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ROYALITE OIL COMPANY LIMITED

v.

KAMLOOPS ASSESSMENT DISTRICT.

Supreme Court of British Columbia (No. 533/57)

Before: CHIEF JUSTICE SHERWOOD LETT

Vancouver, July 9, Sept. 9, 10, 1957

J.S. Maguire for the Appellant
D.R. Verchere, Q.C. for the Respondent

Reasons for Judgment

This appeal is brought pursuant to the provisions of the *Assessment Equalization Act*. The case stated to this Court by the Assessment Appeal Board reads as follows:-

This case stated by the Assessment Appeal Board aforesaid humbly sheweth that the above-mentioned appeal was heard at the Courthouse, Kamloops, British Columbia, on the 8th day of April, A.D. 1957, in the presence of John S. Maguire, Esq., of counsel for the appellant, and David Verchere, Esq., Q.C., counsel for the Provincial Assessor of the District of Kamloops.

The facts are as follows:-

1. The improvement which is the subject of this appeal is known as the Royalite Refinery and consists of an oil refinery which was constructed during 1953 and 1954 at a cost declared by the appellant at $6,188,855.96, and the Assessor fixed the 1957 assessment at $3,119,829. The Court of Revision reduced the assessment to $2,943,117 after making allowance for extra financing and overtime costs incurred "during the period of construction." From that decision of the Court of Revision the appellant appealed to this Board.

2. The appellant appealed to this Board on the following grounds:-

> (1) No adequate allowance or deduction was made on account of extraordinary construction costs of the refinery situate on the lands herein.
>
> (2) No allowance or deduction was made on account of functional obsolescence of the said refinery.
>
> (3) No allowance or deduction was made on account of economic obsolescence in that the said refinery has only operated since its construction at less than 50 per cent of its normal capacity.

3. The Assessor gave evidence at the hearing before the Board and stated that the assessment was calculated by taking 60 per cent of the construction costs of the refinery, which costs were taken from a statement of construction costs submitted to him by the appellant. At the

commencement of the hearing the Assessor declared that due to an oversight the costs of construction should have been higher by $632,446, and as this omission was in the nature of an error the Board directed that 60 per cent of this sum, after depreciation and other adjustments mentioned by the Assessor, be added to the over-all assessment. At the hearing the appellant submitted that the assessment should be reduced in that certain costs of construction included in the statement of costs upon which the Assessor based his assessment were items of expense which should have been deducted in order to arrive at the actual value as provided in section 37 of the said Act. The following were the deductions claimed by the appellant as extraordinary construction costs:-

(1) Loss on sale of surplus warehouse stocks (stocks ordered but not used in construction)	$70,408.31
(2) Costs of operating a bunk-house and cook-house for tradesmen for 1953 to 1955, which bunk-houses were not in use	$214,423.81
(3) Subsistence and traveling expenses to electrical contractor, Hume & Rumble, from Vancouver, B.C.	$7,859.88
	$292,692.00

(4) In addition to the above the appellant submitted evidence that it was letting a contract during 1957 to expend the sum of $850,000 to increase the octane rating of the gasoline produced at the refinery in order to meet the requirements of the newer, more powerful automobile engines. The appellant claimed that the necessity for this expenditure was in the nature of functional obsolescence of the refinery and that the assessment should have been reduced by the amount of this expenditure.

(5) The appellant further submitted that the net cost figure after deduction of the above sums of $292,692 and $850,000 should be further reduced by 45 per cent because, since it had commenced operation, the refinery had operated or had a throughput of less than 50 per cent of its capacity of 5,000 barrels daily, and submitted evidence to show that in 1955 the refinery operated at 45.5 per cent of its capacity and in 1956 at 48.5 per cent of its capacity, and to show that because of the lack of throughput as above that the refinery had lost $1,295,000 in 1955 and $661,000 in 1956. The appellant claimed that this lack of throughput was economic obsolescence due to economic conditions in the area of the refinery beyond the appellant's control. The figure of 45 per cent was suggested by the appellant as a reasonable percentage upon which the allowance should be calculated as the break-even point of the refinery was the throughput of 75 per cent of capacity.

(6) After hearing the evidence and reserving their decision, the Appeal Board, in its decision, refused to allow the costs of surplus materials because it was not disclosed in the evidence given before it whether the original costs of the surplus materials was contained in the statement of costs submitted by the appellant. The Board also refused to make any allowance for the additional costs incurred in maintaining the cook-houses and bunk-houses during the course of construction and the allowance of extra costs for the building contractor, finding that these costs were normal in construction projects of this kind. The Board further refused to make any deduction for alleged functional obsolescence on the ground that in 1956, when the assessment was made, the refinery was capable of producing the highest quality of gasoline now being sold on the market. Further, the Board failed or refused in its reasons to make any allowance on the ground of economic obsolescence. but did make an allowance of 10 per cent of the assessed value, being of the opinion that the assessment could not be based exclusively upon replacement costs without reference to the other factors which affect the value of an industry as a going concern.

(7) As a result of the above the assessment was reduced by the Board under the *Taxation Act* to $1,193,518 and under the *Public Schools Act* to $2,860,499.

(8) The appellant was dissatisfied with the decision of the Board and has required the Board to submit the case for the opinion of the Supreme Court.

Wherefore the following questions are humbly submitted to this Court by the Board for opinion:-

> "1. Was the Assessment Appeal Board right in failing to make any decision for alleged extraordinary construction costs in the amount of $292,692?
>
> 2. Was the Assessment Appeal Board right in failing to make any deduction for the alleged functional obsolescence in the amount of $850,000?
>
> 3. Was the Assessment Appeal Board right in failing to make any deduction for the alleged economic obsolescence claimed by the appellant?
>
> 4. Can an assessment calculated, *inter alia*, by making an allowance of 10 per cent after giving consideration to the revenue value be a valid assessment in law when the evidence adduced before the Board indicated that the appellant's plant was operating at less than 50 per cent of its capacity, that its market was up to the present restricted, and that it suffered operating losses in 1955 and 1956?"

Counsel for the Provincial Assessment District of Kamloops took preliminary objection to the consideration by the Court of Questions land 2 on the ground that they arc questions of fact and not questions of law. I reserved judgment on this preliminary objection. I have considered the transcript of the hearing before the Board, and the written reasons given by the Board for its decision, both of which documents were submitted at the hearing of this appeal.

Section 51 (2) of the *Assessment Equalization Act* provides:

> (a) Any person affected by the decision of the Board in an appeal, including a municipal corporation acting on the recommendation of the Assessor and on the resolution of its Council. may within ten days of the decision, by correspondence addressed to the Board, require the Board to submit the case for the opinion of the Supreme Court on a question of law only.

It has been said that "it is not always easy to distinguish between questions of fact and questions of law for the purposes of taxing Acts" (Viscount Cave, L.C., in *Inland Revenue Commissioners* v. *Lysaght* (1928) A.C. at page 241). At first sight, Question 1 would appear to be a question of law. But, upon analysis of the question itself and the reasons given by the Assessment Appeal Board for its decision relating to the items involved in this question, it is clear that it is not a question of law. The appellant claimed that the amount of $292,692 was a deductible amount in determining actual value because it comprised what appellant claimed were "extraordinary construction costs." The amount was made up of three items set forth in paragraph 3 of the stated case quoted above.

In arriving at his assessment of actual value, the Assessor used the method of approach known as the "cost approach," which means that he began his determination of actual value by starting with a figure representing reproduction or replacement cost new, less depreciation. He did not deduct the items of costs claimed by the appellant as "extraordinary construction costs."

The Assessment Appeal Board, in the reasons for its decision, made reference to the first item-namely, the claim for loss on the sale of surplus warehouse stocks, $70,408.31-and stated "the Board finds that it is not disclosed in the evidence whether the original cost of the surplus materials referred to was contained in the statement of costs submitted as Exhibit 4 before the

Board, or whether they had been deleted." It went on to say that "if those costs were included in the over-all statement and the salvaged value credited to the cost of construction, then it is possible some consideration should be given, but in the absence of specific evidence the Board finds that the appellant has not discharged the onus upon him of this branch of the appeal." Such a finding is, in my view, clearly a finding of fact that the appellant had not established that the item was an extraordinary construction cost.

In regard to the second item-namely, the cost of operating a bunk-house and cook-house during the construction period, the Assessment Appeal Board in its reasons stated: "The fact is that these facilities are very frequently required in construction of projects of this kind and may be considered to be a part of the normal costs of construction."

This I take to be a finding of fact that this item of cost is not an extraordinary construction cost.

The third item of $7,859.88 represented an expense incurred for subsistence and traveling expense of a contractor during construction of the refinery. The reasons given by the Board for its decision do not deal with this item specifically, but in the stated case (*supra*) it is stated that "the Board also refused to make any allowance. . . of extra costs for the building contractor, finding that these costs were normal in construction projects of this kind." This I also take to be a finding of fact that this item is not an extraordinary construction cost. I am not prepared to say that there was no evidence before the Board to support its findings on these items, or that the findings were not justified upon the evidence.

Accordingly, in my view, Question 1 not being a question of law only, I have no power in these proceedings under the *Assessment Equalization Act* to deal with it.

Question 2 refers to so-called functional obsolescence and the amount claimed is $850,000. The Appeal Board's reasons in respect of this item read:-

> The appellant submitted some considerable evidence in an effort to establish functional obsolescence. It was stated that it would be necessary to construct an addition to the .plant at a cost of $850,000 during 1957. Apparently tenders for this had already been called for at the time of the hearing. The addition was said to be necessary because of the expected market requirements for gasoline of an increased octane rating which the plant is not presently equipped to produce. The facts are, however, that in 1956 and at the present time the plant is capable of producing the highest quality of gasoline now being sold on the market. It might well be that when such expenditure has been made some reconsideration must be given. For the moment, however, the plant is fully capable of producing to suit the existing market and the assessment must be based upon the existing facts. This ground of appeal does not commend itself to the Board. [*Underlining added.*]

I take that decision of the Board to be a finding of fact that as at the time of the assessment there was no functional obsolescence. If that be so, again I am precluded by the *Assessment Equalization Act* from dealing with a matter which is not a question of law only, unless I am prepared to say that the Board did not have before it evidence from which such a conclusion could properly be drawn, which I am not prepared to say.

Part of the evidence which the Board had before it was the testimony of Mr. C. E. Innes, an official of the appellant company. Mr. Innes said that the functional obsolescence for which an allowance was claimed was "the impact of the knowledge that we have to make this extra expenditure this year." He was asked by a Board member:-

> Q.-This unit isn't built yet; it is only an estimate, is it not?

to which he replied:

> A.-That is right. It is something that is going to be necessary to bring up the-we call it functional obsolescence.

If I am wrong in concluding that Question 2 is a question of fact and not of law, then, upon considering it as a question of law, I would accept the decision of the Board as being founded upon the accepted principles applicable to such a determination. In the *Sun Life Assurance Co. of Canada* v. *City of Montreal* (1950) S.C.R. 220 at page 224, Rinfret, C.J., stated:-

> I need not insist on the point that a municipal valuation for assessment purposes is not to be made in accordance with the rules laid down with regard to the valuation of a property for expropriation purposes. One main ground why such a course should not be followed is that the expropriation of a property means the permanent divesting of the owner and should legitimately, therefore, take into account the present value and all the prospective possibilities of the property, while the municipal valuation is, generally speaking, only made for one year, or, in the case of the City of Montreal, for three years, with certain provisions for modification if certain events happen, such as alteration, improvement, fire, etc. The rule was laid down by Lord Parmoor in *Great Western and Metropolitan Railway Companies* v. *Kensington Assessment Committee*, that in such case "the hereditament should be valued as it stands and as used and occupied when the assessment is made." In the yearly valuation of a property for purposes of municipal assessment there is no room for hypothesis as regards the future of the property. The Assessor should not look at past or subsequent or potential values. His valuation must he based on conditions as he finds them at the date of the assessment. [*Underlining added.*]

Having made the assessment upon the basis of the conditions as found at the date of the assessment, the Assessor and the Board acted in accordance with accepted legal principles and accordingly, if Question 2 be a question of law, I would answer it in the affirmative.

Question 3 I take to be a question of law. I conclude from the form of this question that the Board did not make any deduction as such for the depreciation claimed as economic obsolescence. This, I feel, is necessary to mention because there was some suggestion in the argument of counsel for the appellant that the 10-per-cent allowance made by the Board referred to in Question 4 was in reality a deduction for economic obsolescence. This suggestion is not borne out by the form of the question, nor in the reasons given by the Board for its decision. It would appear to have refrained from or refused to make the deduction because, as stated in its reasons, "it may be said that the limited throughput referred to is to be expected in a new operation until the business is built up."

There is no definition of economic obsolescence in the *Assessment Equalization Act*. In a manual issued by the Assessment Commissioner appointed pursuant to the *Assessment Equalization Act*, for the guidance only of Assessors, obsolescence is stated to be "a loss in value caused by functional inadequancy, obsolete design, shifting land use, public nuisance, migration and many other factors which influence value."

I was referred by counsel to a volume published by the American Institute of Real Estate Appraisers in 1953. While statements contained in this volume cannot be taken as binding, I found helpful the statement as to the nature of economic obsolescence contained in an article designated "The Theory of Depreciation" at page 544. The statement reads as follows:

> *Economic Obsolescence*
>
> Loss of value through economic obsolescence is apparent if the neighborhood has changed through racial encroachment, through a change in the use of the land, by reason of zoning restrictions, or by the imposition of some other economic law of change. It cannot be estimated as a percentage of reproduction cost new. It has nothing in common with reproduction cost-nothing to do with cost in any analysis. Its measurement

> must be otherwise if it is to be estimated reasonably or intelligently. The estimate of economic loss is economic inutility. It may best be estimated dollar-wise by capitalization of the money loss through estimated comparative failure to produce normal income. [*Underlining added.*]

Obsolescence is a type or classification of depreciation for which an allowance may be made when there is a loss in value resulting from various causes.

But to say that a lack of throughput, arising from lack of market, is a form of depreciation of a newly constructed plant seems to me to be giving an unusual elasticity to the meaning of the words "depreciation" and "obsolescence." The plant and equipment, with a rated capacity of 5,000 barrels, was still in existence at the date of the assessment. Its capacity to produce had not changed; it had not suffered any functional inadequacy or substantial physical deterioration. It is simply not being used to its full capacity for some reason which may be only temporary. How, then, can such a plant be said to have depreciated in value? If there has been no lessening in the value of the property, then it cannot be said to be undergoing economic obsolescence, and it follows that a claim for a deduction for economic obsolescence is not well founded. It is no part of the duty of the Board, in arriving at actual value, to make allowance for claims for factors; the existence of which has not been established.

It would appear from the evidence adduced that the appellant's claim for economic obsolescence was not, in reality, based upon any loss of the usefulness of the plant, but upon a lack of revenue from the operation of the plant at less than its rated capacity. What may be a temporary loss of revenue arising from the voluntary non-user of a portion of the normal capacity of a newly erected plant, in my view, cannot properly be called obsolescence, and is not entitled to an allowance as depreciation. It may, however, be a factor in determining the value of a plant as a going concern, and one way of estimating such an economic loss is to do so in the manner suggested by the above quotation from the article on "The Theory of Depreciation." Fisher, J. (as he then was), in *In re Municipal Act and Dixon* (1939-40) 55 B.C.R. 546 at page 550, stated:

> I pause here to say that I do not think that what has been the net revenue over a period of years is a conclusive test in determining the price which a purchaser would pay for a business property or that an assessor would have to enquire from year to year into the business of the "various owners" of land and assess accordingly (*see* Gates case, *supra*, at p. 933), but I think after a perusal of the cases hereinbefore referred to that the revenue-producing qualities of the property under present conditions should be considered as one of the elements affecting the actual value of the property as such would undoubtedly be taken into consideration by a prospective purchaser in estimating the price he would be willing to pay for the property.

The effect of inutility upon sale value was considered in *Toronto Railway Co.* v. *City of Toronto, Ottawa Electric Co.* v. *City of Ottawa* (1903) 6 O.L.R. 187. In this case the Ontario Court of Appeal considered the propriety of deducting the whole value of unused services installed by public utilities on asphalted streets. Such services are put down provisionally so that streets may not require to be torn up when new services are required. Maclennan, J.A., at page 196, stated:-

> These services, although not in use, are worth all they cost, and not at all like property which has gone out of use. What the statute says is that when and so long as in actual use they shall be assessed at their actual cash value as the same would would be appraised, etc., regard being had to all circumstances adversely affecting their values, including non-user. Now, it cannot be said that these unused services would be of no value upon a sale, nor that their value would be very much less than their original cost, nor can it be said with truth that they are not in use. They were put down for a particular purpose, namely, to save future trouble and expense, and they are serving that purpose. I do not. think the valuation of the learned judges should be interfered with.

It is not to be assumed that a responsible organization such as the appellant would incur the expense of a plant having a capacity of 5,000 barrels per day if it intended to utilize only one-half of that capacity. Nor am I convinced that a prudent purchaser would be unwilling to give more for a plant having a rated capacity of 5,000 barrels than for one with half that rated capacity, even with the knowledge that half the rated capacity was temporarily unused.

Counsel for the appellant did not cite to me any authority which would lead me to the conclusion that the Board erred in failing or refusing to make any deduction for the alleged economic obsolescence claimed by the appellant. In the absence of such authority, I am not prepared to hold that the Board arrived at its assessment by the application of any wrong principle, or that the assessment was not made in conformity with a proper exercise of statutory discretionary powers.

Question 3 is answered in the affirmative.

Question 4 I also find to be a question of law. In its reasons for its decision the Board stated:-

> It is mandatory under the *Taxation Act* to assess these improvements as a going concern and the valuation must be made in that light. The Board has had reference to appraisal authorities and in particular to Bonbright, on "Valuation of Property," page 1147, where is stated, "That there is an element of value in an assembled and established plant doing business and earning money over one not thus advanced is self-evident. This element of value is a property right and should be considered in determining the value of the property. . ." and Bonbright goes on to say, "Going value is thus conceived as the difference between the value of an established plant with its earning power already developed and the value of an otherwise identical new plant which still has to build up its business." In view of the provisions of the statute the Board is of the opinion that the assessment cannot be based exclusively upon replacement cost without reference to the other factors which affect the value of an industry as a going concern. Consideration must be given to revenue value, and this is an important factor in assessing a business as a going concern. In the circumstances, and after careful consideration, the Board is of the view that an allowance should be made of 10 per cent to give consideration to these factors, This figure seems to be in accord with the opinion of a number of appraisal authorities.

Counsel for the appellant suggested in argument that the 10-per-cent allowance made by the Board was in reality for economic obsolescence; that it was an arbitrary allowance made without basis in law or in the evidence. He submitted that on the basis of the evidence adduced, and in the absence of any evidence to the contrary, the Board should have allowed 45 per cent. This was the percentage which Mr. Innes had suggested was the correct percentage allowance for economic obsolescence based on the percentage of the capacity at which the plant was operated to the total rated capacity.

As I interpret the finding of the Board, it rejected the claim for an allowance for economic obsolescence and the percentage allowance therefore suggested by Mr. Innes, but came to the conclusion that an assessment based exclusively upon replacement cost less depreciation, without reference to other factors which affect the value of an industry as a going concern, was not a proper assessment under its governing Statutes. It proceeded to make an allowance in respect of those factors affecting the value of the industry as a going concern, other than the factors considered in arriving at actual value upon the basis of reproduction cost (new).

Section 37 (1) of the *Assessment Equalization Act* and section 30 of the *Taxation Act* require that land and improvements shall be assessed at their actual value. In determining the actual value the Assessor may give consideration to various factors enumerated therein, including "cost of replacement, *revenue or rental value* and the price that such land and improvements might reasonably be expected to bring if offered for sale in the open market by a solvent owner, *and any other circumstances affecting the value*. "Both sections go on to provide that "without limiting

the application of the foregoing considerations where any industry, commercial undertaking, public utility, enterprise, or other operation is carried on, the land and improvements so used *shall be valued as the property of a going concern*."

In striving to give effect to the provisions of the Statute, and particularly to the words "revenue value," "and any other circumstances affecting the value," and "shall be valued as the property of a going concern," the Board obviously felt itself bound to give consideration to the revenue value as being an important factor in assessing the business as a going concern. There would appear to be judicial authority for this action in the judgment of Fisher, J., in *In re Municipal Act and Dixon* (*supra*), where he stated:-

> I think after a perusal of the cases hereinbefore referred to that the revenue-producing qualities of the property under present conditions should be considered as one of the elements affecting the actual value of the property as such would undoubtedly be taken into consideration by a prospective purchaser in estimating the price he would be willing to pay for the property.

While it is not open to Assessors or to the Board to make an arbitrary determination of actual value, nor to make determinations contrary to the evidence placed before or available to them, yet the provisions of section 37 (1) of the *Assessment Equalization Act* would appear to give a wider and more flexible discretion to Assessors in the matter of determining actual value than the provisions of some other Statutes considered by the Courts in assessment cases. Dealing with section 30 of the *Taxation Act*, which is in similar terms, Sloan, C.J.B.C., stated in *Regina* v. *Penticton Sawmills Ltd.* (1954) 11 W.W.R. (N.S.) 351 at page 353:-

> It seems to me that section 30 in its present form clothes the assessor with a very wide and flexible discretion as to the methods he may pursue in his determination of "actual value."

Having declined to make a deduction for alleged economic obsolescence and recognizing that the assessment on a basis of replacement cost did not take into account "revenue value" or "all other circumstances affecting the value," and in an effort to value the land and improvements so used" as the property of a going concern," the Board adjusted the assessment by making an allowance of 10 per cent. How the allowance of 10 per cent is made up and what percentage allowances the Board may have given to the various "other factors" which resulted in a total allowance of 10 per cent is not disclosed in the Board's decision, and I see no reason why it should be. I think there is evidence which justified the Board in making some allowance. The Board was not bound to accept the 45-per-cent allowance suggested by the appellant for economic obsolescence.

I do not conceive it to be the function of this Court, under the provisions of the *Assessment Equalization Act*, to disturb the valuations made by the Board. In the Sun Life Assurance Co. case (*supra*), Taschereau, J., said, at page 246:-

> In coming to this conclusion, I have kept in mind that it is not the function of a Court of Appeal to disturb the valuations made by assessors. But in certain cases it is its duty to do so, particularly when the assessors have proceeded on a wrong principle, and when there is a manifest injustice.

I cannot find here that the Assessors have proceeded on a wrong principle, or that there is a manifest injustice. Nor can I find that the assessments were not made in conformity with the proper exercise of discretionary powers.

Counsel for the appellant relied strongly upon the case of the *Sun Life Assurance Co.* v. *City of Montreal* (*supra*) and submitted that the determination of actual value in the case here under appeal was not made in accordance with the principles set forth by the Supreme Court of Canada

in that case. In that case it was held, *inter alia*, that under the charter of the City of Montreal, as the headnote states, "that the actual value which the assessors must find pursuant to the city charter is the exchangeable value or what the building will command in terms of money in the open market, tested by what a prudent purchaser would be willing to give for it."

Apart from the fact that the problems confronting the Assessors in determining actual value in the Sun Life case differed substantially from the problems raised in the decision here under appeal, and that the assessment there was made under the various provisions of the charter of the City of Montreal, I cannot find, upon a careful consideration, that the Board from whose decision this appeal is taken arrived at its decision as a result of proceeding otherwise than in accordance with the provisions of the Statutes governing its powers and the applicable principles enunciated in the Sun Life case. Whatever errors there may have been in the determination of actual value in the original assessment appear to have been rectified by subsequent correction or remedial action.

Question 4 is answered in the affirmative.