

# Fiscal Note

**BILL #** SB 1204

**TITLE:** centrally assessed property; valuation; pipelines

**SPONSOR:** Mesnard

**STATUS:** As Amended by Senate FIN

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## Description

SB 1204, as amended, is an emergency measure that would amend existing pipeline valuation statutes by adding new language specifying the circumstances that may result in the adjustment of the "base value" used to determine the full cash value of pipeline property. The pipeline property's "base value" is its full cash value in the preceding year.

The bill is retroactive from Tax Year (TY) 2016.

## Estimated Impact

The changes under the bill would have no direct fiscal impact. While the state and local taxing jurisdictions may be required to issue refunds for property taxes levied on pipeline property after TY 2015, such refunds would not be the result of this bill but rather the final court decision on pending valuation appeals.

## Analysis

### Background Information - Valuation of Pipeline Property and Related Litigation

The full cash value of pipeline property is determined by the Department of Revenue (DOR) based on a statutory valuation formula prescribed in A.R.S. § 42-14204. One of the factors determining the full cash value in the current valuation year is the property's full cash value in the preceding valuation year. (The full cash value in the preceding year is referred to as the property's "base value" in A.R.S. § 42-14204.) This means that the pipeline property's value in any given year is directly related to its value determined in the prior year.

Pursuant to A.R.S. § 42-11001(6), a property's full cash value is not allowed to exceed its market value regardless of the method prescribed to determine such value, such as the valuation formula for pipeline property described above. If the property owner believes that the full cash value determined by DOR is greater than the market value, the property owner can appeal such valuation directly to the Tax Court.

According to information from a representative of a large pipeline company that owns and operates a natural gas transmission system in Arizona and several other states, this company has filed lawsuits against DOR in every tax year from 2010 through 2020, except for 2015. According to the same industry representative, the claims for tax years 2010 through 2014 were settled before a trial was held in the Arizona Tax Court. As a result of this settlement, the full cash value of the pipeline property (as originally determined by DOR) was lowered and the company was issued a refund on the property taxes attributable to the "over-valuation."

In February 2019, the Arizona Tax Court ruled in favor of the pipeline company with respect to the TY 2016 and TY 2017 valuations determined by DOR. As a result, the full cash value for TY 2016 and TY 2017 was reduced by \$(237) million and \$(222) million, respectively. This ruling represented a full cash value reduction of approximately (37)% relative to DOR's original valuation. According to DOR, the Department has appealed the Tax Court's ruling with respect to the TY 2016 and TY 2017 valuations to the Arizona Court of Appeals. Therefore, the final court decision on the TY 2016 and TY 2017 valuations is still pending. The pipeline company has also appealed the TY 2018, TY 2019, and TY 2020 valuations by DOR and these cases are currently pending in the Arizona Tax Court.

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**JLBC**

#### Changes under SB 1204

As noted earlier, the base value is the pipeline property's full cash value in the prior year. Effectively, this means that whatever full cash value DOR determines in one year is automatically used to determine the property's full cash value in the following year. SB 1204 provides for 3 circumstances under which the base value (or equivalently, the prior year's full cash value) can be adjusted to reflect the property's market value:

- 1) A final court ruling that the full cash value of pipeline property determined using the statutory valuation formula is more than the market value determined using standard appraisals and techniques.
- 2) An agreement between a pipeline company and DOR (that is the result of a pending tax appeal) to adjust the base value to more accurately reflect the property's market value.
- 3) An agreement between a pipeline company and DOR to correct a material error or omission in the calculation of the property's base value.

The impact of SB 1204 with respect to the valuation of pipeline property depends on the extent to which the base value is adjusted as outlined above. As an example, if the Arizona Court of Appeals agrees with the lower court's decision with respect to the aforementioned pipeline company's TY 2016 and TY 2017 valuations, the base value would be adjusted downward, which would have the effect of reducing the full cash value in future tax years (meaning TY 2018 and subsequent years) as well. (This is due to the statutory valuation formula, which automatically calculates the current valuation year's full cash value based on the preceding year's full cash value.)

If the base value is reduced as a result of a final court ruling, school districts would be required to refund the pipeline company for the "overpayment" of K-12 Qualifying Tax Rate and State Equalization Tax Rate (SETR) taxes levied after TY 2015. Pursuant to A.R.S. § 15-915(B), the state is required to reimburse school districts for such loss of "local share" revenue under the K-12 state aid formula. The amount of refunds in the form of "correction of state aid to school districts" is not currently known. When such refunds were last issued in FY 2015, the state had to reimburse 26 school districts in 7 counties for the loss of \$(3.0) million in state aid owing to the pipeline valuation appeal.

To conclude, the effect of the changes under SB 1204 depends largely on the final court ruling on pending litigation related to the valuation of pipeline property. If the final court ruling is the same as the lower court's ruling that the market value is lower than the statutory formula's full cash value, the base value would be reduced. This would result in the issuance of refunds to the pipeline company, a portion of which would be borne by the General Fund. However, if the final ruling is in line with DOR's valuation, the base value would not be reduced and refunds would not have to be issued.

#### **Local Government Impact**

The bill would have no direct fiscal impact on local governments. Instead, any refunds required to be issued by affected counties, cities and other taxing jurisdictions would ultimately depend on the result of pending litigation with respect to the valuation of pipeline property, as discussed above.

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