



STATE BOARD OF EQUALIZATION
PROPERTY AND SPECIAL TAXES DEPARTMENT
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0064
916 445-4982 • FAX 916 323-8765
www.boe.ca.gov

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June 27, 2005

TO INTERESTED PARTIES:

EMISSION REDUCTION CREDITS RELATING TO
STATE-ASSESSED ELECTRIC GENERATION FACILITIES

At the March 22, 2005 Property Tax Committee meeting, the committee heard discussion regarding the current practice of assessing the cost of emission reduction credits (ERCs) to property owned by state-assessed electric generation facilities. The committee directed staff to initiate the interested parties process to gather information on ERCs. In Letter To Assessors 2005/029, interested parties were invited to provide comments on the issue. Enclosed is a matrix summarizing the comments received.

An interested parties meeting will be held on July 12, 2005 to discuss the comments submitted. The meeting will begin at 9:30 a.m. at the Board's headquarters in Sacramento, 450 N Street, Room 122. The issue is scheduled for discussion before the Property Tax Committee at the September 1, 2005 meeting.

All documents regarding the project on the taxability of ERCs owned by state-assessed electric generation facilities are posted to the Board's website at www.boe.ca.gov/proptaxes/erctimeline05.htm. If you plan to attend the interested parties meeting on July 12, please advise Mr. David Yeung at david.yeung@boe.ca.gov or 916-324-2812. If you are unable to attend the meeting in Sacramento but would like to participate by telephone, you may contact Mr. Yeung to receive conference call information.

Sincerely,

/s/ Dean R. Kinnee

Dean R. Kinnee, Chief
Assessment Policy and Standards Division

DRK:sk
Enclosure

**COMMENTS ON EMISSION REDUCTION CREDITS
RELATED TO STATE-ASSESSED ELECTRIC GENERATION FACILITIES**

No.	SOURCE	COMMENTS
1	<p>Bob Poole, Western States Petroleum Association</p> <p>Terry Palmer, Sempra Energy</p>	<p>WSPA agrees with and supports the position set forth by Board Member Leonard—that ERCs are intangible assets and rights, the value of which must be excluded in the assessment of electric generation facilities or of any other facilities which use ERCs. WSPA contends that ERCs are comparable to billboard use permits and liquor licenses in that their presence may be assumed for purposes of valuing taxable property when put to beneficial or productive use, but the value of the permit or license should not be included with or added to the value of the taxable property. For that reason, ERCs should be excluded as an element of the cost approach to value and, when the income or sales comparison approach to value is used, an increment of value must be deducted to avoid inclusion of ERCs' value in the full market value of the tangible, taxable property being assessed.</p> <p>The SBE has previously determined that billboard use permits, while necessary for operating a billboard, are an intangible asset or right which must be excluded from the assessed value of the billboard. Likewise, the California Supreme Court has held that liquor licenses are not subject to property taxation, though the presence of a liquor license may be assumed when valuing a property for property tax purposes. ERCs are consistent with billboard use permits and liquor licenses and, for property tax purposes, ERCs should be treated in the same manner as these two other forms of intangible assets and rights.</p> <p>Former SBE Chief Counsel Timothy Boyer stated that ERCs should be assessed for property tax purposes because ERCs are a "substitute" for pollution control equipment. Because pollution control equipment will, in most instances, fall into the category of economic or external obsolescence, its value will be excluded from the final value of a power plant or other industrial facility. Consequently, whether ERCs are considered directly (and their value excluded because they are intangible) or indirectly as a substitute for pollution control equipment (the value of which is deducted as economic obsolescence), the net result will be the same—the value attributable to ERCs will be excluded from the value of the taxable tangible real or personal property.</p>

2	<p>Dorothy Rothrock, California Manufacturers & Technology Association</p> <p>Terry Palmer, Sempra Energy</p>	<p>CMTA believes that ERCs are intangible assets and rights, the value of which should be excluded in the assessment of electric generation facilities and any other facilities which use ERCs. CMTA believes that the existence of appropriate permission to operate a plant or facility should be assumed when valuing property in beneficial use, but that any other value derived from the existence of an ERC should be explicitly excluded from the property valuation. SBE treatment of liquor licenses and billboard permits should guide SBE policies to be adopted for ERCs. Like them, and unlike attributes like zoning, ERCs are intangible rights to operate and can be separated from a particular piece of property being assessed.</p> <p>This is consistent with our position that pollution control equipment, an alternative to purchasing or maintaining ERCs, should also not be assessed for property tax purposes. Such investments to achieve regulatory compliance do not add to the productive output or profitability of a venture, and should not result in increased valuation for purposes of taxation.</p>
3	Terry Palmer, Sempra Energy	<p>Sempra agrees with Board Member Bill Leonard's position that ERCs are intangible assets and rights, the value of which should be excluded from the assessment of electric generation facilities and other facilities or taxpayers that hold or use ERCs.</p> <p>ERCs are properly analogized to billboard use permits. LTA 2002/078 states:</p> <p>The siting, construction, and operation of billboard properties is regulated by the Outdoor Advertising Act and/or by county or municipal ordinances. The Outdoor Advertising Act or these local laws (or both in the some instances) control the issuance of billboards use permits. State and local governments have used these laws to limit the number of billboards in many areas. By regulating (i.e., limiting) the number of billboard use permits, government has increased the value of existing billboard properties. The value resulting from the scarcity of billboard use permits should be attributed to the use permits and not to the billboard improvements.</p> <p>Like billboard use permits, ERCs are regulated by, and their creation and issuance is controlled by, federal, state and local governments. Applicable law works to limit the number of ERCs that are available. Such regulation has led to a scarcity of ERCs and increased their value. As with billboard use permits, this increase in value should be attributed to the intangible ERC and not to tangible property.</p>

4	Rick Auerbach, Los Angeles County Assessor	<p>We believe that emission reduction credits that are used by an electric generation facility to meet an air pollution control district's permitting requirement are properly classified as taxable property. Our position is aligned with the Board's legal staff's opinion expressed by Chief Counsel Timothy Boyer in his letter dated October 22, 2004. He stated that such ERCs are classified as taxable intangible attributes and should be included in the valuation of the electric generation facilities (improvements/fixtures).</p> <p>When electric generation operators construct a new facility, they must apply for an "authority to construct permit" and a "permit to operate" from the local air pollution control district. Hence, ERCs are much like the permits that must be issued by the building and safety departments of municipalities prior to the start of any new construction. Such building permits are universally considered to be assessable, including in the AH 501, which classifies new construction permits as a component to be included in the cost approach.</p> <p>ERCs that are used by an electric generation facility to meet an air pollution control district's permitting requirement are site specific and allow the facility to be constructed and used for the purpose intended. It is the highest and best use of the property. Absent these ERCs, the facility would have to construct an emission control system, which is an obvious taxable fixture, to meet the emission requirements. When an electrical generating facility utilizes ERCs to operate, the value of the ERCs should be reflected in the value of the taxable property. The decisions of <i>Freeport-McMoran Resource Partners v. Lake County</i>, 12 Cal.App.4th 634 and <i>Watson Cogeneration Co. v. Los Angeles County</i> (2002) 98 Cal.App.4th 1066 support this position.</p> <p>If ERCs are utilized and deemed non-assessable, there would be a lack of equalization on the assessment of electrical generating facilities. One facility which built emission control systems instead of purchasing ERCs would be assessed for its system while another competing facility would not have an equivalent assessment. In fact, the prudent non-polluting company would be assessed while the polluter would benefit from not having such an assessment.</p>
5	Erika Frank, California Chamber of Commerce	<p>The Chamber agrees with and supports the position that ERCs are intangible assets and rights related to the going concern value of a business and therefore are nontaxable. In essence, we believe that ERCs should not be included in the assessment of electric generation facilities or of any other facilities that use ERCs because they are not attributes of the property but rather are required for the operation of equipment.</p> <p>ERCs are not part of the equipment nor are they connected to the equipment in any manner. Rather, the ERCs convey a right to operate. In this regard, ERCs are analogous to liquor licenses. Liquor licenses give a business the right to sell alcoholic beverages. The liquor license remains with the business even if the location of the business is sold or conveyed. Thus, the liquor license relates to the nature of the business not to a characteristic of the property itself and therefore is a nontaxable intangible asset and right.</p>

6	<p>Jay Dore, Pacific Gas and Electric Company</p> <p>Glenn Bridges, Southern California Edison Company</p>	<p>PG&E and SCE agree with the SBE Member Bill Leonard and support his position that ERCs are intangible assets and rights that should be treated by the Board staff as non-taxable intangible assets. ERCs are not integral to any particular plant and may be transferred to any other business operator or entity. Alternatively, ERCs may be "banked" for possible future use. Based on constitutional and statutory definitions, ERCs are comparable to permits or licenses that are treated as nontaxable intangible property by the courts and by the Board.</p> <p>The Board's appraisal guidelines (AH 502, p. 150) stipulate that in California, the treatment of intangible assets and rights is governed by the fundamental principal that intangible assets and rights are not subject to taxation. R&T Code section 212(c) also states that intangible assets and rights are exempt from property taxation and that the value of intangible assets and rights shall not enhance or be reflected in the value of taxable property. Section 110(d)(1) provides that the value of intangible assets and rights relating to the going concern value of a business shall not enhance or be reflected in the value of the taxable property.</p>
7	<p>Teresa Casazza, Cal-Tax</p> <p>Terry Palmer, Semptra Energy</p>	<p>Cal-Tax was the sponsor of the original bill (SB 657 [Maddy] 1995) that enacted the statutes relating the property tax treatment of intangible assets and rights. The appropriate treatment of ERCs is outlined in California R&T Code section 110(d)(1) which states that the value of intangible assets and rights relating to the going concern value of a business shall not be reflected in the value of the taxable property.</p> <p>ERCs are analogous to liquor licenses. The permitting agency allows a certain number of permits for a specific area, but does not necessarily issue permits based on a specific location's attributes. The liquor license remains even if the location is sold or destroyed, and the license can be transferred to another facility which is completely different from the original location. The liquor license relates to the nature of the business using the property as opposed to a characteristic of the property itself. The same is true for ERCs. If a saloon is replaced by a Jamba Juice, the liquor license is no longer needed and can be sold. If a manufacturing site is replaced by an amusement park, the ERC is no longer needed and can be sold. There is no direct connection between the ERC and the nature of the property itself.</p> <p>This treatment of ERCs is distinguishable from intangible attributes of property such as zoning referred to in California R&T Code section 110(e). Those attributes are clearly and, of necessity, related to a specific property. Zoning or location cannot be separately traded from the real property to which it relates. ERCs, however, are not tied to a specific piece of real property or equipment, and may be used at any location where needed. This key fact places ERCs in the category of nontaxable intangible assets and rights.</p>

8	Cliff Clement, Calpine Corporation	<p>The position of Calpine Corporation is that ERCs are nontaxable intangible assets and rights, the value of which should be excluded in the assessment of electric generation facilities and other facilities which use ERCs.</p> <p>ERCs are intangible assets that can be banked, traded or sold to another facility and can be separated from a particular piece of property when the nature of the business changes and ERCs are no longer needed, i.e., there is no direct connection between ERCs and the property itself. A similar situation exists regarding SBE treatment of liquor licenses, which can be sold or transferred to a facility operating in a different location within a particular region and are not tied to a specific piece of property. ERCs and liquor licenses are intangible assets or rights, which can be separated from the property being assessed.</p> <p>Calpine Corporation believes that ERCs are in the category of intangible assets or rights and should not be assessed for property tax purposes.</p>
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