STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**5/15/02**	Bill No:	**AB 2714**
Tax:	**Property**	Author:	**Aanestad**
Board Position:	**Support – Minimum Percent Good Provision**	Related Bills:	**AB 1380 (2001)**

BILL SUMMARY

This bill would:

- prohibit the use of minimum percent good factors that are determined in an unsupported manner.
- prohibit the practice of averaging percent good factors published by the Board of Equalization where separate factors are provided for property acquired new and used.

Current Law

Averaging percent good factors. In valuing agricultural and construction mobile equipment, the Board of Equalization suggests that counties use the comparative sales approach if possible. Several commercially available valuation guides are available for this purpose.[1] If valuation guides are not used, the reproduction or replacement cost approach to value can be used.

The Board of Equalization annually publishes Assessors' Handbook Section 581 which contains several tables of price index factors, percent good tables, and other valuation factors that aid assessors in the mass appraisal of various types of personal property and fixtures when using the reproduction or replacement cost approach to value property. Generally, using this published information will provide a value estimate within a reasonable band of value for the assessment of business property. Additionally, using the published information serves to promote statewide uniformity in the assessment of this property. Price index factors are applied to the original acquisition cost of an item to estimate its current reproduction cost. Percent good factors are used in conjunction with

[1] Agricultural Equipment: *Used Tractor Price Guide,* Intertec Publishing Corporation; *Official Guide - Tractors and Farm Equipment (Guides 2000),* Iron Solutions; and *Farm Equipment Guide*, Heartland Ag Business Group. Construction Equipment: *Green Guide for Construction Equipment*, Primedia Information Inc.

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the price index factors to estimate reproduction cost new less normal depreciation. This is the value that would be used for property tax purposes.

For mobile construction equipment and mobile agricultural equipment, the Board provides separate percent good factor tables for equipment first acquired new and equipment first acquired used. Under existing assessment practices, some counties average the "new" and "used" tables provided for administrative simplicity.

Minimum percent good factors. Under existing assessment practices, some counties do not depreciate personal property that is still in productive use beyond some "minimum percent good." Current law does not discuss or direct assessors in their use of minimum percent good factors.

Minimum percent good factors are factors used to estimate the lowest value that an item of personal property will attain during its useful life. These factors are applied to replacement, or reproduction cost new, estimates to compute the fair market value of property for property tax purposes as it reaches the end of its economic life.

Proposed Law

This bill would add Section 401.16 to the Revenue and Taxation Code to provide that if the county assessor uses the reproduction or replacement cost approach to determine the value of tangible personal property or trade fixtures, then both of the following apply:

1. If the county assessor depreciates the property using percent good factors published by the Board of Equalization that provide separate factors for property that is first acquired new and property that is first acquired used, the assessor may not average the published factors to apply these factors to both classes of new and used property.
2. If the county assessor depreciates the property using percent good factors, the assessor may not depreciate the property using minimum percent good factors that are determined in an unsupported manner.

Assessors could still use minimum percent good factors, but the factors used must be based on some factual support.

In General

Business Personal Property. Personal property used in a trade or business is generally taxable, and its cost must be reported annually to the assessor on a business property statement, as provided by Revenue and Taxation Code Section 441.

Personal property is not subject to the valuation limitations of Proposition 13. Personal property is valued each lien date at current fair market value. However, it is not administratively possible to individually determine the fair market value of every item of personal property used by all of the businesses in California every year. Consequently, mass appraisal techniques are necessary to complete the annual reassessment process.

Valuation Process. Generally, the valuation of personal property is based on the acquisition cost of the property. The acquisition cost is multiplied by a price index, an inflation trending factor based on the year of acquisition, to provide an estimate of its

reproduction cost new. The reproduction cost new is then multiplied by a depreciation index, also called percent good tables, to provide an estimate of the depreciated reproduction cost of the property (reproduction cost new less depreciation). The reproduction cost new less depreciation value becomes the taxable value of the property for the fiscal year.

The Board annually publishes Assessors' Handbook Section 581, "Equipment Index and Percent Good Factors." http://www.boe.ca.gov/proptaxes/ahcont.htm This handbook section contains several tables of equipment index, percent good, and valuation factors that aid in the mass appraisal of various types of personal property. Separate tables are specifically provided for agricultural equipment, which are excerpted below. The following example, using the "price index factors" and "percent good" tables currently recommended by the Board illustrates how this valuation process works.

The estimated value of agricultural equipment acquired new in 1998 at an acquisition cost of $100,000 would be $59,740 for the January 1, 2002 lien date.

Year Acquired	Cost New	Index Factor	Reproduction Cost New	Percent Good	RCLND
1998	100,000	1.03	103,000	58	$59,740

Price Index Factor. The index factor is an inflation trending factor based on the year of acquisition. The Board of Equalization recommends the following factors for agricultural equipment.

Year Acquired	Index Factor Percent	Year Acquired	Index Factor Percent	Year Acquired	Index Factor Percent	Year Acquired	Index Factor Percent
2001	100	1991	124	1981	168	1971	411
2000	101	1990	128	1980	187	1970	427
1999	102	1989	132	1979	208	1969	445
1998	103	1988	138	1978	227	1968	466
1997	104	1987	142	1977	244		
1996	106	1986	142	1976	265		
1995	109	1985	143	1975	287		
1994	114	1984	144	1974	337		
1993	116	1983	148	1973	384		
1992	120	1982	156	1972	396		

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Percent Good. For 2002, the Board recommends the following percent good factors:

Agricultural Mobile Equipment (Except Harvesters)				
Year Acq.	Age	New	Used	If Avg.*
2001	1	78	92	85
2000	2	70	82	76
1999	3	64	75	69.5
1998	4	58	68	63
1997	5	52	62	57
1996	6	47	56	51.5
1995	7	42	50	46
1994	8	38	45	41.5
1993	9	34	40	37
1992	10	30	36	33
1991	11	27	32	29.5
1990	12	25	30	27.5
1989	13	23	28	25.5
1988	14	22	26	24
1987	15	20	23	21.5
1986	16	18	21	19.5
1985			19	
1984			17	

Agricultural Harvesters				
Year Acq.	Age	New	Used	If Avg.*
2001	1	74	90	82
2000	2	64	78	71
1999	3	57	69	63
1998	4	50	60	55
1997	5	43	53	48
1996	6	38	46	42
1995	7	33	40	36.5
1994	8	29	35	32
1993	9	25	30	27.5
1992	10	21	26	23.5
1991	11	19	23	21
1990	12	17	21	19
1989	13	15	18	16.5
1988	14		16	
1987	15		14	
1986	16		14	

Construction Mobile Equipment				
Year Acquired	Age	New	Used	If Avg.*
2001	1	74	91	82.5
2000	2	66	81	73.5
1999	3	60	74	67
1998	4	55	68	61.5
1997	5	51	62	56.5
1996	6	47	58	54.5
1995	7	42	52	47
1994	8	38	47	42.5
1993	9	35	43	39
1992	10	31	38	34.5
1991	11	28	34	31
1990	12	26	32	29
1989	13	24	29	26.5
1988	14	22	27	24.5
1987	15	20	25	22.5
1986	16	19	23	21
1985	17	16	20	18
1984	18	13	17	15
1983	19	12	13	12.5
1982	20	11	11	11
1981	21		9	

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***Averaging Percent Good.** The Board does not recommend averaging percent good tables. The "if averaged" tables noted above are provided to compare the difference in percent good that would occur if the assessor averages the "new" and "used" tables.

Minimum Percent Good. While the tables provided by the Board do not provide percent good factors for equipment beyond certain ages, they do **include a disclaimer that no minimum percent good is intended.** Board staff has found in its audits of the counties that some assessors have a practice of establishing a minimum percent good factor beyond which they do not depreciate equipment. Where it appears the minimum percent good factor used is not based upon any *factual support,* such as the historical practice of the county, the Board recommends that the practice be discontinued.

Background

Related Bills. During the 2001 Legislative Session, Assembly Bill 1380 (Aanestad) would have exempted implements of husbandry and farm vehicles from property tax. When the bill was heard in the Assembly Revenue and Taxation Committee on May 14, 2001, the testimony of various witnesses representing the Farm Bureau raised concern over the assessment practices of agricultural equipment by various assessors. Specifically, testimony was given to the committee that in one county the value of a new tractor for property tax purposes would be depreciated by only 4% in the first year and that its assessed value would never drop below 20% of its original purchase price. The bill failed to pass out of the committee, but the committee asked that the Board of Equalization investigate and respond. With respect to the depreciation issue, the Board found that while the assessor's office had stated in a conversation that the depreciation was only 4% after the first year; upon review this was incorrect. The actual depreciation used in that county was 15% (the 15% came from averaging the percent good factors for new and used agricultural mobile equipment above: (92 + 78)/2 = 85 percent good). With respect to the minimum percent good issue, the county confirmed that it used a 20% minimum percent good.

Repealed Property Tax Rule Provision. Prior to 1977, subdivision (f) of Property Tax Rule 6 made reference to minimum percent goods. It provided:

> If the assessor adopts a practice of depreciating property to a minimum percent good, that minimum may be any percentage up to but no higher than 25 percent of reproduction or replacement cost new.

This subdivision was amended, deleting the wording referencing minimum percent good, following *Bret Harte Inn, Inc*. v. *City & County of San Francisco (*16 Cal.3d 14, 1976). In this case, the court held that the Constitution commands that all property be assessed at full cash value and requires that depreciation formulas meet a standard of "reasonable accuracy." It appears that the 25 percent maximum formerly outlined in Rule 6 was considered arbitrary, and therefore unsupportable.

COMMENTS:

1. **Sponsor and Purpose.** This bill is sponsored by the California Farm Bureau in an effort to (1) provide clarity that minimum percent good factors used by county assessors must be factually supportable and (2) prohibit the averaging of percent good factors published by the Board of Equalization.

2. **Amendments.** Related to the use of minimum percent goods, the May 15 amendment substitutes the term "unsupported" for "arbitrary." This amendment was made to better clarify the bill's intent as well as substitute a term that could be considered inflammatory. As introduced, this bill only related to the issue of minimum percent goods and its provisions were limited to implements of husbandry. This narrow application could have created an implication that arbitrarily established minimum percent goods are permissible in assessing other types of personal property. Consequently, the Board requested the bill be amended to make its provisions applicable to all types of personal property. The May 7 amendments incorporate this suggestion. Additionally, the amendments add new subdivision (a) to Section 401.16 to provide that assessors may not average "new" and "used" percent good factors. This amendment addresses the issues raised by taxpayers concerning variations in percent good factors published by the Board and the actual percent good factors used by some county assessors.

3. **This bill would prohibit the averaging of percent good factors where separate tables for new and used equipment are provided.** Currently, the Board only publishes such tables for mobile agricultural equipment and mobile construction equipment. For this type of equipment, the Board recommends that counties rely on the **comparative sales approach** if possible using commercial value guides. If this approach is not used, then the alternate method would be the **reproduction or replacement cost approach.** The information published in Assessors' Handbook Section 581 can be used for this purpose, but is not mandatory. The values produced, using this information, provides guidelines rather than absolutes. The published percent good factors are not believed to be appropriate or accurate in all situations. Exceptions may be dealt with on an individual basis, and values can be altered. Additionally, taxpayers may indicate to assessors where values are not appropriate and provide additional information if necessary.

4. **Averaging results in winners and losers.** Averaging new and used percent good factors results in an assessed value that is higher for equipment purchased new and an assessed value that is lower for equipment purchased used. For instance, if a tractor was purchased new, the Board recommends a depreciation factor after the first year of 22% (the complement of 78 percent good). However, if the county averages new and used percent good factors, the depreciation after the first year would only be 15%.

5. **When are minimum percent good factors used?** They are used to estimate the value of property that

   - is at the **end or at a late stage** of its useful life, and/or

- has been determined to have reached its lowest value (i.e., the property has **"fully depreciated"** and the value is not expected to decline any further).

6. **Why are minimum percent good factors used?** Property in use (and generating income) still has utility and value. Because property in use continues to have value it is possible that well-maintained used equipment could be undervalued without minimum percent good factors administratively possible to individually determine the fair market value of every item of personal property used in all businesses in California every year. Consequently, mass appraisal techniques must necessarily be used. Minimum percent good factors are typically used because:

   - they provide administrative practicality.
   - they enhance the equalization process between similarly-situated property owners by assigning a similar percent good factor to like items of personal property as required by Section 410, which provides that there should be a uniform system of assessment for implements of husbandry regardless of where they are physically located in the state.
   - they can produce a value that fairly reflects the value of the property being appraised.

7. **The Board of Equalization distributed a publication on the issue of Minimum Percent Good Factors in November 1999.** This publication (a Special Topics Survey) discusses the issue in depth as well as contains various county assessors opinions on the use of minimum percent good factors. The document is available at http://www.boe.ca.gov/proptaxes/sptscont.htm.

8. **This bill does not prohibit the use of minimum percent good factors.** Rather, it prohibits the use of a percent good factor that is unsupported. The use of minimum percent good factors would be permitted where the development of the factors is based on factual support or some evidence. For instance, arms length sales data information can support a minimum or floor value for used equipment.

9. **Minimum percent good factors are a necessary administrative practicality for mass appraisal programs and, when used properly, provide guidelines rather than absolutes.** Minimum percent good factors are not believed to be appropriate or accurate in all situations. Exceptions may be dealt with on an individual basis, and values can be altered. Additionally, taxpayers may indicate to assessors where values are not appropriate and provide additional information if necessary.

10. **The tables provided by the Board to county assessors do not provide percent good factors for equipment beyond certain ages.** However, the tables include a disclaimer that no minimum percent good is intended. Board staff has found in its audits of the counties that some assessors have a practice of establishing a minimum percent good beyond which they do not depreciate equipment. Where it appears the minimum percent good used is not based upon any factual support, such as the historical practice of the county, the Board recommends that the practice be discontinued and a review of the evidence be evaluated and substantiated.

COST ESTIMATE

The Board would incur some minor absorbable costs in informing and advising county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Percent good factors are applied to depreciate, for age, replacement or reproduction cost new estimates to compute the fair market value of property. Agricultural equipment and mobile construction equipment are currently the only types of property for which the Board of Equalization issues separate "percent good" tables for property first acquired new and for property first acquired used. Under existing assessment practices, some counties apply the average of these "new" and "used" factors. Also, some counties set a minimum percent good when valuing property as it reaches the end of its economic life.

The revenue effect of the prohibitions that would be provided under this bill is difficult to estimate due to the many factors involved and their lack of predictability. Among the factors are:

1. Identifying the counties that average percent good factors for new and used equipment
2. The amount and type of equipment that is first acquired new vs. first acquired used and that are valued with the reproduction or replacement cost approach
3. Identifying the counties that use minimum percents good
4. The age of the equipment

Agricultural equipment is typically valued under the reproduction or replacement cost approach while the preferred approach for mobile construction equipment is using specific value guides, i.e., "blue book values." Assuming that averaging is applied only to agricultural equipment, using average percent good factors results in values that are 7.5 to 10.9 percent higher for equipment other than harvesters, and 10.0 to 11.9 percent higher for harvesters, that are first acquired new. The values for equipment first acquired used are as much as 8.9 percent lower for equipment other than harvesters and 9.6 percent lower for harvesters when average percent good factors are used instead of the used equipment percent good factors. For example, the percent good factor for the first year after acquisition for equipment other than harvesters acquired new is 78 percent, the first year percent good factor for "used" equipment is 92 percent. The average percent good factor at age 1 year is then 85 percent, (78 + 92)/2. The percentage difference can be computed as follows:

(85 – 78)/78 = 9.0% for "new" equipment

(85 – 92)/92 = -7.6% for "used" equipment.

Using "new" and "used" factors instead of averaging would result in a shift in value between "new" and "used" equipment since values for equipment acquired new would be lower and values for equipment acquired used would increase. The shift in the

overall value would be marginal and would depend on the distribution of "new" and "used" equipment and their age.

Minimum percent good factors are used to estimate the value of property that has fully depreciated and the value is not expected to decline any further. This bill prohibits the use of a minimum percent good that is arbitrarily established. This provision has no revenue effect.

Revenue Summary

Any loss or gain will depend on the distribution of the equipment that would be affected by this bill.

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