STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/20/04**	Bill No:	**AB 2592**
Tax:	**Property**	Author:	**Campbell**
Board Position:		Related Bills:	

BILL SUMMARY

This bill would require local assessors and the State Board of Equalization (Board) to assess taxable personal property at the actual cost to the taxpayer, adjusted annually for depreciation, beginning with fiscal year 2005-06.

Current Law

Article XIII, Section 2 of the California Constitution authorizes the Legislature to classify personal property for differential taxation for exemption by means of a statute approved by a 2/3 vote of the membership of each house.

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

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

Valuation Process. Generally, the valuation of personal property is based on the acquisition cost of the property. The acquisition cost is multiplied by a price index, an inflation trending factor based on the year of acquisition, to provide an estimate of its reproduction cost new. The reproduction cost new is then multiplied by a depreciation index, also called percent good tables, to provide an estimate of the depreciated reproduction cost of the property (reproduction cost new less depreciation). The reproduction cost new less depreciation value becomes the taxable value of the property for the fiscal year.

The Board annually publishes Assessors' Handbook Section 581, "Equipment Index and Percent Good Factors." http://www.boe.ca.gov/proptaxes/ahcont.htm This handbook section contains several tables of equipment index, percent good, and valuation factors that aid in the mass appraisal of various types of personal property. Generally, using this published information will provide a value estimate within a reasonable band of value for the assessment of business property. Additionally, using the published information serves to promote statewide uniformity in the assessment of this property.

Proposed Law

This bill would require the Board and the assessor to assess any taxable personal property at that property's actual cost to the taxpayer, as adjusted annually for depreciation. ''Actual cost'' is defined to mean the value of the total consideration, if any, given by the taxpayer or on behalf of the taxpayer in exchange for the personal property.

COMMENTS:

1. **Sponsor and Purpose.** This bill is sponsored by the author to reduce the administrative cost of assessing personal property.

2. **Mass appraisal techniques must be used in valuing personal property.** The assessment of personal property for tax purposes is by necessity a mass appraisal system. Generally, the foundation of this mass appraisal system is based on the acquisition cost.

3. **Eliminates Price Trending.** This bill would eliminate trending actual cost by a price index to account for inflation to provide an estimate of reproduction cost new prior to taking into account depreciation. Instead, as currently drafted, it appears that only a deduction for depreciation would be permitted.

4. **Cost Approach Only**. This bill limits the assessment of personal property to the cost approach to value. This is the approach most often used to value this class of property for tax purposes. However, there are other instances when other approaches to value are preferred. For instance, for boats, planes, and manufactured homes the preferred approach is the market approach using various commercially published market value guides (i.e., "blue book" values).

5. **Full Economic Cost.** When the cost approach to value is used, the cost should include the full cost of placing the property in service. Full economic costs typically incurred in bringing the property to a finished state, including labor and materials, freight or shipping cost, installation costs, and sales and use taxes. This bill may not allow full economic costs to be assessed.

6. **Self-Constructed Property.** In some cases, "actual cost" will not equal fair market value. This is the case of self-constructed property. Currently, Property Tax Rule 10, "Trade Level for Tangible Personal Property" requires that property acquired from internal sources for self-consumption or use shall be valued at the price at which it would be sold to an outside consumer at the same trade level. There are many companies in California that manufacture and use large volumes of their own equipment; for instance computer-related equipment.

7. **Property Aquired at No Cost.** Would property that was acquired or inherited at "no cost" be exempt from any property tax under this bill?

8. **Winners and Losers.** This bill results in winners (lower taxes) and losers (higher taxes). For some, actual cost less depreciation may exceed current market value while for others it may be less than current market value.

9. **State Assessed Property – Unitary Valuation.** Unlike locally assessed property, both real and personal property of state assessees is valued annually at fair market value. Assessment of only personal property at actual cost would conflict with the Board's unitary valuation methods – for instance the income approach to value.

COST ESTIMATE

The Board would incur insignificant costs (less than $10,000) in informing and advising county assessors, the public, and staff of the change in law.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Existing property tax law requires that all taxable personal property be assessed at fair market value. For purposes of this bill, "fair market value" is defined as the amount of cash or its equivalent that property would bring if exposed for sale in the open market.

To arrive at fair market value for most personal property, the cost of the property reported by the taxpayer is trended, usually upward, using an index factor, to arrive at reproduction cost new, an estimate of what the property would cost in today's marketplace. Fair market value is then determined by taking the reproduction cost new, and applying a percent-good depreciation factor. For some types of personal property, comparable sales or commercially published value guides are used to determine fair market value.

Under this bill, actual cost is computed by taking the cost of the property reported by the taxpayer, and applying a percent-good depreciation factor. Unlike the fair market valuation approach, the actual cost method does not allow for the property to first be trended upward.

Locally Assessed Personal Property

The impact of using actual cost valuation on personal property will vary depending on the age and type of the property, as well as the useful life of the property. On average, when using actual cost valuation, percentage loss of locally assessed personal property value is estimated at between 20% and 25%.

Revenue Impact for Locally Assessed Personal Property

Total locally assessed personal property, 2002-03 BOE Annual Report	$152.5 billion
Average % loss of locally assessed personal property	x 20% - 25%
Total loss of locally assessed value	$30.5 - $38.1 billion
Multiplied by the local 1% tax rate	x 1%
Total estimated revenue loss for locally assessed property	$305 - $381 million

Included in the percentage loss described above is in the case of counties with a large concentration of manufacturing; specifically, personal computers, photocopiers, and fax machines, where a significant number of units produced are self-constructed. Santa Clara County estimates a loss of $1 to $2 billion in assessed value, or $10 to $20 million in revenue. Assuming the statewide impact will be double the impact of Santa Clara County, staff estimates the statewide revenue loss for the adjustment for self-constructed equipment for trade level to be $20 to $40 million.

State-Assessed Personal Property

The impact of this bill on state-assessed personal property varies. Following is a breakdown of state-assessed personal property totals for 2002-03:

Gas & Electric Companies	$1,748,968,446
Telecommunications Companies	10,728,189,956
Railroads	232,619,750
Total State-Assessed Personal Property	$12,709,778,152

The total value of state-assessed property for 2002-03, including land, improvements, and personal property, was $69.2 billion.

Revenue Impact for State-Assessed Personal Property

Staff estimates that the revenue impact of this bill on different state-assessed properties will vary.

Gas and electric companies are currently assessed at historical cost less depreciation. Therefore, little to no impact is expected on assessed value.

Technological advances in telecommunication electronic switching and fiber optics are reducing the cost of replacement units and equipment. Assuming actual cost as a valuation method, an increase in assessed value is estimated at $5 billion.

Railroads are currently valued using the income approach. According to staff, utilizing actual cost would double the assessed value of personal property of railroads, $232.6 million for 2002-03.

Gas & Electric Companies		Little to no impact
Telecommunications Companies	$5.0 billion x 1% tax rate =	$50.0 million
Railroads	$232.6 million x 1% tax rate =	=$ 2.3 million
Total estimated revenue gain for state-assessed property		$52.3 million

Revenue Summary

The estimated annual revenue impact at the basic one percent property tax rate can be summarized as follows:

Locally assessed	$305 million to $381 million	loss
State-assessed	$52.3 million	gain
Total	$252.7 million to 328.7 million	net loss

Qualifying Remarks

The impact of this bill on individual properties will differ. For example, personal property acquired by the taxpayer at no cost, gifts or otherwise, would not be taxable, resulting in significant revenue loss in some cases. Conversely, the assessed value of personal property whose replacement cost is lower than its actual cost will increase, resulting in a revenue gain.

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