# Real Property Assessment 2005
# Major Industry Use and Classification Issues

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*May 17, 2005*
*This paper was prepared for the Continuing Legal Education Society of British Columbia*
*for the Real Property Assessment Conference on April 21, 2005*

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## I. Introduction

### A. General Principles of Classification

Under s. 19(14) of the B.C. *Assessment Act*, R.S.B.C. 1996, c. 20 (the "*Assessment Act*") and the Prescribed Classes of Property Regulation (B.C. Reg. 438/81) (the "Classification Regulation"), real property in B.C. is classified for the purposes of assessment and taxation into one or more of the following eight property classes:

- Class 1 – Residential;
- Class 2 – Utilities;
- Class 4 – Major Industry;
- Class 5 – Light Industry;
- Class 6 – Business & Other;
- Class 7 – Managed Forest Land; and
- Class 8 – Recreational Property/Non-Profit Organization.

The class into which property falls determines both the principles used to determine its assessed value, and the rate at which it is taxed by municipal and provincial taxing authorities.

Under s. 10 of the Classification Regulation, the assessment of property that falls into two or more prescribed classes must be split between each class, according to the proportionate value in each class. As set out below, recent decisions of the B.C. Court of Appeal have confirmed the restricted scope of split classification for major industrial and utilities class properties.

The author's goal is to provide a brief overview of the principles of classification of industrial properties in the context of a review of recent classification decisions.

## B. Classification of Major Industry Property

Property is classified based on its "type or use" (s. 19(14) *Assessment Act*), as opposed to its ownership. Under s. 20 of the *Assessment Act*, "industrial improvements" and "land used in conjunction with the operation of industrial improvements" fall within major industry.

An industrial improvement is an "*improvement*" that is "*part of a plant*," whether or not the plant can be operated as a going concern or is temporarily or permanently unprofitable; that is *designed and built for the purpose of one or more of the following*:

- mining ore or coal (s. 20(1)(a), (b));
- producing aluminium (s. 20(1)(c));
- smelting or refining metal from ore or ore concentrate (s. 20(1)(d));
- producing or refining petroleum or natural gas (s. 20(1)(e));
- manufacturing lumber or other sawmill/planing wood products (s. 20(1)(f));
- manufacturing wood veneer, plywood, etc. (s. 20(1)(g));
- manufacturing pulp, paper (s. 20(1)(i));
- manufacturing chemicals or chemical fertilizer (s. 20(1)(j), (k));
- manufacturing cement (s. 20(1)(m);
- manufacturing insulation (s. 20(1)(n);
- manufacturing sheet glass or bottles (s. 20(1)(o));
- building, refitting or repairing ships (s. 20(1)(p));
- loading cargo onto seagoing ships or barges, and associated cargo storage and loading facilities, including grain elevators (s. 20(1)(q).

Certain industrial plants with less than a prescribed capacity are exempt from major industry (e.g., placer mines with a capacity of less than 500 cubic metres of pay dirt per day—Exemption from Industrial Improvements Regulation, B.C. Reg. 97/88).

As set out further below, the incentive to taxpayers to seek more favourable assessments and tax rates has, since the inception of the major industry class in 1988, resulted in a significant number of appeals to the Board and courts on classification issues. The question of when a particular improvement is an "industrial improvement" has been the subject of numerous decisions, the most recent and significant of which are reviewed below.

## C. Valuation of Major Industry Property

Generally, the assessed value of properties that fall within residential, business, light industry and several other classes are determined on a market basis using traditional appraisal methods (e.g., the cost approach, income approach, or direct sales comparison approach).

As an exception, the value of major industry improvements is determined using prescribed (manualized) costs and prescribed depreciation. Improvement values are generally determined using unit-in-place costs prescribed by the Lieutenant Governor in Council in the B.C. *Major Industrial Properties Manual*," or "*MIPS Manual*" under ss. 20(4) and (5) of the *Assessment Act*. Where costs do not exist in the *MIPS Manual*, the *Marshall & Swift* manual is used. The regulated costs are depreciated at fixed, prescribed rates (B.C. Reg. 379/88, Depreciation of Industrial Improvements Regulation). The assessed values of major industrial lands are determined by market value appraisal principles, as though part of a going concern (s. 4 Classification Regulation; s. 19(4) *Assessment Act*).

The Legislature implemented the major industry class in 1988 to stabilize municipal tax bases that had experienced extreme cyclical variations when valued on traditional market approaches (e.g., discounted cash flow). Assessments of major industry properties based on manualized costs and prescribed deprecation are not intended to reflect the fair market value of industrial improvements or industrial plants as going concerns. There is a perception within industry that assessments of major industry properties determined on the basis of indexed historical costs and prescribed depreciation do not fully reflect all measures of depreciation present in the market (e.g., economic and functional obsolescence), and as a result, that major industry assessments are typically higher than if determined on traditional market principles. As noted, this has provided a continuing incentive to taxpayers to seek reclassification of their industrial facilities from major industry to light industry or business class, where market valuation principles and full measures of economic and functional obsolescence apply. Recent cases have also addressed the distinction between utility and major industry, light industry or business class properties.

### D. Taxation of Major Industrial Property

Generally, local governments have the power to establish different tax rates for each class of property in their tax base. Historically, since the inception of the major industry class in 1988, municipalities have tended to increase major industry tax rates relative to light industry, residential and business tax rates, generating appeals by industrial facility owners to seek reclassification to a lower tax rate class.

## II. Overview of Recent Major Industry Classification Decisions

### A. Introduction

Despite a relatively high volume of major industry appeals to the Board since 1988, it was not until recently that the first major industry classification case reached the Court of Appeal. However, in the last five years the Board and courts have addressed industrial classification in a number of cases, establishing and refining tests which, as noted below, provide some measure of predictability for assessors, property owners, and tax advisors. The following is an overview of the issues that have been addressed in these decisions by the Board and courts.

### B. Threshold for Exemption from Major Industry Classification

As noted, industrial improvements that are part of a plant with less than a prescribed capacity are exempt from major industry, falling to be classified, valued and taxed in light industry. The question of how this threshold capacity is measured is important to plants operating at a relatively low capacity.

The Board considered this issue in *Weyerhaeuser, C & C Holdings Inc., Duke Point Reman Ltd., and Mid-Island Reman Inc. v. Assessor of Area #04 – Nanaimo/Cowichan*, (2003) PAABBC 20027127. The issue was whether the threshold capacity for exemption from major industry was met by two lumber remanufacturing facilities on Vancouver Island, the owners of which sought reclassification from major to light industry based on the relatively low output capacity of their facilities. The owners argued that their capacity should be measured by the "output," or the amount of finished product generated by the facilities, akin to mines and sawmills. The Board disagreed, finding that the threshold capacity of reman plants is properly determined based on their "input" capacity, or their ability to process raw materials. On this basis, the Board found that the capacity of the reman plants exceeded the threshold capacity in the regulation, and the facilities remained major industry. The regulation has since been amended to reduce the threshold capacity of reman plants for major industry classification.

## C. Classification of Shipping Facilities

Mines, mills, grain terminals, bulk terminals and refineries typically ship their products to domestic and international markets on barges and freighters using warehouses, docks and loading areas situated either at tidewater at the plant, or elsewhere on the coast. Shipping facilities can fall into major industry in one of two ways: first, if the shipping facility is "*part of*" a mill, mine, refinery or other plant, and second, if the shipping facility is a stand-alone plant designed and built for the purpose of loading cargo onto *sea-going ships or barges* (s. 20(1)(q) *Assessment Act*). The Board and courts have on several occasions recently grappled with the question of when shipping facilities are properly classified major industry, light industry, or business. These decisions are briefly addressed below.

### 1. Section 20(1)(q)—"loading cargo onto seagoing ships or barges"

*Quinsam Coal v. Assessor of Area #06 – Courtenay*, 2003 SC 442 (B.C.C.A.) was the first major industry classification case to reach the Court of Appeal. The operator of the Middlepoint coal barge-loading facility in Campbell River sought reclassification of the loading facility from major industry to light industry. Middlepoint had been redesigned to accommodate increased shipments of coal from the Quinsam Coal Mine (some 16 miles inland of Middlepoint) by barge to Texada Island and to domestic customers on the Fraser River and the Puget Sound. The assessor believed the loadout was properly classified major industry, either as "part of" the mine (the loadout having been built in conjunction with the mine and dedicated to shipping its product), or as a stand-alone "sea-going barge" shipping facility under s. 20(1)(q) of the *Assessment Act*.

The Board disagreed and reclassified the loadout as light industry as a separate shipping facility. On the first aspect of the case, the Board did not find a sufficient degree of physical, functional and operational integration between the loadout and the mine for the loadout to be "part of" the mine plant.

On the second aspect, the Board found that "sea-going ships and barges" are those that are both designed to travel, and actually travel, on the open sea outside of the protected waters of the Juan de Fuca Straight, Straight of Georgia, and Puget Sound. In comparison, the barges accommodated by the Middlepoint loadout were neither capable of travelling, nor did they travel, the open seas. The Supreme Court and Court of Appeal upheld this ruling on appeal.

### 2. Split/Concurrent Classification

The Board and courts again had occasion to address the classification of shipping facilities in *Timberwest Forest Products v. Assessor of Area #04 – Nanaimo/Cowichan Valley*, 2004 SC 470 (B.C.C.A.). Timberwest sought reclassification of Stuart Channel Wharves, its Vancouver Island wood products shipping facility (comprising a warehouse, paving and a dock) from major industry to light industry or a mix of major and light industry. Timberwest contended that the facility did not comprise a "plant" because it did not have any machinery typically associated with an industrial facility. Alternatively, Timberwest contended that, as a "plant," the facility's classification should be split between major and light industry on the basis of the relative proportion of its products shipped on coastal barges as opposed to sea going freighters.

The Board held that despite there being no machinery at the facility, it nevertheless comprised a "plant" under s. 20(1)(q) of the *Assessment Act*. The Board went on to find, however, (on the basis of the *Quinsam Coal* decision), that since some 25% of its products were shipped by coastal barge, the classification should be split 75% major industry/25% light industry. This raised the interesting practical question of how one would value a single improvement like a shipping dock, partly on a manualized basis, and partly on a market value basis.

Following on this decision, a number of plant owners sought, and some were granted, a similar split classification of their shipping facilities.

The Board's decision was upheld by the Supreme Court. However, on further appeal, the Court of Appeal set the Board and Court's decisions aside, finding, on the authority of its previous decision in *Assessor of Nelson/Trail v. Cominco Ltd.* (1998), 48 B.C.L.R. (3d) 371 (C.A.), that the exclusionary words of s. 5 establishing

Class 5 – Light Industry in the Classification Regulation specifically preclude property that falls into the major industry class from being classified, wholly or partly, as light industry. On this basis, the Court of Appeal ordered the classification of the entire property as Major Industry.

While it would appear that the Court of Appeal's decisions in *Cominco* and more recently in *Timberwest* preclude any split classification of facilities situated within the site of a Major Industry plant, the author proposes that it may still be open to seek "concurrent" classification of those facilities that can be isolated physically, functionally and operationally from the components of a plant as Class 5 – Light Industry, while the remainder of the plant falls to be classified Class 4 – Major Industry, based on the recent formulation of the test established in *Norske Skog* (set out below) for the classification of industrial improvements.

## D. Classification of Hydroelectric Facilities

The question of when remote improvements are "part of a plant" and thus "industrial improvements" arose in *Norske Skog Canada Limited v. Assessor of Area #06 – Courtenay*, 2004 SC 476 (B.C.S.C.). The owner of the Powell River pulp and paper mill sought reclassification of the Powell Lake and Lois Lake hydroelectric dams and the Theodosia river diversion from Class 2 – Utilities to Class 4 – Major Industry, on the basis that the hydroelectric facilities are "part of" the mill. The Dams had been built to supply electricity to the mill and although they had the capability to supply surplus electricity not consumed by the mill to the provincial hydro system, virtually all of the electricity was consumed by the mill.

Applying the *Quinsam Coal* decision, the Board ruled that despite the remote location of the Lois Dam (some 20 km from the mill) and the Theodosia diversion, the hydroelectric facilities were sufficiently "*physically, functionally and operationally integrated*" with the mill to be "part of" the mill plant, and thus, industrial improvements. The Board observed that it is a question of fact in each case whether improvements meet this test. The Board's decision was upheld by the Supreme Court. Leave to appeal was not pursued.

The Board had occasion to apply the "physical, functional and operational integration" test again in the context of classification of shipping facilities, in *Norske Skog Canada Limited v. Assessor of Area #06 – Courtenay/Comox* (2003), PAABBC 20030456. In an appeal argued and decided prior to the Court of Appeal's more recent decision in *Timberwest*, Norske Skog sought reclassification of the pulp and paper shipping docks as its Elk Falls pulp and paper mill from major industry to light industry, based on the discrete shipping function of the facilities, and their proportionate use of coastal barges and sea-going barges and freighters to their use of sea going freighters. The Board denied reclassification, ruling that the shipping facilities, situated within the mill site, were sufficiently physically, functionally and operationally integrated with the mill plant itself to comprise "part of the plant." On this basis, the Board did not find it necessary to consider whether the facilities ought to be split-classified on the basis of proportionate sea-going and coastal vessel use, which the author observes would, on the facts, likely have been ultimately precluded by the subsequent Court of Appeal decision in *Timberwest*.

The Board had occasion to apply the *Quinsam Coal*, *Timberwest* (pre-Court of Appeal decision) and *Norske Skog* classification principles in the context of port property assessment issues in *TSI Terminal Systems Inc. v. Assessor of Area #09 – Vancouver* (2004), PAABBC 20040010. TSI contended that Vanterm, a Port of Vancouver inter-modal transportation facility, is not a "plant" in the sense contemplated by s. 20 of the *Assessment Act* and thus not subject to major industry classification, and alternatively, that the berth corridor, berth extension and associated improvements, used to handle empty cargo containers and not specifically to load them onto seagoing vessels, did not fall within s. 20(1)(q) of the major industry class, and ought to be split classified major and light industry. TSI also contended that the vessels handled by the facility are not sea-going, on the test enunciated in *Quinsam Coal*.

The Board rejected all of these positions, finding, on the basis of the trilogy of classification cases, that Vanterm is a plant in the sense contemplated by s. 20 of the *Assessment Act* based on the physical, functional and operational integration of the facilities on site; that no split classification is warranted, and that the vessels handled by the facility, while perhaps not all travelling on the open sea, were nevertheless capable of this. As to split classification, the Board held that it would make no sense to carve the facility into dysfunctional operational activities where loading and offloading of containers is the very essence of Vanterm.

## E. Classification of Inter-Facility Oil and Gas Pipelines

Although the primary focus of this paper is classification issues relating to Major Industrial plants, the recent decision of the five-judge panel of the Court of Appeal in *Burlington Resources Canada Ltd. v. Assessor of Area #27 – Peace River*, 2005 BCCA 72 bears mention both for the classification principles relating to utilities property and the Court's observations with respect to the Board's powers.

On the merits, the issue for the Board and courts was whether inter-facility piping should be classified as utility or light industry. Burlington owns pipeline through which it transports gases from its Noel processing plant in northeastern B.C. to its Elmworth deep-cut processing plant in Alberta. Prior to construction of the secondary processing facility, the pipeline had been classified utility, and the assessor continued to classify it this way after construction of the facility. Burlington appealed the assessment to the Board, seeking reclassification of the inter-facility pipeline to light industry on the basis it was used for processing of gas, not in conjunction of the business of transmission or transportation of finished product to market.

The Board agreed, finding that the pipeline is not used for the purpose of transmission by pipeline, but for the production part of Burlington's undertaking (to produce natural gas for its chosen market), to transport natural gas for further processing into the form in which it enters Nova, Alliance or Pembina pipelines for transmission to market. The Board found that the pipeline was properly classified light industry.

The Supreme Court set aside the Board's decision, ruling that the pipeline properly fell within utility class. The Court found that the Board had misapplied the previous Court of Appeal decision in *Cominco* in failing to characterize Burlington's use of the inter-facility pipeline as part of its business of transporting finished gas to market.

On further appeal, the Court of Appeal reversed the Supreme Court's decision and reinstated the Board's decision. Burlington sought a five-judge panel to reconsider the meaning of "business of" in *Cominco*. The Court found that the Board had properly interpreted and applied the *Cominco* meaning of "business of" in the utilities classification provisions to exclude the pipeline, ruling that the question is not whether the owner is in a particular business, but whether the improvement in question is used as part of a particular business. The Court found that the inter-facility pipeline does not have a business use of transporting finished product to market, and so did not fall into the utilities class.

In addition to the merits of classification, several noteworthy issues concerning the nature of an appeal to the Board, and of a stated case appeal, were addressed by the Court of Appeal.

The first is the standard of review of a Board decision. The panel found that the Chambers judge had erred in applying a standard of "patent reasonableness" to the questions of law posed by the assessor, and that the proper standard of review is that of "correctness."

The second issue is the scope of the Board's ability to rely on its experience as an expert tribunal. The issue was whether the Board had erred in referring to industry meanings of phrases in the classification regulations derived from a previous case. The panel found that the Board's expertise allows it take notice of factual matters that are within the scope of its core expertise, derived from its specialized knowledge about classification of properties and its application of the regulations to specific properties. As a result, it was appropriate for the Board, where, as here, there was no prejudice to the assessor, to take notice of industry meanings of words absent positive evidence led to establish those meanings. This is an important practice point before the Board, raising the question of whether and how notice ought to be given to the Board and opposing parties when a party intends to lead evidence to depart from common industry meanings.

# III. Summary

It is the author's observation that, while the Board and courts have made significant advances in articulating the tests to classify property, these principles will continue to evolve as new cases come before the Board. Nevertheless, the recent developments set out above provide some measure of guidance to assessors, property owners and tax advisors concerned with the classification of their industrial facilities.

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