

Issue Paper Number 99-038



- Board Meeting
- Business Taxes Committee
- Customer Services Committee
- Legislative Committee
- Property Tax Committee
- Technology & Administration Committee
- Other

PROPERTY TAX RULE 10

TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

I. Issue

Should the Board authorize publication of proposed amendments to Property Tax Rule 10, Trade Level for Tangible Personal Property (Title 18, California Code of Regulations)?

II. Staff Recommendation

Staff recommends that the proposed amendments to Property Tax Rule 10 as shown on Attachment A, "SBE Staff Version," be authorized for publication and submitted to the Office of Administrative Law for publication in the California Regulatory Notice Register.

III. Other Alternative(s) Considered

1. Adopt California Assessors' Association's (CAA) proposed amendments to Property Tax Rule 10 as shown on Attachment B, "CAA Version" (deletion to staff's proposed amendments is shown on the attached matrix, Attachment D).
2. Adopt Industry's proposed amendments to Property Tax Rule 10 as shown on Attachment C, "Industry Version" (deletions and modifications to staff's proposed amendments are shown on the attached matrix, Attachment D).

IV. Background

Under Government Code section 15606, subdivision (c), the Board is given the authority to prescribe rules and regulations to govern local boards of equalization when equalizing and assessors when assessing. Accordingly, staff was directed to review and revise Property Tax Rule 10. (Section 10, Title 18, of the California Code of Regulations.)

Consistent with this direction, Property Taxes Department and Legal Division staff drafted proposed amendments to Property Tax Rule 10, and disseminated a draft to interested parties.

After receiving comments from interested parties requesting additional changes to the proposed revision, a second draft was prepared. On June 22, 1999, staff held a meeting in Sacramento with interested parties to attempt to reach agreement on the language and issues of the proposed revisions. Consensus was reached on all items except language involving four issues that are identified on the attached matrix (Attachment D).

The four areas of disagreement regarding Rule 10 are set forth below in the form of questions:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?
2. Should references to various trade levels be deleted from Rule 10?
3. In the determination of a trade level factor, should the full economic cost include an allowance for warranties?
4. (a) Should Rule 10 include an example applying trade level principles to propane gas tanks? (b) If yes, is a trade level adjustment appropriate in the case of installed propane tanks?

V. Staff Recommendation

A. Description of the Staff Recommendation

The Constitution requires that all taxable property must be assessed at "fair market value" (Cal. Const. Art. XIII, § 1(a)). Section 110(a) of the Revenue and Taxation Code defines "fair market value" or full cash value as the "amount of cash or its equivalent which property would bring if exposed for sale in the open market under conditions which neither buyer or seller could take advantage of the exigencies of the other." The trade level principle is consistent with the constitutional and statutory requirement that all property be assessed at fair market value, which includes the concept of highest and best use. Under staff's proposed Rule 10, property must be assessed at the proper level of trade based on its location and use on the lien date. Revenue and Taxation Code section 401.3 states:

"The assessor shall assess all property subject to general property taxation on the lien date as provided in Articles XIII and XIII A of the Constitution and any legislative authorization thereunder."

In addition, an appraiser must recognize that property normally increases in value as it progresses through production and distribution channels, to the consumer, whether or not the cost or value added is booked in accounting records. The trade level concept, as described in staff's proposed version of Rule 10 (Attachment A), is applicable when book cost does not provide adequate information for making a fair market value appraisal. It is most frequently applied to leased equipment and self-constructed equipment.

Trade level adjustments ensure assessment uniformity for similar property that may be acquired through different means (i.e. self-constructed or leased vs. purchased by a consumer). The trade level concept ensures that property is valued at fair market value rather than book value.

Staff's version is consistent with the open market transaction mandate of Revenue and Taxation Code section 110, and the proper determination of a trade level factor described currently in Rule 10 which has been upheld in court cases. Section 110 defines "full cash value" as:

"the amount of cash or its equivalent that property would bring if exposed for sale in the open market..."

B. Pros of the Staff Recommendation

Staff's recommendation addresses the four questions outlined in Part IV "Background" of this issue paper in the following manner:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?

Yes. Staff believes that general trade level principles are applicable to all types of taxable property, both real and personal for a number of reasons, including two very basic reasons. The first basic reason is the need to meet the constitutional requirement of fair market value as defined in section 110. The second basic reason is the need to recognize the principle of fairness and equity that has been enunciated by the courts in a number of cases. In *Xerox Corp. v. County of Orange* 91977) 66 Cal.App.3d 746, the court said at page 755:

"...the trade level concept is useful in assessing the leased property for two reasons; namely, it establishes the trade level at which the property is to be appraised and it focuses on the elements that help establish the market price."

"...the trade level theory produces equity between taxpayers by assuring that the taxpayer consumer who owns his equipment will pay the same tax on identical equipment, as the taxpayer who leases the equipment to the ultimate consumer. The market value of the property is the same if the property is held by the ultimate consumer regardless of who pays the tax."

(See also *Beckman Instruments, Inc. v. County of Orange* (1977) 53 Cal.App.3d 767 at 782 and *Ex-Cell-O Corp. v County of Alameda* (1973) 32 Cal.App.3d 135 at 141.)

Indeed, it is clear that incremental value is to be recognized in assessing real property. This is inherent in the provisions of Revenue and Taxation Code section 71, requiring the assessment of construction work in progress. Such construction work invariably includes fixtures that must be valued at the trade level evident on the lien date.

Further, in a number of cases, the courts have held that fixtures could be assessed separately to the owner of the fixtures rather than the owner of the land, the building, or the tenant improvements. Such an assessment requires recognition of the trade level concept in order to arrive at the appropriate fair market value. *Morse Signal Devices v. Los Angeles County* (1984) 161 Cal.App.3d 570 (components of installed burglar alarm systems are taxable to the installer, even though they are fixtures permanently attached to subscribers' premises.); *Ventura County v. Channel Islands State Bank* (1967) 251 Cal.App.2d 450 (sign and night depository constituting trade fixtures, owned by a bank and installed on leased premises were properly classified as improvements even though assessed to the lessee and placed on the unsecured roll); *Tele-vue Systems, Inc. v. Contra Costa* (1972) 25 Cal.App.3d 340 (permanently affixed interior household connection to a cable system installed by the system owner constitutes a fixture assessable to the owner of the realty rather than the system owner).

Finally, propane tanks, unburied but which remain in place, are listed in Rule 124 as an example of an improvement. Staff believes that the valuation of propane tanks should be clarified in Rule 10. If fixtures (improvements) are not to be included within the scope of Rule 10, then proposed paragraph (d)(1) must be deleted from Rule 10, and the propane tank issue addressed in another Rule.

2. Should references to various trade levels be deleted from Rule 10?

No, trade level is a principle that ensures assessment uniformity. Section 1 of Article XIII of the California Constitution states in part that "All property is taxable and shall be assessed at the same percentage of fair market value." Fair market value is defined in subdivision (a) of section 110 of the Revenue and Taxation Code:

"Except as is otherwise provided in Section 110.1, "full cash value" or "fair market value" means the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes."

Section 110 requires assessment uniformity. Staff's proposed draft of Rule 10 gives guidance on the valuation of property to ensure assessment uniformity and valuation of property at fair market value. To omit discussion of the various trade levels would be to omit guidance and information that is both necessary and helpful to taxpayers and appraisers.

In addition, staff's version of the proposed rule is supported by judicial precedent which has upheld the trade level principles in the current rule 10:

Ex-Cell-O Corp. v. County of Alameda (1973) 32 C.A.3d 135. At 141:

"The purpose of the assessor is to find the fair market value of any given property in the hands of the person who holds it on the lien date of any year. By using the trade level concept, the assessor puts all of the identical equipment on the same basis, whether the ultimate user chooses to lease it or to buy it, because its value is the same to all."

Xerox Corp. v. County of Orange (1977) 66 Cal.App.3d 746. At 755:

"...the trade level concept is useful in assessing the leased equipment for two reasons; namely, it establishes the trade level at which the property is to be appraised, and it focuses on the elements that help establish the market price."

"...the trade level theory produces equity between taxpayers by assuring that the taxpayer consumer who owns his equipment will pay the same tax on identical equipment as the taxpayer who leases the equipment to the ultimate consumer. The market value of the equipment is the same if the property is held by the ultimate consumer regardless of who pays the tax."

In *Beckman Instruments, Inc. v. County of Orange* (1975) 53 Cal.App.3d 767, the court observed at 782:

"The concept of trade level increase in value simply recognizes the fact...that property normally increases in market value as it progresses from goods in process to manufactured goods, to wholesale, to retail, or to some other definable intermediate level.... The trade level principle simply recognizes the fact that as property flows through various stages from production to distribution, at certain intermediate levels the property attains a market value which includes the element of profit. The value increase does not turn upon change in possession or ownership but on the stage of production or distribution."

Using the logic of *Beckman*, what matters is the fair market value of the property. The significance of the current Rule 10 is not that it created any new value, but that it provides explicit details and certainty as to how property is to be assessed depending on its situation on the lien date. Thus understood, trade level principles can be seen as a corollary of the principle of highest and best use.

Therefore, under the principles stated in the *Beckman*, *Ex-Cell-O*, and *Xerox* cases, the California Supreme Court and Courts of Appeal have recognized trade level in the current Rule 10 as valid for purposes of determining fair market value. As such, staff has appropriately included a discussion of the trade level principle in the proposed Rule 10.

3. In the determination of a trade level factor, should the full economic cost include an allowance for warranties?

No, unless the warranty is separately purchased. The costs of warranty contracts are appropriate adjustments to the calculation of retail trade level factors only when such costs are separately stated; i.e., they can be purchased separately from the product. The full economic cost of property, therefore, should not include an adjustment for a warranty unless the warranty is separately purchased.

Staff's proposed language excluding warranty as an adjustment to the trade level factor is consistent with the trade level discussion in Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures*, adopted by the Board December 10, 1998. The wording approved by the Board in AH 504 does not include "warranty" as an adjustment in the determination of the trade level factor. Thus, staff's proposed language has been guided by the Board's decision on this issue upon its approval of the handbook. (See also issue paper number 98-036.)

4. (a) Should Rule 10 include an example applying trade level principles to propane gas tanks? (b) If yes, is a trade level adjustment appropriate in the case of installed propane tanks?

(a) Yes, Rule 10 should include an example applying trade level principles to propane gas tanks. Currently propane tanks are not valued uniformly in the State of California. An example in Rule 10 that provides guidance on valuation of propane tanks will promote assessment uniformity. Providing guidance on the valuation of propane tanks in proposed Rule 10 would also be responsive to the petition for regulatory action by the propane industry requesting that the Board exercise its rulemaking authority to adopt or amend a regulation that would subject propane tanks to trade level valuation.

(b) Trade level adjustments may be required in the valuation of propane gas tanks. Propane gas tanks, similar to other types of property, must be valued at the price to the consumer of the property. Staff's draft of Rule 10 provides criteria for purposes of determining the identity of the consumer of the tank. The criteria listed in the example are costs incurred by the consumer of the property.

Consumers of property pay sales tax on the cost of the property. In addition, consumers of property will incur freight or shipping costs, installation, or any other types of costs incurred in bringing the property to a finished state. Staff researched the business practices of several propane gas companies to determine the identity of the consumers of propane gas tanks, the costs that typically are incurred by the propane gas companies, and the costs that typically are incurred by their customers.

Our research indicates that some propane gas companies pay sales tax on the propane tanks when purchased while others which lease the tanks to customers buy the tanks ex-tax for resale and collect sales tax on the lease payments. In addition, a company may have tanks that it owns and tanks that it leases. In short, our research indicates a lack of uniformity as to how propane companies do business and confusion among the counties as to the valuation of the tanks. Staff's draft ensures assessment uniformity of propane gas tanks by identifying specific criteria to determine the tank consumer's identity for property tax purposes.

C. Cons of the Staff Recommendation

(1) Industry does not believe the inclusion of fixtures in Rule 10 is appropriate. Industry also believes that the inclusion of fixtures is confusing since the title of Rule 10 is Trade Level for Personal Property. In addition, even though the trade level theory applies to fixtures, fixtures are not included in the current version of Rule 10.

(2) Currently, the major portion of the text in Rule 10 applies to the valuation of inventory. Industry believes that the current Rule 10 was adopted specifically for inventory. Since inventory is now exempt, trade level predominately applies to self-constructed and leased

equipment. Industry's version replaces "at the same trade level" with "in the open market." Industry believes substituting the broader fair market value concept for the specific trade level principle, (a specific valuation methodology for determining market value) is more appropriate. Staff's version does not use the phrase "in the open market."

(3) Industry believes that a warranty cost adjustment is a factor in the trade level adjustment. Staff's draft does not address warranties in the rule, thereby not identifying them as a cost adjustment. This is incorrect in industry's view.

(4)(a) Staff's draft includes a propane gas tank example in the rule, but no other specific examples are included in the draft. The CAA considers this special treatment for a special interest group.

(b) Staff's draft does not specifically state whether or not the propane gas companies are to be treated as the consumers of propane gas tanks for property tax purposes; and instead, merely provides a list of criteria to be used to identify the consumer of the tank. Industry believes an absolute statement regarding which trade level the tanks should be assessed at is necessary to produce uniformity.

D. Statutory or Regulatory Changes

Action by the Board on the attached Property Tax Rule will amend Section 10, Title 18 of the California Code of Regulations.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

See attached Revenue Estimate.

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The lien date is January 1 for the assessment year July 1 through June 30. In order for assessors to have this guidance for the processing of the 2000-01 roll the Property Tax Committee should authorize publication of amendments to the Rule at its meeting on September 1, 1999.

VI. Alternative 1

A. Description of the Alternative

The Board could adopt the California Assessors' Association's (CAA) proposed amendments to Property Tax Rule 10. Attachment B shows CAA's proposed revisions to the current Rule 10; the difference between staff's proposed Rule 10 and CAA's proposed Rule 10 is shown on the attached matrix (Attachment D).

The CAA is in agreement with staff's version of Rule 10 with the sole exception of the propane gas tank example. The CAA opposes the inclusion of a propane gas tank example in Rule 10 because they believe instructions for a specific property type is more appropriately addressed in a Letter to Assessors.

In addition, the CAA does not agree with the wording of the example proposed by staff or by industry. CAA believes the adoption of staff's example will cause confusion and inconsistency in the valuation of propane tanks. CAA believes Industry's example is contrary to the Board's property tax rules and inconsistent with appraisal principles.

B. Pros of the Alternative

4. (a) Should Rule 10 include an example applying trade level principles to propane gas tanks? (b) If yes, is a trade level adjustment appropriate in the case of installed propane tanks?

(a) No. In the CAA's view, which removes the only proposed example in Rule 10, the rule should not identify a special interest property for purposes of clarification. If the reason for inclusion is to promote uniformity of assessment practices, then they believe that a Letter to Assessors is a better forum.

(b) Staff's proposed example considers tanks as "leased, rented, or loaned to the ultimate consumer" when the consumer pays for sales tax, installation, maintenance, or any other periodic charge for the tank. In some instances, propane companies will place a tank on site, free of charge, with the condition that the customers purchase gas only from them. This means the tank is not leased, rented, or loaned to the consumer of the gas since no specific charge has been made for the tank. Thus, under these facts, the propane gas company is the consumer of the tank. In other instances, propane companies will place a tank on site but charge installation, maintenance, a rental fee, and sales tax on the rental of the tank. This factual situation indicates that the tanks are leased, rented, or loaned to the consumer of the gas. Thus, under such facts, the consumer of the gas will be the consumer of the tank. This situation would result in tanks for which no rental charge is made to be valued one way, while a company that does charge a rental fee would have their tanks valued in different ways. As can be seen from these few examples, the proper valuation of propane tanks is dependent upon the terms of the contract between the propane gas company and the consumer of the propane gas.

The CAA contends, in support of its position, that including the example will cause confusion and inconsistency in the valuation of propane tanks. It would become necessary to know the terms of the contract in order to determine the consumer of the tank prior to valuation of the

property, which will be burdensome for the assessor. In addition, CAA's view is that this example would result in inequitable assessment practices contrary to *Ex-Cell-O Corp. v. County of Alameda*. Property should not be valued based on individual assessee billing procedures. To do so, would create an inequity between assessees performing the same services but following different business procedures.

The CAA argues that the Industry example is contradictory to existing law and standard appraisal practice, and would undermine the trade level principle as it applies to the valuation of propane tanks. Industry's proposed example makes the assumption that in all situations the propane gas companies are the consumers of the tanks. In addition, Industry's example limits the method of valuation to a cost approach that does not include all appropriate costs. Property Tax Rule 6 mandates, when using the cost approach to value, that materials, labor, entrepreneurial profit, interest on borrowed funds and any other costs typically incurred shall be used to value property. Industry's proposed paragraph on tanks in Rule 10 would contradict Rule 6. In addition, industry's example does not mention or reference other methods of valuation. Thus, industry's example is contrary to the Board's property tax rules and inconsistent with appraisal principles.

C. Cons of the Alternative

(4)(a & b) Adopting the CAA's version of Rule 10 removes an example that attempts to provide clarification on assessment of propane gas tanks. The purpose of both drafts of the example (staff and industry) is to provide assessment uniformity.

The assessors' version would not assist in resolving the current conflict regarding the proper application of trade level to propane tanks. It, therefore, would not further the purpose of rulemaking by the Board, which is to promote uniformity and implement, interpret, or make specific the law being administered.

D. Statutory or Regulatory Change

Action by the Board on the attached Property Tax Rule will amend Title 18 of the California Code of Regulations.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

See attached Revenue Estimate.

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The lien date is January 1 for the assessment year July 1 through June 30. In order for assessors to have this guidance for the processing of the 2000-01 roll the Property Tax Committee should authorize publication of amendments to the Rule at its meeting on September 1, 1999.

VII. Alternative 2

A. Description of the Alternative

The Board could adopt Industry's proposed amendments to Property Tax Rule 10. Attachment C shows Industry's proposed revisions to the current Rule 10; differences between staff's proposed Rule 10 and Industry's proposed Rule 10 are arrayed on the attached matrix (Attachment D).

B. Pros of the Alternative

Industry's recommendation addresses the four questions outlined in Part IV "Background" of this issue paper in the following manner:

1. Do trade level adjustments apply in the valuation of personal property that has been affixed to real property (fixtures)?

No. Industry does not think that the inclusion of personal property that has been affixed to real property in Rule 10 is appropriate. Inclusion of fixtures is confusing since the title of Rule 10 is Trade Level for Personal Property.

2. Should references to various trade levels be deleted from Rule 10?

Yes, "at the same trade level" should be replaced with "in the open market." The phrase "in the open market" is language from section 110 of the Revenue and Taxation code. Section 110 in part states:

"Except as otherwise provided in Section 110.1 "full cash value" or "fair market value" means the amount of cash or its equivalent that property would bring if exposed for sale in the open market..."

3. In the determination of a trade level factor, should the full economic cost include an allowance for warranties?

Yes, when a manufacturer withdraws equipment from inventory, it might not include a warranty. When a customer purchases equipment with a warranty, the customer will not incur a cost to have the equipment repaired. When the manufacturer needs the equipment repaired or serviced, it will bear the cost to have the equipment repaired. The warranty costs should reduce the amount of the trade level adjustment.

4. (a) Should Rule 10 include an example applying trade level principles to propane gas tanks? (b) If yes, is a trade level adjustment appropriate in the case of installed propane tanks?

(a) Yes, Rule 10 should include an example applying to propane gas tanks. Currently propane tanks are not valued uniformly in the State of California. An example in Rule 10 that provides guidance on valuation of propane tanks to promote assessment uniformity is consistent with the Board's duty.

(b) No, a trade level adjustment is not appropriate because the propane gas companies are the consumers of the tanks. Fuel tanks and related delivery appurtenances (meters, regulators, piping, pumps, etc.) are not used by nor controlled by the consumer of the gas. The gas user licenses the use of his or her real property for placement of the tank in return for having a ready supply of the gas. Public policy necessitates the seller of gas products to be responsible for their safety through the delivery process to the ultimate consumer.

C. Cons of the Alternative

(1) Not including fixtures in Rule 10 results in inconsistencies in Industry's draft. Propane gas tanks, according to Rule 124, are fixtures. If fixtures are not included in the trade level rule, then it would follow that Rule 10 should not include an example dealing with the proper trade level of a fixture.

General trade level principles can apply to any type of property. If applying a trade level adjustment to a fixture results in fair market value and equity between taxpayers, then it is an appropriate adjustment whether or not it is specifically identified in a Board rule. Excluding fixtures from the rule does not mean that the trade level theory does not apply to fixtures and would eliminate the clarification that trade level may apply to fixtures.

(2) Industry's proposed draft deletes references to trade level in the body of the rule. Trade level is a principle that ensures assessment uniformity. Industry seeks to substitute the broader fair market value concept for the specific trade level principle, (a specific valuation methodology for determining market value) in its proposal to replace the phrase "at the same trade level" with "in the open market." Proposed Rule 10 would not be as useful for valuation purposes by repeating the "in the open or fair market" value concept in subdivision (a) of section 110 of the Revenue and Taxation Code and in the Constitution (subdivision (a) of Section 1 of Article XIII) in lieu of providing specific guidance on how to make the trade level adjustments in the determination of the fair market value of property.

Deleting the term trade level from proposed Rule 10 would be contrary to well established judicial precedent which has upheld the trade level principles in current Rule 10, including, *Ex-Cell-O Corp. v. County of Alameda* (1973) 32 C.A.3d 135, *Xerox Corp. v. County of Orange* (1977) 66 Cal.App.3d 746 and *Beckman Instruments, Inc. v. County of Orange* (1975) 53 Cal.App.3d 767. (See discussion of cases under pros of staff's position.)

Industry's proposed wording on deleting references to various trade levels included a revision to the last sentence in paragraph (f): "The property shall be valued ~~based on how it is situated or used on the lien date~~ pursuant to subdivisions (b), (c), (d), and (e)." (See Attachment D, Issue Paper Matrix). This sentence guides the reader to the appropriate subdivision of the rule that gives instruction on trade level adjustments based on how the property is situated on the lien date.

Deleting the phrase "based on how it is situated or used on the lien date" is in conflict with section 401.3 of the Revenue and Taxation code. Section 401.3 provides that:

"The assessor shall assess all property subject to general property taxation on the lien date as provided in Articles XIII and XIII A of the Constitution and any legislative authorization thereunder."

In accordance with section 401.3, the proposed rule needs to confirm that the assessor must look at how the property is situated on the lien date. How it is situated will aid in the determination of the proper trade level adjustment.

(3) The costs of warranty contracts are appropriate adjustments to the calculation of retail trade level factors only when such costs are separately stated; i.e., they can be purchased separately from the product. The full economic cost of property, therefore, should not include an adjustment for a warranty unless the warranty is separately purchased.

Industry's proposal to include warranty as an adjustment to the trade level factor is in conflict with the trade level discussion in Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures* adopted by the Board December 10, 1998. The wording approved by the Board in AH 504 does not include "warranty" as an adjustment in the determination of the trade level factor. (See issue paper number 98-036.)

(4) In general, propane gas tanks are fixtures, but Industry's draft of Rule 10, however, does not include "fixtures." This results in an example that is not within the scope of the rule. If the rule is to be limited only to personal property, then any example that may be part of the rule should be an example giving guidance on the proper trade level of personal property, not fixtures.

(a) Industry's draft includes a propane gas tank example in the rule, but no other specific examples are included in the draft.

(b) Industry's proposed example (1) makes the arbitrary assumption that in all situations the propane gas companies are the consumers of the tanks; and, (2) limits the method of valuation to a cost approach that does not include all appropriate costs. Industry's example provides inadequate guidance in that it does not mention or reference other methods of valuation. Further, in assuming that in all situations the propane gas companies are the consumers of the tanks, the costs listed in the example do not include installation costs and costs typically incurred in bringing property to a finished state. Thus, typical costs incurred by a consumer of property are not addressed, contrary to fundamental appraisal principles.

Industry's example also makes the generalization that "Tanks and other tangible personal property used as a means of storage, delivery, or transfer of liquefied petroleum gas products, whether leased, rented, or loaned, and regardless of situs, shall be valued at owners full cost less a reasonable allowance for depreciation." In other words, all propane gas tanks should be valued at the owner's cost regardless of how the property is situated (in conflict with section 401.3) and regardless of whom the consumer of the property is. Thus, industry's proposal is contrary to existing law.

D. Statutory or Regulatory Change

Action by the Board on the attached Property Tax Rule will amend Section 10, Title 18 of the California Code of Regulations.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

See attached Revenue Estimate.

G. Taxpayer/Customer Impact

None

H. Critical Time Frames

The lien date is January 1 for the assessment year July 1 through June 30. In order for assessors to have this guidance for the processing of the 2000-01 roll the Property Tax Committee should authorize publication of amendments to the Rule at its meeting on September 1, 1999.

Prepared by: Property Taxes Department; Policy, Planning, and Standards Division

Current as of: August 11, 1999

**ATTACHMENT A
STAFF VERSION**

Rule 10 TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

References: Chapter 147, Statutes of 1966, First Extraordinary Session.

Sections 110, 401, Revenue and Taxation Code.

(a) In appraising tangible personal property, the assessor shall give recognition to the trade level at which the property is situated and to the principle that property normally increases in value as it progresses through production and distribution channels. Such property normally attains its maximum value as it reaches the consumer level. Accordingly, tangible personal property shall be valued by procedures that are consistent with the general policies set forth herein. Trade level adjustments shall also be considered when appraising personal property affixed to real property.

~~(b) Tangible personal property in the hands of a primary producer which is produce of the soil and for which there are regular markets established by the buyers of the property, such as petroleum and other minerals, logs, livestock, and other farm products, shall be valued at the price offered by the buyers less the unincurred cost of preparing the property for market and of moving the property to the market place at which such price is applicable, or plus the cost of moving the goods from that market place to the place at which they are to be processed if the latter location is the tax situs.~~

(b) Except as provided by the following subdivisions, tangible personal property held by a consumer at any trade level shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level. This value shall be estimated in accordance with regulations 4, 6, and 8. If a cost approach is employed, the cost shall include the full economic cost of placing the property in service. Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state including freight or shipping cost, installation cost, sales or use taxes, and market supported entrepreneurial profit (with appropriate allowances for trade, quantity, or cash discounts).

~~(c) Tangible personal property in the hands of a manufacturer who holds it for processing or for sale shall be valued at the amount for which it would transfer to other manufacturers of like property. This value shall be estimated (1) by reference to the cost of the property in its condition on the lien date or (2) by reference to the cash price at which the manufacturer is expected to sell the property less costs yet to be incurred and experienced gross profits. When the cost approach is used, there shall be added to the cost of raw materials all other direct costs and manufacturing burden, including depreciation and property taxes, but excluding selling and general administrative costs. Unprocessed raw material cost is the cost of replacement on the lien date as evidenced by recent purchases by the assessee or other recent market transactions.~~

(c) Tangible personal property leased, rented, or loaned for a period of six months or less, having a tax situs at the place where the lessor normally keeps the property as provided in

**ATTACHMENT A
STAFF VERSION**

regulation 204, shall be valued at the amount of cash or its equivalent for which it would transfer to other lessors or retailers of like property at the same trade level. The value may be estimated by reference to the price at which the lessor could be expected to sell the property at fair market value to other lessors or retailers of like property at the same trade level. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessor's full economic cost of the property with a reasonable allowance for depreciation; (2) the cost indicated in subdivision (e) if the lessor is also the manufacturer; or (3) in accordance with subdivision (b).

~~(d) Tangible personal property in the hands of a retail merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other retailers of like property; and tangible personal property in the hands of a wholesale merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other wholesalers of like property. This value shall be estimated (1) by reference to the property's cost to the merchant, including freight in and deducting trade, quantity, and cash discounts, with reasonable allowance based on proper substantiation for damaged, shopworn, out of style, used, or overage stock, or (2) by reference to the price at which the merchant is expected to sell the property less his experienced gross profit.~~

(d) Tangible personal property leased, rented, or loaned for an extended but unspecified period or leased for a term of more than six months, having tax situs at the lessee's situs as provided in regulation 204, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade as the lessee. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessee's full economic cost of the property with a reasonable allowance for depreciation, or (2) in accordance with subdivision (b).

(1) For purposes of subdivision (d) tanks and other tangible property used as a means of storage, delivery, or transfer of liquefied petroleum gas products are considered leased, rented, or loaned to the ultimate consumer of the gas if the consumer is required to pay sales tax, installation, maintenance, or any periodic charge for the tank.

~~(e) Tangible personal property in the hands of a person who holds it for consumption shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When, however, such property is leased or rented for a period of less than six months so that its tax situs, as provided in section 204 of this chapter is at the place where the lessor normally keeps the property, it shall be valued in accordance with the last sentence of subdivision (d).~~

(e) Tangible personal property acquired from internal sources for self-consumption or use, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer using the property at the same trade level. If that price is unknown, then the value may be estimated by reference to one

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or more of the following indicators of value: (1) the cost of the property in its condition and location on the lien date, had it been acquired at fair market value from an outside supplier (including labor, materials, overhead, interdivisional profits, interest on borrowed or owner supplied funds, sales or use tax, installation and other costs incurred in bringing the property to a finished state, with appropriate allowances for trade, quantity, or cash discounts, and depreciation), or (2) in accordance with subdivision (b). The quantity discount allowed a manufacturer, when it is its own largest customer, should be at least as large as that allowed its largest wholesale or retail customer.

~~(f) When tangible personal property is in the hands of a person engaged in two or more of the functions of producer, manufacturer or processor, wholesaler, retailer, or consumer, the level of trade at which the property is held shall be determined by reference to its form, location, quantity, acquisition source, and probably purchasers or lessees. A person is operating at two or more levels when the property consists of raw materials, semi-manufacturers, or finished goods which were acquired from sources within a business entity (other than component parts meeting the tests of the following sentence) and the property is held (1) for consumption by the business entity or (2) for processing and/or marketing in competition with similar products marketed by other business entities that have purchased like raw materials, semi manufacturers, or finished goods at the same stage of production from external sources. Component parts held at the manufacturing processing level, however, shall not be considered to be at a higher level than that at which they are manufactured when they have been manufactured by a business entity specifically and exclusively for (1) incorporation by the entity in its finished product, (2) marketing as replacement parts for its finished product, or (3) both.~~

~~When it is concluded that the person holding tangible personal property is operating at more than one trade level, property at the higher trade level or levels acquired from internal sources shall be valued (1) by estimating what the property, in its condition and location on the lien date, would have cost had it been acquired in an arm's length transaction from an outside supplier, (2) by reference to the cash price at which the property could be sold in an arm's length transaction to an outside customer less a reasonable gross profit, or (3) if held at the consumer level, in accordance with subdivision (e).~~

~~(g) Storage of tangible personal property in a warehouse, in and of itself, does not alter the trade level. The trade level of such property will be determined in accordance with subdivision (f).~~

(f) Tangible personal property in the hands of a person engaged in the function of a manufacturer, wholesaler, or retailer and a consumer shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade. The property shall be valued based on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).

History: Adopted June 21, 1967, effective July 23, 1967.

ATTACHMENT A
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Amended February 18, 1970, effective March 26, 1970.
Amended January 6, 1971, effective February 18, 1971.
Amended April 19, 1971, effective May 22, 1971.

**ATTACHMENT B
CAA VERSION**

Rule 10 TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

References: Chapter 147, Statutes of 1966, First Extraordinary Session.

Sections 110, 401, Revenue and Taxation Code.

(a) In appraising tangible personal property, the assessor shall give recognition to the trade level at which the property is situated and to the principle that property normally increases in value as it progresses through production and distribution channels. Such property normally attains its maximum value as it reaches the consumer level. Accordingly, tangible personal property shall be valued by procedures that are consistent with the general policies set forth herein. Trade level adjustments shall also be considered when appraising personal property affixed to real property.

~~(g) Tangible personal property in the hands of a primary producer which is produce of the soil and for which there are regular markets established by the buyers of the property, such as petroleum and other minerals, logs, livestock, and other farm products, shall be valued at the price offered by the buyers less the unincurred cost of preparing the property for market and of moving the property to the market place at which such price is applicable, or plus the cost of moving the goods from that market place to the place at which they are to be processed if the latter location is the tax situs.~~

(b) Except as provided by the following subdivisions, tangible personal property held by a consumer at any trade level shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level. This value shall be estimated in accordance with regulations 4, 6, and 8. If a cost approach is employed, the cost shall include the full economic cost of placing the property in service. Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state including freight or shipping cost, installation cost, sales or use taxes, and market supported entrepreneurial profit (with appropriate allowances for trade, quantity, or cash discounts).

~~(h) Tangible personal property in the hands of a manufacturer who holds it for processing or for sale shall be valued at the amount for which it would transfer to other manufacturers of like property. This value shall be estimated (1) by reference to the cost of the property in its condition on the lien date or (2) by reference to the cash price at which the manufacturer is expected to sell the property less costs yet to be incurred and experienced gross profits. When the cost approach is used, there shall be added to the cost of raw materials all other direct costs and manufacturing burden, including depreciation and property taxes, but excluding selling and general administrative costs. Unprocessed raw material cost is the cost of replacement on the lien date as evidenced by recent purchases by the assessee or other recent market transactions.~~

(c) Tangible personal property leased, rented, or loaned for a period of six months or less, having a tax situs at the place where the lessor normally keeps the property as provided in

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regulation 204, shall be valued at the amount of cash or its equivalent for which it would transfer to other lessors or retailers of like property at the same trade level. The value may be estimated by reference to the price at which the lessor could be expected to sell the property at fair market value to other lessors or retailers of like property at the same trade level. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessor's full economic cost of the property with a reasonable allowance for depreciation; (2) the cost indicated in subdivision (e) if the lessor is also the manufacturer; or (3) in accordance with subdivision (b).

~~(i) Tangible personal property in the hands of a retail merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other retailers of like property; and tangible personal property in the hands of a wholesale merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other wholesalers of like property. This value shall be estimated (1) by reference to the property's cost to the merchant, including freight in and deducting trade, quantity, and cash discounts, with reasonable allowance based on proper substantiation for damaged, shopworn, out of style, used, or overage stock, or (2) by reference to the price at which the merchant is expected to sell the property less his experienced gross profit.~~

(d) Tangible personal property leased, rented, or loaned for an extended but unspecified period or leased for a term of more than six months, having tax situs at the lessee's situs as provided in regulation 204, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade as the lessee. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessee's full economic cost of the property with a reasonable allowance for depreciation, or (2) in accordance with subdivision (b).

~~(j) Tangible personal property in the hands of a person who holds it for consumption shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When, however, such property is leased or rented for a period of less than six months so that its tax situs, as provided in section 204 of this chapter is at the place where the lessor normally keeps the property, it shall be valued in accordance with the last sentence of subdivision (d).~~

(e) Tangible personal property acquired from internal sources for self-consumption or use, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer using the property at the same trade level. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the cost of the property in its condition and location on the lien date, had it been acquired at fair market value from an outside supplier (including labor, materials, overhead, interdivisional profits, interest on borrowed or owner supplied funds, sales or use tax, installation and other costs incurred in bringing the property to a finished state, with appropriate allowances for trade, quantity, or cash discounts, and depreciation), or (2) in accordance with subdivision (b).

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The quantity discount allowed a manufacturer, when it is its own largest customer, should be at least as large as that allowed its largest wholesale or retail customer.

~~(k) When tangible personal property is in the hands of a person engaged in two or more of the functions of producer, manufacturer or processor, wholesaler, retailer, or consumer, the level of trade at which the property is held shall be determined by reference to its form, location, quantity, acquisition source, and probable purchasers or lessees. A person is operating at two or more levels when the property consists of raw materials, semi-manufacturers, or finished goods which were acquired from sources within a business entity (other than component parts meeting the tests of the following sentence) and the property is held (1) for consumption by the business entity or (2) for processing and/or marketing in competition with similar products marketed by other business entities that have purchased like raw materials, semi-manufacturers, or finished goods at the same stage of production from external sources. Component parts held at the manufacturing processing level, however, shall not be considered to be at a higher level than that at which they are manufactured when they have been manufactured by a business entity specifically and exclusively for (1) incorporation by the entity in its finished product, (2) marketing as replacement parts for its finished product, or (3) both.~~

~~When it is concluded that the person holding tangible personal property is operating at more than one trade level, property at the higher trade level or levels acquired from internal sources shall be valued (1) by estimating what the property, in its condition and location on the lien date, would have cost had it been acquired in an arm's length transaction from an outside supplier, (2) by reference to the cash price at which the property could be sold in an arm's length transaction to an outside customer less a reasonable gross profit, or (3) if held at the consumer level, in accordance with subdivision (e).~~

~~(g) Storage of tangible personal property in a warehouse, in and of itself, does not alter the trade level. The trade level of such property will be determined in accordance with subdivision (f).~~

(f) Tangible personal property in the hands of a person engaged in the function of a manufacturer, wholesaler, or retailer and a consumer shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade. The property shall be valued based on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).

History: Adopted June 21, 1967, effective July 23, 1967.
 Amended February 18, 1970, effective March 26, 1970.
 Amended January 6, 1971, effective February 18, 1971.
 Amended April 19, 1971, effective May 22, 1971.

**ATTACHMENT C
INDUSTRY VERSION**

Rule 10 TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY

References: Chapter 147, Statutes of 1966, First Extraordinary Session.

Sections 110, 401, Revenue and Taxation Code.

(a) In appraising tangible personal property, the assessor shall give recognition to the trade level at which the property is situated and to the principle that property normally increases in value as it progresses through production and distribution channels. Such property normally attains its maximum value as it reaches the consumer level. Accordingly, tangible personal property shall be valued by procedures that are consistent with the general policies set forth herein.

~~(l) Tangible personal property in the hands of a primary producer which is produce of the soil and for which there are regular markets established by the buyers of the property, such as petroleum and other minerals, logs, livestock, and other farm products, shall be valued at the price offered by the buyers less the unincurred cost of preparing the property for market and of moving the property to the market place at which such price is applicable, or plus the cost of moving the goods from that market place to the place at which they are to be processed if the latter location is the tax situs.~~

(b) Except as provided by the following subdivisions, tangible personal property used in a trade or business shall be valued at the amount of cash or its equivalent for which that property would bring if exposed for sale in the open market. This value shall be estimated in accordance with regulations 4, 6, and 8. If a cost approach is employed, the cost shall include the full economic cost of placing the property in service. Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state including freight or shipping cost, installation cost, sales or use taxes, and market supported entrepreneurial profit (with appropriate allowances for trade, quantity, cash discounts, and warranties).

~~(m) Tangible personal property in the hands of a manufacturer who holds it for processing or for sale shall be valued at the amount for which it would transfer to other manufacturers of like property. This value shall be estimated (1) by reference to the cost of the property in its condition on the lien date or (2) by reference to the cash price at which the manufacturer is expected to sell the property less costs yet to be incurred and experienced gross profits. When the cost approach is used, there shall be added to the cost of raw materials all other direct costs and manufacturing burden, including depreciation and property taxes, but excluding selling and general administrative costs. Unprocessed raw material cost is the cost of replacement on the lien date as evidenced by recent purchases by the assessee or other recent market transactions.~~

(c) Tangible personal property leased, rented, or loaned for a period of six months or less, having a tax situs at the place where the lessor normally keeps the property as provided in regulation 204, shall be valued at the amount of cash or its equivalent for which it would

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transfer to other lessors or retailers of like property in the open market. The value may be estimated by reference to the price at which the lessor could be expected to sell the property at fair market value to other lessors or retailers of like property in the open market. If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessor's full economic cost of the property with a reasonable allowance for depreciation and warranties; (2) the cost indicated in subdivision (e) if the lessor is also the manufacturer; or (3) in accordance with subdivision (b).

~~(n) Tangible personal property in the hands of a retail merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other retailers of like property; and tangible personal property in the hands of a wholesale merchant who holds it for sale, lease, or rental shall be valued at the amount for which it would transfer to other wholesalers of like property. This value shall be estimated (1) by reference to the property's cost to the merchant, including freight in and deducting trade, quantity, and cash discounts, with reasonable allowance based on proper substantiation for damaged, shopworn, out of style, used, or overage stock, or (2) by reference to the price at which the merchant is expected to sell the property less his experienced gross profit.~~

(d) Tangible personal property leased, rented, or loaned for an extended but unspecified period or leased for a term of more than six months, having tax situs at the lessee's situs as provided in regulation 204, shall be valued in accordance with subdivision (b). If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessee's full economic cost of the property with a reasonable allowance for depreciation, or (2) in accordance with subdivision (b).

(1) Tanks and other tangible personal property used as a means of storage, delivery, or transfer of liquefied petroleum gas products, whether leased, rented, or loaned, and regardless of situs, shall be valued at owners full cost less a reasonable allowance for depreciation. Cost may include cost of the property, freight, sales tax or use tax.

~~(o) Tangible personal property in the hands of a person who holds it for consumption shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When, however, such property is leased or rented for a period of less than six months so that its tax situs, as provided in section 204 of this chapter is at the place where the lessor normally keeps the property, it shall be valued in accordance with the last sentence of subdivision (d).~~

(e) Tangible personal property acquired from internal sources for self-consumption or use, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an external wholesale or retail customer, and in accordance with subdivision (b). If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the cost of the property in its condition and location on the lien date, had it been acquired at fair market value from an outside supplier (including labor, materials, overhead, interdivisional profits, interest on borrowed or owner supplied funds, sales or use tax,

ATTACHMENT C INDUSTRY VERSION

installation and other costs incurred in bringing the property to a finished state, with appropriate allowances for trade, quantity, or cash discounts, depreciation, and warranties), or (2) in accordance with subdivision (b). The quantity discount allowed a manufacturer, when it is its own largest customer, should be at least as large as that allowed its largest wholesale or retail customer. This discount should be further increased for the value of a manufacturer's warranty which normally accompanies equipment sold to others, but does not so accompany equipment used by the manufacturer for internal purposes.

~~(p) When tangible personal property is in the hands of a person engaged in two or more of the functions of producer, manufacturer or processor, wholesaler, retailer, or consumer, the level of trade at which the property is held shall be determined by reference to its form, location, quantity, acquisition source, and probable purchasers or lessees. A person is operating at two or more levels when the property consists of raw materials, semi-manufacturers, or finished goods which were acquired from sources within a business entity (other than component parts meeting the tests of the following sentence) and the property is held (1) for consumption by the business entity or (2) for processing and/or marketing in competition with similar products marketed by other business entities that have purchased like raw materials, semi manufacturers, or finished goods at the same stage of production from external sources. Component parts held at the manufacturing processing level, however, shall not be considered to be at a higher level than that at which they are manufactured when they have been manufactured by a business entity specifically and exclusively for (1) incorporation by the entity in its finished product, (2) marketing as replacement parts for its finished product, or (3) both.~~

~~When it is concluded that the person holding tangible personal property is operating at more than one trade level, property at the higher trade level or levels acquired from internal sources shall be valued (1) by estimating what the property, in its condition and location on the lien date, would have cost had it been acquired in an arm's length transaction from an outside supplier, (2) by reference to the cash price at which the property could be sold in an arm's length transaction to an outside customer less a reasonable gross profit, or (3) if held at the consumer level, in accordance with subdivision (e).~~

~~(g) Storage of tangible personal property in a warehouse, in and of itself, does not alter the trade level. The trade level of such property will be determined in accordance with subdivision (f).~~

(f) Tangible personal property in the hands of a person engaged in the function of a manufacturer, wholesaler, or retailer and a consumer shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade. The property shall be valued pursuant to subdivisions (b), (c), (d), and (e).

History: Adopted June 21, 1967, effective July 23, 1967.

**ATTACHMENT C
INDUSTRY VERSION**

Amended February 18, 1970, effective March 26, 1970.
Amended January 6, 1971, effective February 18, 1971.
Amended April 19, 1971, effective May 22, 1971.

**ATTACHMENT D
ISSUE PAPER MATRIX**

ITEM 1: INDUSTRY'S VERSION DELETES REFERENCE TO FIXTURES		
Paragraph	Source	Position
Paragraph (a), last sentence	SBE staff & CAA	Trade level adjustments shall also be considered when appraising personal property affixed to real property.
Paragraph (a), last sentence	Industry	Trade level adjustments shall also be considered when appraising personal property affixed to real property.

**ATTACHMENT D
ISSUE PAPER MATRIX**

ITEM 2: INDUSTRY'S VERSION DELETES REFERENCES TO VARIOUS TRADE LEVELS		
Paragraph	Source	Position
Paragraph (b), first sentence	SBE staff & CAA	Except as provided by the following subdivisions, tangible personal property held by a consumer at any trade level shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level.
Paragraph (b), first sentence	Industry	Except as provided by the following subdivisions, tangible personal property held by a consumer at any trade level shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level. <u>used in a trade or business shall be valued at the amount of cash or its equivalent for which that property would bring if exposed for sale in the open market.</u>
Paragraph (c), first sentence	SBE staff & CAA	Tangible personal property leased, rented, or loaned for a period of six months or less, having a tax situs at the place where the lessor normally keeps the property as provided in regulation 204, shall be valued at the amount of cash or its equivalent for which it would transfer to other lessors or retailers of like property at the same trade level.
Paragraph (c), first sentence	Industry	Tangible personal property leased, rented, or loaned for a period of six months or less, having a tax situs at the place where the lessor normally keeps the property as provided in regulation 204, shall be valued at the amount of cash or its equivalent for which it would transfer to other lessors or retailers of like property at the same trade level. <u>in the open market.</u>
Paragraph (c), second sentence	SBE staff & CAA	The value may be estimated by reference to the price at which the lessor could be expected to sell the property at fair market value to other lessors or retailers of like property at the same trade level.
Paragraph (c), second sentence	Industry	The value may be estimated by reference to the price at which the lessor could be expected to sell the property at fair market value to other lessors or retailers of like property at the same trade level. <u>in the open market.</u>

**ATTACHMENT D
ISSUE PAPER MATRIX**

ITEM 2: INDUSTRY'S VERSION DELETES REFERENCES TO VARIOUS TRADE LEVELS		
Paragraph	Source	Position
Paragraph (d), first sentence	SBE staff & CAA	Tangible personal property leased, rented, or loaned for an extended but unspecified period or leased for a term of more than six months, having tax situs at the lessee's situs as provided in regulation 204, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade as the lessee.
Paragraph (d), first sentence	Industry	Tangible personal property leased, rented, or loaned for an extended but unspecified period or leased for a term of more than six months, having tax situs at the lessee's situs as provided in regulation 204, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer operating at the same level of trade as the lessee. <u>in accordance with subdivision (b).</u>
Paragraph (e), first sentence	SBE staff & CAA	Tangible personal property acquired from internal sources for self-consumption or use, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer using the property at the same trade level.
Paragraph (e), first sentence	Industry	Tangible personal property acquired from internal sources for self-consumption or use, shall be valued by estimating the cash price or its equivalent for which the property could be sold at fair market value to an outside customer using the property at the same trade level <u>an external wholesale or retail customer, and in accordance with subdivision (b).</u>
Paragraph (f), last sentence	SBE staff & CAA	The property shall be valued based on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).
Paragraph (f), last sentence	Industry	The property shall be valued based on how it is situated or used on the lien date pursuant to subdivisions (b), (c), (d), and (e).

**ATTACHMENT D
ISSUE PAPER MATRIX**

ITEM 3: INDUSTRY'S VERSION INCLUDES WARRANTY ADJUSTMENTS		
Paragraph	Source	Position
Paragraph (b), last sentence	SBE staff & CAA	Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state including freight or shipping cost, installation cost, sales or use taxes, and market supported entrepreneurial profit (with appropriate allowances for trade, quantity, or cash discounts).
Paragraph (b), last sentence	Industry	Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state including freight or shipping cost, installation cost, sales or use taxes, and market supported entrepreneurial profit (with appropriate allowances for trade, quantity, or cash discounts, <u>and warranties</u>).
Paragraph (c), last sentence	SBE staff & CAA	If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessor's full economic cost of the property with a reasonable allowance for depreciation; (2) the cost indicated in subdivision (e) if the lessor is also the manufacturer; or (3) in accordance with subdivision (b).
Paragraph (c), last sentence	Industry	If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the lessor's full economic cost of the property with a reasonable allowance for depreciation, <u>and warranties</u> ; (2) the cost indicated in subdivision (e) if the lessor is also the manufacturer; or (3) in accordance with subdivision (b).
Paragraph (e), second sentence	SBE staff & CAA	If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the cost of the property in its condition and location on the lien date, had it been acquired at fair market value from an outside supplier (including labor, materials, overhead, interdivisional profits, interest on borrowed or owner supplied funds, sales or use tax, installation and other costs incurred in bringing the property to a finished state, with appropriate allowances for trade, quantity, or cash discounts, and depreciation), or (2) in accordance with subdivision (b).

**ATTACHMENT D
ISSUE PAPER MATRIX**

Paragraph (e), second sentence	Industry	If that price is unknown, then the value may be estimated by reference to one or more of the following indicators of value: (1) the cost of the property in its condition and location on the lien date, had it been acquired at fair market value from an outside supplier (including labor, materials, overhead, interdivisional profits, interest on borrowed or owner supplied funds, sales or use tax, installation and other costs incurred in bringing the property to a finished state, with appropriate allowances for trade, quantity, or cash discounts, and depreciation, <u>and warranties</u>), or (2) in accordance with subdivision (b).
Paragraph (e), last sentence	Industry	<u>This discount should be further increased for the value of a manufacturer's warranty which normally accompanies equipment sold to others, but does not so accompany equipment used by the manufacturer for internal purposes.</u>
Paragraph (e), last sentence	SBE staff & CAA	This discount should be further increased for the value of a manufacturer's warranty which normally accompanies equipment sold to others, but does not so accompany equipment used by the manufacturer for internal purposes

**ATTACHMENT D
ISSUE PAPER MATRIX**

ITEM 4: CAA VERSION DELETES PROPANE GAS TANK EXAMPLE INDUSTRY VERSION REWRITES PROPANE GAS TANK EXAMPLE		
Paragraph	Source	Position
Paragraph (d)(1)	SBE staff	For purposes of subdivision (d) tanks and other tangible property used as a means of storage, delivery, or transfer of liquefied petroleum gas products are considered leased, rented, or loaned to the ultimate consumer of the gas if this consumer is required to pay sales tax, installation, maintenance, or any periodic charge for the tank.
Paragraph (d)(1)	CAA	For purposes of subdivision (d) tanks and other tangible property used as a means of storage, delivery, or transfer of liquefied petroleum gas products are considered leased, rented, or loaned to the ultimate consumer of the gas if this consumer is required to pay sales tax, installation, maintenance, or any periodic charge for the tank.
Paragraph (d)(1)	Industry	<p>For purposes of subdivision (d) tanks and other tangible property used as a means of storage, delivery, or transfer of liquefied petroleum gas products are considered leased, rented, or loaned to the ultimate consumer of the gas if this consumer is required to pay sales tax, installation, maintenance, or any periodic charge for the tank.</p> <p><u>Tanks and other tangible personal property used as a means of storage, delivery, or transfer of liquefied petroleum gas products, whether leased, rented, or loaned, and regardless of situs, shall be valued at owners full cost less a reasonable allowance for depreciation. Cost may include cost of the property, freight, sales tax or use tax.</u></p>

**BOARD OF EQUALIZATION
REVENUE ESTIMATE**

ISSUE #99-038**Property Tax Rule 10, Trade Level for Tangible Personal Property****Proposal**

Board staff has proposed amendments for Property Tax Rule 10, Trade Level for Tangible Personal Property. The issue paper considers the alternatives to these amendments as proposed by industry and by the county assessors.

Background, Methodology, and Assumptions

Under the trade level concept, property is assessed based on its location and use on the lien date. Trade level adjustments ensure that property is valued at market value and are most frequently applicable to leased equipment and to equipment that is self-consumed by the manufacturer.

The issue paper deals with the four items that remain unresolved among the three proposals. The two matters of greatest consequence are the deletion of references to trade level and the adjustment for warranty. These differences would significantly affect valuations in the computer hardware manufacturing industry.

Discussions last year with the Assessor's office in Santa Clara County indicate that total personal property and fixture values for computer hardware manufacturers in the county exceed \$3 billion. Also based on information from Santa Clara County, it is estimated that up to one-half of this is self-constructed equipment that will be affected by the trade level adjustments and that the alternative proposed by industry could reduce the assessed value by as much as one-third. For Santa Clara County, the annual maximum reduction in assessed value under the alternative proposal is: \$3 billion x 1/2 x 1/3 = \$500 million. We estimate that Santa Clara represents close to 50 percent of the total statewide computer hardware manufacturing industry. Total statewide assessed value attributable to the self-constructed equipment at issue could be, but probably is no more than, \$1 billion.

Another unresolved item is the reference to fixtures; it is deleted in the industry's version of Rule 10. This deletion should not have a revenue effect since the assessors will continue to apply trade level adjustments to fixtures with or without the explicit reference.

The last matter under discussion is the propane gas tank example. Under the version proposed by staff, propane gas tanks would typically be valued at the trade level of the ultimate consumer of the gas. In the industry version, the tanks would be valued at the trade level of the propane gas company. In the California Assessors Association (CAA) version, the example is deleted and, since no specific instruction is provided, the varying assessment practices currently in place would continue.

Staff estimates that there are 300,000 households that use propane. Assuming that this count closely approximates the number of tanks owned by the fuel suppliers instead of the consumer and that the average difference in assessed value between the staff and industry proposals is \$100, then the assessed value of these tanks under the industry version is \$30,000,000 (300,000 x \$100) lower than the staff proposal.

Under current practice, some counties make a trade-level adjustment and some do not; more or less, an amalgam of the staff and industry proposals. Therefore, the effect of continuing current practice would be much less than that of the industry version. It is likely that the assessed value of the tanks under the CAA version is only \$12 - \$15 million lower than the staff proposal.

Revenue Summary

There is no revenue change for the staff recommendation. Under the industry proposal, the decrease in property taxes at the basic one percent property tax rate is about \$10 million [(\$1 billion + \$30 million) x 1 percent] annually. Property taxes at the basic one percent property tax rate under the CAA proposal are \$120,000 to \$150,000 lower annually than under the staff recommendation.

Preparation

This revenue estimate was prepared by Aileen Takaha Lee, Statistics Section, Agency Planning and Research Division. The estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division. For additional information, please contact Ms. Aileen Takaha Lee at 445-0840.

Current as of November 10, 1999.