Big Property Tax Appeal:
Supreme Court Upholds $10 Billion Value of Trans-Alaska Pipeline[1]

Article Overview

This article is a case summary of the Alaska Supreme Court's decision in the 2006 property tax appeal of the Trans-Alaska Pipeline System. The taxpayers argued for an $850 million "fair market value" using the income approach, or in the alternative, a cost approach value with much depreciation and obsolescence. Municipalities argued for a $12 billion "use value" using the cost approach. Each appeal brought higher valuations, until ultimately the highest court in Alaska upheld a $10 billion valuation.

Taxpayers own the Trans-Alaska Pipeline System (TAPS). TAPS is an 800-mile oil pipeline that transports crude oil from Alaska's North Slope to a shipping terminal in the City of Valdez. The Department of Revenue valued TAPS by the cost approach at $3.6 billion in 2006. Both the taxpayers and municipalities appealed to the State Assessment Review Board, which raised the value to $4.3 billion. Both sides appealed to the superior court, which raised the value to $10 billion. Both parties appealed to the Supreme Court, which affirmed.[2] The two main discussions covered the proper method of value to use, and the cost approach deductions for depreciation and obsolescence.

Taxpayers argued that TAPS should be assessed an $850 million "fair market value" using the income approach, based on their regulated tariff income stream. The municipalities argued for an almost $12 billion valuation using the cost approach. Nevertheless, the Supreme Court affirmed the lower court which held that TAPS should be assessed at "full and true value," or "use value," because there was a limited market for TAPS and it was a special purpose property. Furthermore, unlike most pipelines, TAPS is a closed system mostly used by affiliated oil producers. Three companies that owned 95% of TAPS also controlled 91% of the North Slope oil production. Therefore, the court affirmed that it would be inappropriate to value TAPS using the *related-party* tariff income that the producers paid TAPS.

Most of the court's discussion concerned cost approach depreciation and obsolescence. Taxpayers argued for higher deductions for depreciation and obsolescence, and the municipalities argued for lower deductions.

---

[1] This article was originally prepared for the International Association of Assessing Officers (IAAO) 35th Annual Legal Seminar, December 11, 2014, Chicago, Illinois. Published here with IAAO's permission.

[2] *BP Pipelines (Alaska) Inc. v. State of Alaska, Department of Revenue*, Supreme Court of Alaska, May 9, 2014, 325 P.3d 478.

First, taxpayers argued for additional obsolescence deductions due to tariff regulation – calculated by the income shortfall method – based on the theory that a hypothetical new pipeline would be allowed to charge higher tariffs because it would have a higher rate base. The court rejected taxpayers' argument, just as it did their income approach valuation, in part, again, based on the close affiliation and integration of the owners and producers: "the value of the pipeline is completely divorced from the Owners' ability to charge tariffs."

Second, taxpayers argued for a shorter economic life of TAPS. "Alaska law requires that the measure of a pipeline's economic life be based on the estimated life of 'proven' reserves of oil and gas." The court affirmed that TAPS could operate until 2047. Taxpayers argued that *undeveloped* reserves are unproven and should be excluded from the economic life estimate. The court disagreed and cited industry definitions of *proven reserves* which included undeveloped reserves.

Third, the court upheld a super-adequacy obsolescence deduction for excess capacity. TAPS is required to maintain capacity of 1.1 billion barrels per day, but operates at less than that. The municipalities questioned whether it was economic or functional obsolescence, which the court dismissed as irrelevant. Municipalities also argued, in part, that a super-adequacy obsolescence deduction double-counted what the economic age-life depreciation already deducted from value. The court disagreed with the municipalities and held that while economic age-life accounted for the level of reserves, it did not account for the physical capacity of the pipeline.

Finally, the taxpayers were dealt a further blow when the court affirmed the superior court in holding that interest on the supplemental taxes runs from the date the original taxes were due. The original taxes were due in 2006, meaning taxpayers owe eight years of interest.

Two justices dissented in part. They opined that the super-adequacy obsolescence deduction for excess capacity might be improper. Since the owners of TAPS are closely affiliated with the producers, the use of TAPS is controlled by the producers. Thus, TAPS's declining throughput might *not* be caused by external factors, but might instead be based on the producers' own business decisions of holding back oil reserves.

Interestingly, the same court in a related case about attorneys' fees, 327 P.3d 185, ruled three months later that the municipalities, as the prevailing parties, were entitled to their costs plus the *enhanced* 45% of their reasonable attorneys' fees, with a total award of around $2.5 million. The court notes that as a result of the valuation case, taxpayers will pay the municipalities $152 million in supplemental taxes for the 2006 tax year.

About the Author

Benjamin M. Williams, a former appraiser, is an attorney at Podell, Schwartz, Schechter & Banfield, LLP, the largest law firm in New York City that is solely dedicated to reducing property taxes. Ben has presented to the International Association of Assessing Officers (IAAO), the New York State Society of CPAs (NYSSCPA), and several chapters of the American Society of Appraisers. He has guest lectured at Rutgers Law School. Ben previously served on the board of the Northern New Jersey chapter of the American Society of Appraisers.

Ben is an Accredited Senior Appraiser of the American Society of Appraisers and holds an engineering degree. He used both in his past performing cost segregation studies and power plant appraisals. Ben may be reached at the following:

Benjamin M. Williams, ASA
Attorney
Podell, Schwartz, Schechter & Banfield, LLP
605 Third Avenue, New York, NY 10158

212-883-6500 x 252
bwilliams@pssb-law.com
Fax: 212-883-6518
http://pssb-law.com