the particular owner were alleviated, and that the most appropriate method to determine market value was the replacement cost approach. The Board affirmed the assessment at just under $40 million.

Not surprisingly, the owner has filed a stated case which is pending. The assessment community will await with considerable interest the Court's decision on the Appellant's stated case appeal from the Board ruling, and particularly the Court's view of when the replacement cost approach is and is not appropriate in valuing purpose-built, specialized facilities with a limited market.

7. Quantification of Obsolescence

Sears Canada Inc. v. Assessor of Area #09 – Vancouver, PAABBC Decision No. 20050284 (October 4, 2005) (stated case pending)

The Board is often faced with the question of whether an adjustment for economic obsolescence should be made in the assessment of an overbuilt facility, and if so, how to quantify the obsolescence. Here, the Board found that the Sears department store on Robson Street in downtown Vancouver, though fully occupied by the owner, was nevertheless twice the size of the modern department store that would replace it. The Board reasoned that a prospective tenant would compensate for this by paying only the rent it would pay for a modern store at that location.

Despite this, the Board rejected, as overly simplistic, the Appellant's proposal to reduce the economic rent by 50% for obsolescence, reasoning that because the owner occupied the entire space, there must be some value in that space which must be accounted for.

In a subsequent hearing to determine the adjustment, the Panel Chair (whose decision carried the day), faced with the reality that the owner occupied the entire building (not just the useful portion), reasoned that it was speculative to value the facility as if partly occupied by the current owner with vacant space available to another tenant, and that the store must be valued in its current configuration but at a rent representative of the market demand for space for this use. The Chair ruled that the previously-suggested 50% reduction in rent best reflected the likely conclusion of a potential department store tenant in assessing the rent it would pay for the Robson store. The dissenting member felt that the best way to measure the value of the benefit the owner enjoyed in the excess space was to apply a different rent for the "useful" portion of the building and a discounted rent to the balance of the building. This would reflect both the inherent economic obsolescence and the residual value in use.

This decision is under appeal by stated case.

As is apparent from this review, we can look forward to a variety of interesting decisions from the Courts in the next several months covering a broad range of topical issues.

Meanwhile, the Board continues its ongoing consultation with stakeholders on the usefulness of its initiative to streamline appeals through mandatory filing of statements of issues, evidence and legal principles. Feedback from taxpayers and agents to date has been mixed. The Board is likely to continue with the initiative as it strives to clear its backlog of cases and streamline the appeal process with a view to concluding the majority of appeals within the year of filing.

This concludes my legal update for the Western Chapter 2006 Education Seminar Legal Panel.

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