C. A. DAW
CHARLENA TORO
COURTNEY JENKINS
Special Assistant Attorneys General
MONTANA DEPARTMENT OF REVENUE
Legal Services Office
125 North Roberts Street
PO Box 7701
Helena, MT 59604-7701
Phone: (406) 444-1763

Attorneys for the Department

**BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA**

OMIMEX CANADA, LTD., **Appellant,** **vs** **STATE OF MONTANA, DEPARTMENT OF REVENUE,** **Respondent.**	**Cause No.: CT-2006-6** **DEPARTMENT OF REVENUE'S OPENING BRIEF ON FIRST QUESTION PURSUANT TO STAB'S 7/2/09 ORDER**

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COMES NOW Respondent, Montana Department of Revenue, and hereby submits this Opening Brief pursuant to the State Tax Appeal Board's July 2, 2009, Order. This Brief demonstrates that it is "legally permissible for the Department to centrally assess certain class 8 property." Order, July 2, 2009.

ARGUMENT

1. The Department is Required to Centrally Assess Certain Class Eight Properties.

No legal barrier prevents the Department from centrally assessing certain class eight properties. In fact, if the property at issue satisfies the criteria for central

assessment under § 15-23-101, MCA, and falls within the properties described in § 15-6-138, MCA, the Department must centrally assess those properties. Montana law also requires that the Department appraise property at 100% of its fair market value. Section 15-8-111, MCA; Mont. Const. Article VII, § 2. The Department achieves fair market value for centrally assessed properties falling within § 15-23-101, MCA, through the use of the unit method of valuation.

The Department classifies property subsequent to a determination on central versus local assessment. Historically, the Department interpreted § 15-23-101, MCA, to prescribe a property's proper classification as a result of § 15-6-141(1)(c), MCA's, catchall that brings all other unclassified centrally assessed property within class 9. The Montana Supreme Court has made clear that the Department's interpretation was incorrect. Controlling law now provides that certain properties, such as Omimex's, can be centrally assessed but otherwise fall within class 8. *See Omimex Canada, Ltd. v. Montana Dep't of Revenue*, 2008 MT 403, ¶ 27, 347 Mont. 176, 201 P.3d 3. Accordingly, the Department now understands that some central assessment and classification decisions are independent of one another. As it relates to Omimex, it would be legally impermissible for the Department to locally assess its properties in contravention of §§ 15-23-101 and 15-8-111, MCA, even though its properties may be classified as class eight properties.

A. Section 15-23-101, MCA, Defines Properties that the Department Must Centrally Assess.

The Legislature directs the Department to centrally assess certain properties to meet its statutory and constitutional duty of assessing all taxable property at 100% of its market value. Section 15-8-111, MCA; Mont. Cons. art. VII, § 2. Although the terms

"central assessment" and "unit valuation" are often used interchangeably, technically "central assessment" relates to appraisals done at the Department's Helena office, and "unit valuation" is the actual appraisal methodology used to appraise centrally assessed properties. Unit valuation focuses on capturing the business value in order to ensure the Department arrives at the true market value of certain types of property described in § 15-23-101, MCA. For such properties, unit valuation represents the only way that the Department can achieve the true market value.

When assessing properties as part of its legislative and constitutional mandate, the Department first looks to § 15-23-101, MCA, to determine whether the Legislature requires the Department to centrally assess the subject property. Section 15-23-101, MCA, provides, in part, that the Department "shall centrally assess each year . . . (2) property owned by a corporation . . . operating a single and continuous property operated in more than one county or more than one state, including . . . natural gas or oil pipelines . . . ." (Emphasis added.)

Thus, pursuant to § 15-23-101(2), MCA, the Department is required to centrally assess a corporation's property if: 1) the corporation operates the type of property described by the statute; 2) the business is operated in a single and continuous fashion; and 3) the business operates its single and continuous property in more than one county or more than one state.

When the subject property consists of property enumerated in § 15-23-101(2), MCA, such as natural gas or oil pipelines, the Department next ensures that the property is operated in a single and continuous fashion. "Single and continuous property" under central assessment theory represents property that is functionally

integrated over a wide area, and whose value as a whole operating economic unit exceeds the value of its component parts. *Western Union Telegraph v. State Bd. of Equalization* (1932), 91 Mont. 310, 7 P.2d 551. (Section 15-23-101, MCA, clearly contemplates consideration of a centrally assessed property's operating characteristics. The Department reserves a more in-depth discussion of the relevant factors for determining whether a property operates as a functionally integrated economic unit for the briefing on the second question set forth in the Board's July 2, 2009, Order).

Notably, Montana law does not require "single and continuous" properties to share physical connectivity. The Montana Supreme Court has held that the "unity of tangible property such as will support the application of the unit method of assessment is not dependent upon physical connection of the separate pieces of property composing the unit." *Western Union Tel. Co. v. State Bd. of Equalization* (1932), 91 Mont. 310, 322, 7 P.2d 552, 552. Rather, as this Board has recognized, the focus is on whether the corporation operates its facilities as a single, integrated property. *See PPL Montana, LLC v. Dep't of Revenue*, SPT-2002-4 and SPT-2002-6, pp.28-29. For instance, the benefit derived from a natural gas or oil pipeline company's major purchasing contract with a gas marketing entity would support the conclusion that the pipeline company operates as a single, integrated property. Significant leasehold interests throughout the state and hundreds of miles of pipeline with appurtenant easements would similarly denote operation as a single, integrated property.

Finally, before determining that a property is properly subject to central assessment and applying the attendant unit method of valuation, the Department evaluates whether the property operates in more than one county or more than one

state. Section 15-23-101, MCA. If all of the above criteria apply to the subject property—owned by a corporation operating a single and continuous natural gas or oil pipeline operated in more than one county or more than one state—the Department is legally required to centrally assess the property. Section 15-23-101, MCA.

B. The Department Employs Unit Valuation to Appraise Properties at Their Fair Market Value

Once the Department determines that it must centrally assess property, it then employs the unit method of valuation to arrive at its fair market value pursuant to § 15-8-111, MCA. The unit valuation method represents a widely accepted appraisal methodology. Its validity has been repeatedly recognized by the Montana and United States Supreme Courts. *See e.g., Department of Revenue v. PPL Montana*, 2007 MT 310, ¶ 30, 340 Mont. 124, 172 P.3d 1241 (recognizing the "long-settled constitutionality of the unit method of valuation"); *Department of Revenue v. Soo Lines* (1977), 172 Mont. 1, 5, 560 P.2d 512, 514 (stating that "[t]he use of the three-factor, unitary method of assessment of the local property of an interstate corporation is hardly novel in this jurisdiction. This method has been approved by this court repeatedly and as recently as December 29, 1976"); *Yellowstone Pipe Line Co. v. State Bd. of Equalization* (1960), 138 Mont. 603, 611, 358 P.2d 55, 60 (concluding that "the proper way to find the true cash value of any part of this property requires that the system as a unit be valued"); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897) (determining that the property of an express company whose properties were not physically interconnected were nonetheless properly unit valued).

Property that is not subject to central assessment, or "locally assessed property", on the other hand, is trended and depreciated by individual pieces of property. *See,*

e.g., ARM 42.21.154 through 42.21.157. This brick-by-brick approach to valuation fails to capture the economic value of a centrally assessed operation as an integrated unit and thus fails to adhere to the constitutional and statutory requirements to appraise property at its fair market value. Section 15-8-111, MCA; Mont. Cons. art. VII, § 2. Montana law has recognized the fundamental tenet of unit valuation—that "[t]he true and actual value of [centrally assessed] property is something more than an aggregation of the values of separate parts of it, operated separately." *Western Union*, 91 Mont. at 324, 7 P.2d at 553. The Legislature accordingly directs the Department to centrally assess certain properties.

The Department employs the unit method of valuation to determine the market value of an integrated business operation. "This involves appraising, as a going concern and as a single entity, the entire unit, wherever located, then deducting the intangible personal property value and then ascertaining the part thereof in this state. The resulting value is referred to as the state allocated value." ARM 42.22.101(30). The Department appraises centrally assessed property using three different approaches to value—the income, cost, and market approaches. ARM 42.22.111; *see also DeVoe v. Dep't of Revenue* (1993), 263 Mont. 100, 111-12, 866 P.2d 228, 235-36 (holding that the consideration of only one approach to value does not meet the requirements of § 15-8-111, MCA, that a property's assessed value equal its market value). These methods of valuing an integrated business operation require examination of the business as a whole, not just its component pieces.

After the value of an integrated business operation is established for each of the three approaches to value, the Department correlates the three values to arrive at the

market value of the business as a going concern. The Department then allocates to each taxing jurisdiction the value of the property located within each taxing jurisdiction. ARM 42.22.121 and 4.22.122.

In sum, in light of the Supreme Court's decision in *Omimex*, the Department first makes a determination on whether the Legislature requires that it centrally assess a particular property or properties pursuant to § 15-23-101, MCA. It then utilizes unit valuation to arrive at a fair market value for that property. For properties that the Legislature obligates the Department to centrally assess, unit valuation represents the sole means of achieving fair market value in conformity with § 15-8-111, MCA, and Article VII, § 2 of the Montana Constitution. Only after ensuring it conducts an appraisal in compliance with §§ 15-23-101 and 15-8-111, MCA, and the Montana Constitution, does the Department determine the appropriate classification for the property based on the classification statutes, §§ 15-6-101, *et seq.*, MCA.

C. Certain Centrally Assessed Properties Fall Within § 15-6-138, MCA, Class Eight Properties

The process of classification remains separate from the assessment of property or the determination of assessed value. *Pacific Power & Light Co. v. Dep't of Revenue* (1991), 249 Mont. 33, 36, 813 P.2d 433, 435. This is the case except where the classification statutes reference the assessment process. The Legislature has codified the processes for the appraisal of property and the classification of property in different statutes. *Pacific Power*, 249 Mont. at 36, 813 P.2d at 435, *citing* Part 1, Chapter 6, of Title 15, and Part 1, Chapter 23, of Title 15. The Department's historical take was that centrally assessed properties were properly classified as class nine, twelve, or thirteen, largely by virtue of those properties requiring central assessment. The Supreme Court,

however, had held that "[r]egardless of whether . . . property is centrally or locally assessed, its tax rate is determined by the application of the physical attributes of . . . the properties to the terms of the property classification statutes . . . ." *Omimex*, ¶ 18.

Following the Supreme Court's recent holding in *Omimex*, the Department must classify as class eight certain centrally assessed properties whose physical attributes meet the terms of § 15-6-138, MCA. Specifically, the Department must place within class eight those properties that require central assessment and unit valuation under §§ 15-23-101 and 15-8-111, MCA, respectively, and that fall out of class nine's dragnet in § 15-6-141(1)(c), MCA.

Before the benefit of the Supreme Court's decision in *Omimex*, the Department determined that the physical attributes of centrally assessed natural gas or oil pipeline companies most appropriately required class nine classification as "centrally assessed companies' allocations." Section 15-6-141, MCA. The Department did not, however, base its interpretation upon any legal barrier to classifying centrally assessed properties as class eight. Even Omimex has asserted that the Department's "argument, that central assessment alone compels class nine property classification, flows in reality from nothing more than '[t]he Department's longstanding interpretation of the central assessment and classification statutes . . . .'" Omimex Brief in Opposition and Objections to Petition for Rehearing, pp. 11-12 (internal citations omitted). Omimex went on to state that the "[i]nternal polices of [the Department] cannot conflict with the law." Omimex Brief in Opposition and Objections to Petition for Rehearing, pp. 11-12 (citation omitted).

The Department agrees that it cannot act in conflict with controlling law. The Supreme Court has invalidated the Department's longstanding interpretation of the classification statutes and the Department must comply with this decision. The Supreme Court has held that certain properties "regardless of whether they are centrally or locally assessed, should be classified as . . . class eight properties subject to a 3% tax rate." *Omimex*, ¶ 26 (emphasis added). Omimex itself has recognized that the Department's "concern over its practice of piecemeal or brick-by-brick valuation of class eight property is laid to rest because [the Department] may continue to centrally assess the property, or not. With this decision, the Court has not disturbed the existing central assessment." (Omimex Brief in Opposition and Objections to Petition for Rehearing, p. 12 (internal citations omitted).

Beyond "not disturbing the existing central assessment," the Court implicitly recognized the legal permissibility of classifying as class eight certain centrally assessed properties. In its analysis of § 15-8-141, MCA, the Court stated that "[i]f the legislature had intended to place all centrally assessed natural gas companies into class nine, it had two simple ways to do so . . . ." *Omimex*, ¶ 25 (emphasis added). The Court went on to state that if "the legislature wanted to single out centrally assessed natural gas companies to be certain they would all be placed in class nine, it could have deleted the qualifier "having a major distribution system in this state." *Omimex*, ¶ 25 (emphasis added).

The Court repeatedly mentions centrally assessed natural gas companies and recognizes that, like Omimex, not all such properties properly belong in class nine. No other classification statute specifically captures centrally assessed natural gas

companies or natural gas and oil pipeline properties. Thus, the Court clearly acknowledged that properties could both require central assessment under § 15-23-101, MCA, and classification under § 15-6-138(1)(n), MCA, as class eight properties. The Court's analysis, along with Omimex's own statements to the Court, lead to only one conclusion: it is legally permissible for the Department to centrally assess certain class eight properties.

Moreover, had the Court foreseen any legal impermissibility to classifying as class eight certain centrally assessed properties, it surely would have addressed the issue, as it was squarely before the Court. It did not, and in fact stated that the central versus local assessment of property "does not make any difference for its classification." *Omimex*, ¶ 27. The Court here again acknowledges that no legal barrier prevents class eight classifications of certain centrally assessed properties.

Importantly, no conflict results from centrally assessing a property that arrives in class 8 through the negative implication of falling out of § 15-6-141(1)(b), MCA. Omimex's properties, for instance, fall squarely within both §§ 15-23-101 and 15-6-138, MCA. The Department has consistently maintained that Omimex's properties constitute "natural gas or oil pipelines" operated as a "single and continuous property in more than one county or more than one state." The District Court agreed. *Omimex Canada, Ltd. v. Montana Dep't of Revenue*, BDV-2004-288, Findings of Fact, Conclusions of Law, and Order (February 2, 2007).

The District Court heard evidence over the course of a three-day trial and concluded "that the Omimex properties were properly centrally assessed under Section 15-23-101, MCA. It appears clear that the Omimex properties are operated as a single

and continuous property." *Omimex Canada, Ltd.,* Findings of Fact, Conclusions of Law, and Order, p. 17. The Court then added that "the Omimex properties are located in more than one county. If property is operated as a single and continuous property in more than one county and is a natural gas pipeline, it is to be centrally assessed." *Omimex Canada, Ltd.,* Findings of Fact, Conclusions of Law, and Order, p. 17. The Supreme Court's decision on appeal "has not disturbed the existing central assessment." Omimex's Brief in Opposition and Objections to Petition for Rehearing, p. 12.

The Supreme Court did, however, conclude that "Omimex's properties, regardless of whether they are centrally or locally assessed, should be classified as § 15-6-138(1)(c) or (n)[1], MCA, class eight property subject to a 3% tax rate." *Omimex*, ¶ 26. Thus, taken together, the District Court's undisturbed determination that the Department properly centrally assessed Omimex's properties, and the Supreme Court's holding that those same properties belong in class eight, demonstrates that the Department can, and must, classify certain centrally assessed properties within class eight.

Similarly, no legal barrier exists on the faces of §§ 15-23-101 and 15-6-138(1)(n), MCA, to prevent inclusion within each. Section 15-6-138(1)(n), MCA, represents a catchall that incorporates "all other property that is not included in any other class in this part." Thus, "property owned by a corporation . . . operating a single and continuous property operated in more than one county or more than one state" not included in any other class necessarily belongs in class eight without creating a statutory conflict. In

[1] The Department maintains that following the Supreme Court's decision properties such as Omimex's fall within § 15-6-138(1)(n), MCA, except its real properties that now fall within § 15-6-134(1)(a) and (b), MCA.

fact, a determination that the Department cannot centrally assess certain class eight properties would conflict with § 15-8-111, MCA and Article VII, § 2 of the Montana Constitution, by preventing the Department from appraising such properties at 100% of their fair market value. This Board should endeavor to harmonize statutes relating to the same subject, giving effect to each. *See Albright v. State* (1997), 281 Mont. 196, 206, 933 P.2d 845, 821-22.

Even Omimex argued to the Supreme Court that centrally assessed property could be included within class eight. *See Omimex Canada, Ltd., v. State of Montana, Department of Revenue*, No. DA 07-0356, Appellant's Brief, pp. 18-21. The Department again acknowledges that its historical construction of the classification statutes lead it to believe that all centrally assessed natural gas or oil pipeline companies' properties fell within class nine as "centrally assessed companies' allocations." Section 15-6-141(c), MCA. But the Supreme Court disagreed. Settled law now requires the Department to classify within class eight properties such as Omimex's—centrally assessed natural gas or oil pipeline companies' property.

The Department's approach to determining whether a property is properly subject to central assessment and the attendant determination of the property's fair market value remains valid. The Department will continue to first look to the nature and characteristics of the property at issue to determine whether the Legislature and the Montana Constitution require central assessment and unit valuation pursuant to §§ 15-23-101 and 15-8-111, MCA, and Article VII, § 2, of the Montana Constitution. The Department then places property into its appropriate class. In the wake of the Supreme

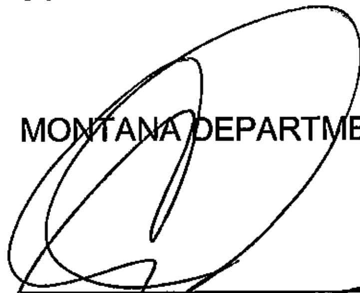
Court's decision in *Omimex*, the law requires that the Department place certain centrally assessed properties within class eight rather than class nine.

CONCLUSION

Not only is it legally permissible for the Department to classify certain centrally assessed properties as class eight—the law requires that it do so. To hold that the Department cannot assign class eight classification to certain centrally assessed properties is to impale the Department with a Morton's Fork. The Department would be forced to either: 1) ignore the mandates §§ 15-23-101 and 15-8-111, MCA, and the Montana Constitution by foregoing central assessment and unit valuation for properties that require such assessment and valuation; or 2) run afoul of the Supreme Court's holding in *Omimex*, by classifying as class nine certain centrally assessed property even though its physical attributes meet the class eight terms of § 15-6-138, MCA. As noted by Omimex, the Department cannot act in conflict with controlling law. The Department must therefore classify within class eight those centrally assessed properties that fall within §§ 15-23-101, MCA, and 15-6-138, MCA. The Department respectfully urges the Board to find accordingly.

Dated this 31 day of July, 2009.

MONTANA DEPARTMENT OF REVENUE



C. A. DAW, Chief Legal Counsel
CHARLENA TORO
COURTNEY JENKINS
Special Assistant Attorneys General

CERTIFICATE OF SERVICE

I hereby certify that I served true and accurate copies of the foregoing *Department of Revenue's Opening Brief on First Question Pursuant to STAB's 7/2/09 Order* by depositing said copies into the U.S. Postal Service, postage prepaid, addressed to the following:

James P. Sites
Jared M. Le Fevre
Monique S. Waddington
Crowley Fleck PLLP
490 North 31st Street
PO Box 2529
Billings, MT 59103-2529

Dated this 31 day of July, 2009.