STATE BOARD OF EQUALIZATION
PROPERTY TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Petition for Reassessment of and Abatement of the Penalty Applied to the 2015 Unitary Value for: **LIBERTY UTILITIES, LLC** **(CALPECO ELECTRIC) (0163)** Petitioner	Appeal No.: SAU 15-018 Case ID No.: 903788 Nonappearance Hearing date: December 16, 2015

Representing the Parties:

For the Petitioner: Dannie A. Tobias, Dan Tobias & Associates, Inc.
Neal Panish, Attorney at Law

For the Respondent: Leslie Ang, Tax Counsel
Attorney for State-Assessed Properties Division

Richard D. Reisinger, Business Taxes Administrator III
State-Assessed Properties Division

Counsel for Appeals Division: Dana R. Brown, Tax Counsel III (Specialist)

VALUES AT ISSUE

	Value	Penalty	Total
2015 Board-Adopted Unitary Value	$144,200,000	$14,420,000	$158,620,000
Petitioner's Requested Unitary Value	$129,786,000	$0	$129,786,000
Respondent's Recommendation On Appeal	$144,200,000	$0	$144,200,000
Petitioner's Revised Requested Value	$75,294,000	$0	$75,294,000

FACTUAL BACKGROUND

Liberty Utilities, LLC (CalPeco Electric) (petitioner), an electricity distribution facility, is a wholly-owned subsidiary of Algonquin Power and Utilities Corporation. Petitioner provides electric services to small and mid-sized communities in Alpine, El Dorado, Mono, Nevada, Placer, Plumas, and Sierra Counties. The 2015 Board-adopted unitary value of $144,200,000 for petitioner's facility is

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based on a 75-percent reliance on the Historical Cost Less Depreciation (HCLD) value indicator and a 25-percent reliance on the Capitalized Earning Ability (CEA) value indicator.

LEGAL ISSUE 1

Whether petitioner has shown reasonable cause for the abatement of the 10-percent penalty imposed by the State-Assessed Properties Division (respondent) for petitioner's failure to timely file its property statement.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the 10-percent penalty imposed by respondent should be abated as it was due to reasonable cause notwithstanding the exercise of ordinary care and not from willful neglect that it failed to timely file its property statement. In a declaration submitted after the appeals conference, Kendrick Wittman, petitioner's Senior Manager of Finance, Accounting and Regulatory Affairs, asserts that petitioner failed to timely file its property statement because it was "attempting to close its year-end financial statements" and had "general rate case application activities." After the appeals conference, respondent reviewed the declaration and it now recommends that the penalty should be abated.

APPLICABLE LAW

Revenue and Taxation Code (R&TC) section 830, subdivision (c)[1] requires that a 10-percent penalty be added to the full value of an assessment if an assessee "fails to file the property statement, in whole or in part, by March 1 . . . ." R&TC section 830, subdivision (f) provides in pertinent part that the penalty may be abated, in whole or in part, "[i]f the assessee establishes to the satisfaction of the board that the failure to file the property statement or any of its parts within the time required by this section was due to reasonable cause and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect . . . ."

ANALYSIS AND DISPOSITION

We find that petitioner has established reasonable cause for an abatement of the penalty by showing that it exercised ordinary business care and prudence but was unable to file the property

[1] All further statutory references are to the Revenue and Taxation Code unless otherwise indicated.

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statement by the March 1, 2015 deadline due to the competing demands on the time and resources of petitioner's staff.

LEGAL ISSUE 2

Whether petitioner has shown that the 2015 Board-adopted unitary value is excessive.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that the Board-adopted unitary value includes nontaxable intangible value and that the CEA value indicator erroneously includes value for all assets. Petitioner asserts that respondent's "explicit weighting methodology" is improper because the Assessors' Handbook section 502, *Advanced Appraisal* (AH 502) at pages 111-112 provides that "the use of an arithmetic mean of value to arrive at a final conclusion of value is generally recognized as inappropriate." Petitioner contends that respondent has not provided any market data to support its methodology and that the HCLD value indicator is "not reflective of market valuation."

Petitioner contends that the 37.4-percent variance between the indicators is a "strong indicator of an improper weighted average and an improper application of the valuation approaches" and "incorrectly implies" that the value indicators have equal validity. Petitioner notes that Property Tax Rule 6, subdivision (a) provides that the cost approach is a preferred approach when neither reliable sales data nor income data are available, but asserts that income data are available as evidenced by respondent's CEA value indicator. For that reason, petitioner contends that the 2015 Board-adopted unitary value should be based on a 100-percent reliance on the CEA value indicator.

Respondent notes that Property Tax Rule 3, subdivision (d)[2] states that the HCLD value indicator shall be considered if the income from the property is regulated by law and the regulatory agency used historical cost or historical cost less depreciation as the rate base. Accordingly, respondent contends that the HCLD and CEA value indicators are appropriate value indicators here because petitioner is a regulated public utility.

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[2] All references to Property Tax Rules are to sections of title 18 of the California Code of Regulations.

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APPLICABLE LAW AND APPRAISAL PRINCIPLES

Burden of Proof

Assessing officers are presumed to have properly performed their duties. (Evid. Code, § 664.) Petitioner has the burden of proof as to all issues of fact. (Cal. Code Regs., tit. 18, § 5541, subd. (a).)

Reconciliation of Value Indicators

Property Tax Rule 3 requires that, in estimating value, the assessor shall consider one or more of the approaches to value "as may be appropriate for the property being appraised," which includes the HCLD approach and the income approach. The appropriateness of an approach is often related to the type of property being appraised and the available data. (AH 502, p. 109.) The greatest reliance should be placed on that approach or combination of approaches that best measures the type of benefits the subject property yields. The final value estimate reflects the relative weight that the appraiser assigned, either implicitly or explicitly, to each approach. (AH 502, p. 112.)

Historical Cost Less Depreciation Value Indicator

Property Tax Rule 3, subdivision (d) requires that, in estimating value, an assessor should consider "[i]f the income from the property is regulated by law and the regulatory agency uses historical or historical cost less depreciation as a rate base, the amount invested in the property or the amount invested less depreciation computed by the method employed by the regulatory agency."

Income Approach to Value

Property Tax Rule 8, subdivision (a) states that "the income approach is used in conjunction with other approaches when the property under appraisal is typically purchased in anticipation of a money income and either has an established income stream or can be attributed a real or hypothetical income stream by comparison with other properties."

ANALYSIS AND DISPOSITION

Petitioner is a regulated public utility with an established income stream and thus a reliance on both the HCLD and CEA value indicators is appropriate as provided by Rule 3 and Rule 8. Petitioner has not met its burden to establish facts that would support any adjustment to the 2015 Board-adopted unitary value based on the Board's reliance on both the HCLD and CEA value indicators.

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LEGAL ISSUE 3

Whether petitioner has shown that the 2015 Board-adopted unitary value includes the value of nontaxable intangible assets.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that respondent's application of the CEA value indicator improperly accounts for nontaxable property and that the 2015 Board-adopted unitary value improperly includes the value of the following exempt intangible assets: (1) working capital; (2) a trained and experienced workforce; (3) corporate overhead; and (4) name recognition and expertise. Petitioner contends that respondent improperly adjusted for working capital requirements in its CEA calculation and asserts that it is unclear how respondent derived the adjustment. Petitioner asserts that respondent's adjustment for working capital requirements "does not accurately reflect the amount of cash needed to meet operating expenses."

Petitioner contends that respondent must deduct from the income stream the value of a trained and experienced workforce and name recognition and expertise for purposes of calculating the CEA value indicator. In support of its contention, petitioner cites *Shubat* v. *Sutter County Assessment Appeals Board* (1993) 13 Cal.App.4th 794, in which petitioner asserts the court held that "business and technical procedures, accounting and billing systems, programming contracts . . . and relationships with local advertisers" all constituted intangibles that existed separate from the possessory interest at issue in that case, as were a "trained workforce in place and procedures for operating its business."

Petitioner contends that respondent improperly ignored the value of corporate overhead, which petitioner refers to as "economies of scale," and argues that it receives value from its parent company, which owns and manages a number of transmission, distribution, and power production facilities similar to the subject property. Petitioner asserts that such benefits include favorable contract terms and favorable rates for legal, insurance, engineering, and vendor relationships.

Respondent states that the property taxation of intangible assets is governed by R&TC sections 110, subdivisions (d) and (e) and 212, subdivision (c) and cites *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593, 602, in which the Supreme Court discussed the treatment of intangible assets and rights under the cost approach and income approach valuation methods.

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Respondent states that the Court held that the Board was required to deduct the cost of the applied emission reduction credits (ERCs) from the Replacement Cost Less Depreciation (ReplCLD) value indicator because the estimated cost of replacing the ERCs was included as a separate line item in the Board's replacement cost calculation. Respondent notes that the Court further held that "[w]here the taxpayer does not proffer evidence that the Board included the fair market value of an intangible right or asset in the unit whole, the Board would not have to make a deduction prior to assessment."

Respondent asserts that no deduction is appropriate because petitioner fails to identify the alleged intangible assets and fails to specify the extent of any reduction. Respondent states that the *Elk Hills* court held that the taxpayer must articulate "a basis for attributing to the [proferred intangible rights or assets] a separate stream of income related to an enterprise activity," in order to impute to the income stream "some independent value that would be deducted from the total income generated by the taxable property."

Respondent states that the Court in *Elk Hills* made a distinction between (1) intangible assets that indirectly enhance the value of tangible property and the income stream produced by the tangible property by authorizing the beneficial and productive use of the tangible property (which respondent describes as "indirect intangibles") and (2) intangible business or enterprise assets that directly enhance the business income stream, but are not necessary to the beneficial and productive use of the tangible property (which respondent describes as "direct intangibles"). Respondent concludes that no deduction from the income stream should be made for indirect intangibles, while a deduction from the income stream may be made for direct intangibles if the taxpayer adequately proves that the direct intangibles have created a separate stream of income or have enhanced the income stream above that which ordinarily would be reasonably expected from prudent business operations.

Respondent contends that its CEA calculation for petitioner's property adjusts for working capital requirements on line 6 of the CEA perpetual life calculation, and petitioner has not provided any evidence to indicate that such adjustments were improper. Accordingly, respondent contends that no additional adjustments are warranted. Respondent also notes that Property Tax Rule 8, subdivision (c) provides that a deduction in the CEA value indicator may be appropriate if the intangible asset creates a separate or enhanced income stream above that expected to be yielded under prudent management.

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Because a trained and experienced workforce is necessary for the prudent management of the facility, respondent argues that it is improper to deduct any costs related to a trained and experienced workforce that does not produce income above what would be expected with a typical trained and experienced workforce. Respondent argues that petitioner has not shown that its trained and experienced workforce and "name recognition and expertise" produced an income superior to others with an ordinary workforce and ordinary expertise as required for a deduction. Respondent further argues that it calculated the CEA value indicator assuming that all appropriate expenses, including corporate overhead, were included in the expense information provided in the property statement.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Revenue and Taxation Code section 110

Subdivisions (d) and (e) of R&TC section 110 set forth the limitations on the taxation of intangible value and provide in part that:

> (d) Except as provided in subdivision (e), for purposes of determining the "full cash value" or "fair market value" of any taxable property, all of the following shall apply:
> (1) The value of intangible assets and rights relating to the going concern value of a business using taxable property shall not enhance or be reflected in the value of the taxable property.
> (2) If the principle of unit valuation is used to value properties that are operated as a unit and the unit includes intangible assets and rights, then the fair market value of the taxable property contained within the unit shall be determined by removing from the value of the unit the fair market value of the intangible assets and rights contained within the unit.
> [¶] . . . [¶]
> (e) Taxable property may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use.

Elk Hills Power LLC v. State Board of Equalization (2013) 57 Cal.4th 593

In *Elk Hills*, the Supreme Court held that the Board improperly assessed the intangible value of the taxpayer's ERCs in violation of R&TC section 110 when it added the replacement cost of the ERCs to the ReplCLD value indicator. (*Elk Hills*, 57 Cal.4th at p. 616.) The Court found that ERCs fall within the class of intangibles described in R&TC section 110, subdivision (d)(1), because the ERCs are intangible assets that enable the day-to-day functioning of the power plant and, therefore, necessarily relate to the going concern value of that business under either definition of going concern value. (*Id.* at p. 602.) The Court further held that under the income approach "not all intangible rights

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have a quantifiable fair market value that must be deducted" (*Id.* at p. 617) and that, "[t]here was no credible showing that there is a separate stream of income related to enterprise activity or even a separate stream of income at all that is attributable to the ERCs in this case." (*Id.* at p. 602.) Thus, the Court concluded that the Board was not required to deduct a value attributable to the ERCs from the CEA value indicator. (*Ibid.*)

ANALYSIS AND DISPOSITION

Based on the court's analysis in *Elk Hills*, there is no deduction from the income stream for intangibles that indirectly enhance the value of the tangible property while there may be a deduction for intangibles that directly enhance the income stream if the taxpayer adequately proves that such intangibles have created a separate stream of income or an enhanced income stream to an extent greater than would be reasonably expected from the property at its highest and best use under prudent management pursuant to Property Tax Rule 8. Here, petitioner has not presented any evidence that any of the claimed intangibles has created a separate stream of income or an enhanced income stream and therefore has not met its burden of proof.

Petitioner is a rate base regulated public utility, and nontaxable intangible assets are not included in the rate base and, therefore, are not included in the HCLD value indicator. The *Elk Hills* court noted that "[w]here the taxpayer does not proffer evidence that the Board included the fair market value of an intangible right or asset in the unit whole, the Board would not have to make a deduction prior to assessment." (*Id.* at p. 617, fn.11.) Here, petitioner has not presented evidence to meet its burden of proof that respondent's valuation is incorrect or that respondent is required to make adjustments for nontaxable intangible assets that are not included in the rate base.

LEGAL ISSUE 4

Whether petitioner has shown that the 2015 Board-adopted unitary value overstates the percentage of completed construction work in progress.

FINDINGS OF FACT AND RELATED CONTENTIONS

Petitioner contends that it has estimated the percentage of physical construction completed for multiple projects and that it is entitled to a reduction for the construction work in progress (CWIP) it reported. Petitioner further contends that these alleged indirect costs were "phased in or metered in

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based upon the percentage of physical completion."

Respondent asserts that it relied upon the information provided in petitioner's property statement to value petitioner's CWIP in the HCLD value indicator. Respondent further asserts that petitioner now claims a reduction in the CWIP value it reported, after filing its property statement, but fails to provide supporting documentation. Accordingly, respondent contends that no additional adjustments are warranted.

APPLICABLE LAW AND APPRAISAL PRINCIPLES

Burden of Proof

Please see Applicable Law and Appraisal Principles under Legal Issue 1 above.

ANALYSIS AND DISPOSITION

Here, petitioner requests a reduction for the CWIP value it reported after it filed its property statement, but has failed to meet its burden of proof because petitioner has not provided evidence to show that the CWIP it reported in its property statement is inaccurate and has not provided evidence to support its claimed deductions in the CWIP value it reported.

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DECISION

Accordingly, the petition for reassessment is denied and the petition for the abatement of the penalty is granted which reduces the 2015 Board-adopted unitary value from $158,620,000 to $144,200,000.*

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

* The decision was rendered in Sacramento, California on December 16, 2015. This summary decision document was approved on February 23, 2016, in Culver City, California.

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