State of California

Board of Equalization
Legal Department-MIC: 83
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Memorandum

To: Honorable Betty T. Yee, Chairwoman
Honorable Jerome E. Horton
Ms. Barbara Alby, Acting Board Member
Honorable Michelle Steel
Honorable John Chiang

Date: April 29, 2010

From: Kristine Cazadd
Chief Counsel

Subject: Other Chief Counsel Matters – May 25-26, 2010
Item Number M1
Request for Authorization to File *Amicus Curiae* Brief

Orange County Superior Court - *consolidation of the following four cases:*
Netjets Aviation Inc. v. Webster J. Guillory, Case Number 30-2008-00107805-CU-MC-CJC;
Flight Options LLC v. Webster J. Guillory, Case Number 30-2008-00110932-CU-MC-CJC;
CitationShares Management LLC v. Joseph E. Holland, Santa Barbara County Assessor, Case Number 30-2009-00288116-CU-MC-CJC; and
Bombardier Aerospace Corp. v. Joseph E. Holland, Santa Barbara County Assessor, Case Number 30-2009-00303518-CU-MC-CJC.
(Gov. Code, § 11126(e))

The Legal Department requests the Board's authorization to file an amicus curiae brief in the above-referenced consolidated local property tax action challenging the fractionally owned aircraft taxation statutes that were adopted on August 24, 2007, and became effective on January 1, 2008 (Rev. & Tax. Code, §§ 1160 et seq.). Santa Barbara County has requested that the Board of Equalization (Board) file an amicus brief in support of the counties' position in defending the validity of the statute, the enactment of which the Board supported in 2007. (See attached letter)

Senate Bill 87, effective January 1, 2008, established, for the first time, a fleet-wide method of assessment for fractionally owned aircraft, similar to the method already used to assess commercial aircraft. It expressly provides that a fleet of fractionally owned aircraft operated pursuant to a fractional aircraft ownership agreement obtains situs in California when any aircraft within the fleet lands in California. (Rev. & Tax. Code, § 1161, subd. (b).) It also provides a value allocation or pro rata formula to ensure that the fleet is taxed in a manner reflecting its actual presence in the state, and in a particular county. Specifically, a fleet of fractionally owned aircraft is assessed on an allocated basis, and value is apportioned to each county based on that county's annual share of landings and departures of each aircraft type in the fleet as a proportion of total annual worldwide landings and departures. (Rev. & Tax. Code, § 1161, subd. (c).) Until the enactment of the statute at issue, fractional aircraft owners enjoyed a tax advantage or "loophole," and consequently, an economic and business advantage that was not available to commercial carriers.

Senate Bill 87 included detailed findings that: (1) a substantial portion of business aviation aircraft is owned and operated under fractional ownership agreements; (2) such fractionally-owned aircraft have a substantial presence in California; (3) taxing such aircraft on an aircraft-by-aircraft basis places undue burden on both taxpayers and tax officials; (4) aircraft are constitutionally required to be taxed; and (5) the proposed assessment of fractionally-owned aircraft is appropriate and fair, allocates assessed value among counties in a reasonable manner, and reduces the administrative burden on taxpayers and county assessors. (See attached Bill Analysis.)

To date, four major fractional aircraft ownership operators (NetJets, Flight Options, CitationShares, and Bombardier) have filed lawsuits against two counties, Orange County and Santa Barbara County, all of which have been consolidated into one action in Orange County Superior Court. The complaints seek declaratory relief under Revenue and Taxation Code section 4808 (and under the authority of Code of Civil Procedure section 1060, et seq.) that tax assessments and collections under Revenue and Taxation Code sections 1160-1162 (Senate Bill 87) are illegal and unconstitutional because the statute: (1) imposes liability for personal property tax on managers in control of the fleet rather than the owners; (2) assesses property tax based on an entire "fleet" of aircraft even though individual aircraft within the fleet or the owners may not have established a property tax situs in California; (3) seeks to levy an unlawful retroactive tax, predating the tax year in which it was enacted; and (4) purports to impose a tax on aircraft registered with the Federal Aviation Administration (FAA) as fractionally owned, even though the FAA does not register any aircraft as "fractionally owned." Currently, the consolidated case is still in the discovery stage. (See attached letter from Deputy County Counsel.)

The California Assessors' Association has estimated that the statute in question will result in one-time statewide tax revenues on escape assessments of approximately $30-$40 million, which we understand will apply retroactively to assessment years 2003-2007 (the bill became effective for the 2007-2008 assessment year). Furthermore, if upheld, the statute also will result in anticipated on-going statewide tax revenues of approximately $10-$25 million per year, distributed among the California counties.

Due to the Board's prior support of the legislation, the significance of the statewide legal issues, and the materiality of the assessments, we recommend that the Board grant authorization to the Legal Department to file an amicus brief in this case in both the trial court and, if necessary, the appellate courts. If you need more information or have any questions, please contact Assistant Chief Counsel Robert Lambert at (916) 324-6593 or Tax Counsel IV Richard Moon at (949) 440-3486.

Approved:

Ramon J. Hirsig
Executive Director

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Attachments: (1) Letter from County of Santa Barbara, County Counsel's office dated March 22, 2010; and (2) Legislative Division's Bill Analysis of Senate Bill 87.

cc:	Mr. Ramon J. Hirsig	MIC: 73
	Mr. David Gau	MIC: 63
	Mr. Robert Lambert	MIC: 82
	Mr. Randy Ferris	MIC: 82
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COUNTY OF SANTA BARBARA

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COUNTY COUNSEL

March 22, 2010

Via Electronic and U. S. Mail

Robert W. Lambert
Assistant Chief Counsel
Litigation Division/Legal Department
State Board of Equalization
P.O. Box 942879
Sacramento, CA 94279

Re: CitationShares Management, LLC v. Joseph E. Holland, Santa Barbara County Assessor, Orange Superior Court Case No. 30-2008-00107805, [Consolidated with Orange County Superior Court Case Nos. 30-2008-00107805,30-2008-00110932 and 30-2009-00303518]

Dear Mr. Lambert:

As counsel for the Assessor for the County of Santa Barbara, I ask that you consider this request for amicus support in the ongoing fractionally owned aircraft litigation. All four of the consolidated cases identified above will be heard by Judge William Monroe in Department C16 of Orange County Superior Court.

Background

Fractional owned aircraft companies have evolved over the last two decades to cater to clients with enough resources to buy a share of a private jet. In the "fractional jet" industry, owners buy anywhere from one-16th to half ownership of a jet and share it with other co-owners. Fractional owners also pay monthly management fees to the operating company, as well as fuel and other in-flight costs. These owners don't necessarily always fly on the plane they own; if their plane is in use, the company will provide another similar plane.

Full owners of private planes, as well as commercial airline companies, have long paid property taxes on their planes, but until now California had not come up with a method of taxing the fractional plane owners. The mix of ownership interests and the unscheduled usage made it practically impossible to assess and tax these fleets on an aircraft-by-aircraft basis.

To date, no other state has been able to successfully tax these companies and they are very proud of that fact. The non-taxation of these aircraft creates a very unequal playing-field between the fractional-operators and the large commercial carriers such as Delta, United and American etc. who properly pay their taxes.

To address this problem, Revenue and Taxation Code sections 1160-1162 were enacted in 2008. The new law applies a fleet-wide method of assessment similar to the method already used to assess commercial aircraft. It imposes a 1 percent tax on the value of a fractionally owned fleet based on the number of takeoffs and landings the fleet makes in California

Fractional Aircraft Litigation

The four major fractionally owned aircraft companies (NetJets, Flight Options, CitationShares and Bombardier) filed declaratory relief lawsuits in 2009 to challenge the constitutionality of the new law. Two of the lawsuits were filed in Santa Barbara County and two were filed in Orange County. Pursuant to Revenue and Taxation Code section 4808, the named respondent in each lawsuit is the County assessor. All four lawsuits have been consolidated and are currently pending in Orange County Superior Court.

The goal of the consolidated lawsuits is to invalidate Revenue & Taxation Code sections 1160 - 1162. Those statutes provide new methodology for the assessment of fractionally owned aircraft and also allow assessors to file escape assessments retroactively for 4 years. The California Assessors' Association has estimated the one-time lump sum for escape assessments to be between **$30 - $40 million**. The on-going annual revenue will be **$10 to $25 million** allocated among California counties based on the number of takeoffs and landings for each fleet in each respective county.

Santa Barbara's Allocation of Tax Revenue

Santa Barbara's allocated portion of the Taxable Value for the fractionally owned fleets is small because fractionally owned aircraft make relatively few takeoffs and landings in this county. However, since two of the lawsuits were filed in Santa Barbara County, our county (with the assistance of Orange County) is defending this case on behalf of all California counties.

Relevant Litigation Dates

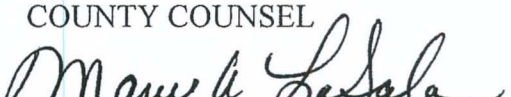
Mar. 31, 2010	Discovery/Motion Cut-Off
Apr. 01, 2010	Initial Expert Witness Disclosures
Apr. 30, 2010	Supplemental Expert Witness Disclosures
May 28, 2010:	Deadline to complete all expert depositions
Jun. 07, 2010:	Plaintiffs' deadline to file and serve dispositive motions

Jul. 05, 2010:	Defendant Assessors' deadline to file and serve oppositions
Jul. 19, 2010:	Plaintiffs' deadline to file and serve replies
Aug.06, 20I0:	Hearing on dispositive motions [9:30 am Dept C16]

Thank you for our consideration. If you have any questions regarding this litigation please fee free to contact me.

Best regards,

DENNIS A. MARSHALL
COUNTY COUNSEL



Marie A. La Sala
Deputy County Counsel

MLS/cd
cc: Rick Holly, Chief Deputy Clerk-Recorder-Assessor
Joseph E. Holland, Clerk-Recorder-Assessor
James Harman, Supervising Deputy County Counsel

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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**07/19/07**	Bill No:	SB 87
Tax:	**Property** **Sales and Use**	Author:	**Committee on Budget and Fiscal Review**
Related Bills:	**SB 77 (Budget Committee)**	Position:	**Support**

BILL SUMMARY

This Budget trailer bill makes changes necessary to implement the Budget Act of 2007. This bill, among other things unrelated to the Board, does the following:

- Establishes streamlined property tax administration procedures to use in the assessment of fractionally owned aircraft using a centralized approach whereby the manager in control of the aircraft fleet would file a single property statement with a designated "lead" county. It also provides for coordinated multi-county audits.
- Requires annual business property statements filed with county assessors for property tax purposes to include information about the use tax, as specified.

ANALYSIS

Fractionally Owned Aircraft

Adds Article 7 (commencing with Section 1160) of Chapter 5 of Part 2 of Division 1 to the Revenue and Taxation Code

Amends Revenue and Taxation Code §441 and §5368

CURRENT LAW

Personal Property. Article XIII, Section 1 of the California Constitution provides that all property is taxable unless otherwise exempt by the state constitution or the laws of the United States. Section 2 thereof provides that the Legislature may, two-thirds of the membership of each house concurring, classify any personal property for differential taxation or for exemption. Revenue and Taxation Code Section 405[1] requires the assessor to assess all taxable property in the county and the assessor may assess the property to the person either owning or controlling the property.

Situs. In a well-established line of cases, the United States Supreme Court has held that personal property involved in interstate travel or commerce, such as an aircraft, may be subject to taxation by any state or states (or their political subdivisions) in which the property maintains a substantial presence. As a necessary precondition to the taxing power of a state or subdivision, the constitutional principle of due process requires that the property receive the "opportunities, benefits, and protections" of the taxing jurisdiction by reason of its "habitual or continuous" presence in that jurisdiction.

Property may have substantial contact with two or more states sufficient to establish a taxable situs in each of those states. If two or more states acquire the power to tax certain property owing to the property's having acquired tax situs in their states, constitutional principles relative to interstate commerce require that each state impose

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

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position

such a tax only on a nondiscriminatory basis. That is, each state may impose a tax only in proportion to the "opportunities, benefits and protections" that it affords to the property. Apportionment ensures that property is not subjected to a greater tax burden by reason of its substantial presence in more than one state.

Thus, when property has situs in California but has its permanent or primary situs in another state or country, it is taxable here only to the extent of time spent in California. Consequently, taxation of aircraft may require value apportionment.

General Aviation Aircraft and Certificated Aircraft. Currently, there are no special assessment provisions for fractionally owned aircraft used in Fractional Ownership Programs that are using California airports. The Revenue and Taxation Code contains separate provisions of law related to the taxation of aircraft depending upon one of two types of traditional ownership and use: (1) general aircraft and (2) certificated aircraft. Typically, "certificated aircraft" are commercial aircraft operated by air carriers for passenger or freight service, while "general aircraft" are typically privately owned aircraft, such an aircraft kept at a hangar at a local airport. General aircraft are assessed on an aircraft by aircraft basis and an assessment is made only in a single county where the aircraft is habitually situated – even if the aircraft routinely uses other airports in other counties in the state. Certificated aircraft are assessed based on a "fleet basis" and assessments are made for each county in which the aircraft in the fleet land.

Under current law fractionally owned aircraft that have acquired taxable situs in California would be assessed under the provisions for general aircraft. However, in actual practice, fractionally owned aircraft are a new form of ownership and these aircraft have not yet been assessed in California. Essentially, the business model of fractional ownership programs is a hybrid of general and commercial aviation.

The provisions for general aircraft are contained in Part 10 (commencing with Section 5301) of Division 1 of the Revenue and Taxation Code. The provisions for certificated aircraft are contained in Article 6 (commencing with Section 1150) of Chapter 5 of Part 2 of Division 1 of the Revenue and Taxation Code. Additionally, streamlined centralized assessment provisions have been provided for certificated aircraft in Section 441(l) which allows commercial air carriers to file a single property statement for all their holdings with a lead county and provides for centralized audits.

Mandatory Audits. Section 469 requires assessors to audit the personal property holdings of any property owner with an assessed value of more than $400,000 once every four years. These audits are commonly referred to as "mandatory audits."

Information from Airport Operators – Home Based Aircraft. Section 5366 requires airport operators to provide the local county assessor with specified information about aircraft owners that use the airport as a base by January 15 of each year.

PROPOSED LAW

This bill would add Article 7 (commencing with Section 1160) to Chapter 5 of Part 2 of Division 1 of the Revenue and Taxation Code. Article 7 would be entitled "Fractionally Owned Aircraft" and would follow Article 6 related to the assessment of certificated aircraft. Article 7 together with an amendment to Section 441 and cross references to sections of code within Part 10's provisions for general aircraft would establish the administrative procedures to use in assessing fractionally owned aircraft that use airports in California. The administrative procedure would be a hybrid of provisions for general aircraft and the simplified centralized system used for certificated aircraft as well as the fleet concept used for certificated aircraft.

This bill includes detailed findings stating that: (1) a substantial portion of business aviation aircraft is now owned and operated under fractional ownership programs, (2) the aircraft in the programs have a substantial presence in California, (3) taxing these aircraft on an aircraft-by aircraft basis would be a burden for both taxpayers and tax officials warranting simplification, (4) the aircraft are constitutionally required to be taxed, and (5) the proposed simplified procedure is appropriate and fair, allocates assessed value among counties in a reasonable manner and reduces the administrative burden on taxpayers and county assessors.

This bill specifically provides the following:

Situs. Expressly provides that a fleet of fractionally owned aircraft operated in a fractional aircraft ownership program obtains situs in California when an aircraft within the fleet lands in California. With respect to ensuring the fleet are taxed in a manner that will reflect their actual presence in California, the bill provides a value allocation formula based upon the presence of aircraft in California, as specified.

Centralized Administrative System. Implements a centralized administrative system by outlining the process for selecting the lead county for each fractionally owned aircraft program, notifying the manager of the responsible lead county to which it would file its information, and detailing the duties of the lead county.

Consolidated Property Statement. Provides that the manager in control of a fleet of fractionally owned aircraft; file a single property statement with a designated "lead" county. Flight data included in the statement would be required to be segregated by airport.

Centralized Fleet Valuation. The lead county would calculate the unallocated fleet value of aircraft operated in the fractional ownership program for each make, model, and series. This information would then be transmitted to the other counties.

Value Standard. The value of the aircraft within the fleet would be valued the same as general aircraft. That is, current market value using commercially available aircraft price guides approved by the Board.

Value Allocation. Each individual county would then determine their allocated portion of the total fleet value based on the flight data for that particular county. The formula, based upon the number of landings in, and departures from, a county in proportion to landings and departures worldwide. Each county assessor is responsible for assessing and enrolling the taxable value of the aircraft that has situs in his or her county.

Assessments. Provides that the fleet be assessed to the manager in control of the fleet.

Applicable Years. These provisions would apply beginning with fiscal years 2007-08. However, for fractionally owned aircraft that have not been previously assessed the provisions could apply for preceeding fiscal years, as specified.

Mandatory Audits - One Coordinated Audit. The lead county would head up an audit team of up to three counties. The audit would be deemed to be made on behalf of all California counties that would otherwise be required to perform a mandatory audit under Section 469

Information from Airport Operators – Aircraft using Facilities. This bill would add Section 5386 to require airport operators, upon an assessor's request, to provide information related to the aircraft that uses the airport facilities.

IN GENERAL

General Aviation Aircraft. Existing property tax law requires that aircraft, other than certificated aircraft, be valued and assessed only in the county in which it is habitually situated. General aircraft is annually reassessed each year at its current fair market value on the lien date. In valuing aircraft, the Board, pursuant to Section 5364, approves and recommends the use of certain commercially available aircraft valuation guides. These guides ensure uniformity in the valuation of aircraft in California for property tax purposes. The Board officially adopted two commercially available aircraft price guides for use when estimating the value of general aircraft: Aircraft Bluebook-Price Digest is the primary guide for valuing general aircraft, while the Vref Aircraft Value Reference is the alternate guide for aircraft not listed in the Aircraft Bluebook.

Certificated Aircraft. Certificated aircraft used by air carriers is subject to taxation when in revenue service in California. Generally, certificated aircraft are commercial aircraft operated by air carriers for passenger or freight service. Certificated aircraft are valued for purposes of property taxation under a "fleet" concept. This means that the basis of the assessed value is not the value of any single aircraft owned by an air carrier, but rather the value of ***all*** aircraft of each particular fleet type[2] (i.e., all aircraft owned of an identical make and model regardless of age) that is flown into the state. Aircraft fly in and out of the state; no single or particular aircraft remains located in the state on a permanent basis. Under the "fleet" concept, the types of aircraft that have gained situs in California by their entry into revenue service are valued as a fleet and then only an allocated portion of the entire value of the fleet is ultimately taxed to reflect actual presence in California.

The Fleet Concept - Example. An individual air carrier, Blue Sky Airlines, for example, may operate the following types of aircraft in its overall fleet: Boeing 737-300s and 737-500s, Boeing 747-400s, and Boeing 767-200s and 767-300s. Each of these types of aircraft are considered to be a fleet type. Thus, Blue Sky Airlines may have a fleet of 100 Boeing 737-500s, but only 30 of those aircraft may actually make contact in Sacramento County during the year. For purposes of property taxation in Sacramento County, the full cash value of all 100 of Blue Sky Airline's Boeing 737-500 aircraft is determined and the computed allocation ratio is applied to that value.

Valuation and Apportionment. Section 401.17 details the assessment methodology for determining the market value of certificated aircraft owned by commercial air carriers to be used for the 2005 through 2010 assessment years. (Section 401.15 details the methodology that was used for the 1997 through 2004 years) and Section 1152 provides an allocation formula to determine the frequency and the amount of time that an air carrier's aircraft makes contact and maintains situs within a county. Property Tax Rule 202, subdivision (c) provides further details in the allocation procedure. An allocation ratio is made up of two components: a ground and flight time factor, which accounts for 75% of the ratio, and an arrivals-and-departures factor, which accounts for 25% of the ratio. The sum of these two factors yields the allocation ratio, which is applied to the full cash value of a fleet of a particular type of aircraft operated by an air carrier and, thus, the calculation of the assessed value for that type of aircraft. The sum of the assessed allocated values for each make and model used by an air carrier, results in the total assessed value of the aircraft for that air carrier for a particular county.

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[2] Types are grouped by make and model. For example, Boeing 737-300s and 737-500s, Boeing 747-400s; Airbus A300-F4-600S; and McDonnnel Douglas DC 10-30s.

Centralized Assessment Procedures. Beginning in 2006, legislation established centralized assessment procedures for certificated aircraft. Section 441(l) provides a centralized system for commercial air carriers to file one annual property statement with a designated "lead" county for certificated aircraft as well as other personal property and real property fixtures located at airport locations. Additionally, Section 1153.5 provides for a coordinated multi-county audit team to perform mandatory audits of commercial air carriers. (AB 964, Ch. 699, Stats. 2005)

COMMENTS

1. **Sponsor and purpose.** This a budget trailer bill. The purpose of this provision is to establish a simplified procedure for assessing fractionally owned aircraft that is appropriate and fair, that allocates assessed value among counties in a reasonable manner, and that reduces the administrative burden on taxpayers and county assessors.
2. **Budget Bill Appropriation related to the assessment of fractionally owned aircraft.** The Budget Bill provides $3,500,000 in one time grants to county assessors (Item 9210-107-0001, page 728) if the Department of Finance determines that at least $30,000,000 in assessments has resulted from the assessment of fractionally owned aircraft fleets.
3. **What are Fractionally Owned Aircraft?** Fractionally owned aircraft, as defined by the Federal Aviation Administration (FAA), are aircraft that are privately owned and operated pursuant to FAA regulations for operations in Fractional Ownership Programs. Essentially these are fleets of aircraft that are managed and maintained by an operating company but ownership is distributed like a time-share. Participants in the programs have on demand, random access to aircraft in the program. Fractional ownership of aircraft is an overall concept using (1) shared ownership, (2) exchange of "dry leases" which allows the exchange of aircraft between owners in the program, and (3) the use of an aircraft management company. The management company handles all operating requirements of the aircraft, including availability, maintenance, billing, shareowner usage, training, and flight crews. The National Business Aviation Association estimates that 1,200 fractionally owned aircraft operate in the United States with approximately 10,000 individual owners or "shareholders."
4. **Fractional Aircraft Ownership Programs are an emerging commercial aviation industry that has rapidly expanded in the last 10 years and will likely continue to grow.** Existing law requires that the aircraft be taxed using the provisions for general aircraft. But the assessment of these aircraft does not fit well into a body of law set up for traditional forms of aircraft ownership and use. It would be administratively impractical to use these particular sections of law. Furthermore, the revenues would likely be dedicated to one county in California (the one particular airport most often used) rather than shared among the counties.
5. **This bill would create a new body of law to address these specific types of aircraft.** Fractionally owned aircraft are relatively new, and assessment has generally been deferred by the counties pending approval of the streamlined approach that also resolves the administrative difficulties.
6. **A centralized administrative system**. The central assessment of these aircraft would result in administrative efficiencies for both fractional ownership programs and counties. This bill uses elements of the recently enacted streamlined administrative approach for certificated aircraft owned by commercial airlines: one-stop reporting,

the lead county concept, and coordinated audits. It also borrows from the "fleet concept" used for assessing certificated aircraft, whereby the entire fleet is valued and then only an allocated portion of the entire value of the fleet is ultimately taxed to reflect presence in California and the individual counties within California.

7. **Revenue distribution - sharing California's portion of allocated value among the counties.** The value allocation between counties within the state would be more similar to that used for certificated aircraft than general aircraft. Specifically, value would be apportioned to each county based on that county's annual share of landings and takeoffs of each aircraft type in the fleet as a proportional of total annual worldwide landings. With general aircraft, value is allocated to a single county.

8. **Supporters note that fractional ownership programs are currently enjoying a competitive advantage**. Both charter operators of aircraft located at airports based in California or that habitually use California airports and aircraft owned by commercial airlines using California airports are subject to property tax. Both of these commercial sectors are losing customers to the fractional ownership programs.

9. **Various terms used in the bill would benefit from expansion and clarification to avoid implementation uncertainties and the creation of opportunities to restructure the ownership programs to avoid assessment under the proposed provisions.**
   - This bill expressly provides that the fleet will be assessed to the "manager in control of the fleet" but the phrase is not defined. Providing a definition of this term would be beneficial.
   - It would also be beneficial to specify the circumstances under which an aircraft is "operated" by a manager for purposes of determining the composition of specific fleets.
   - While the bill states that a "notice of assessment" will be "issued" to the manager in control of a fleet, it does not expressly state that the "notice" will ultimately result in a property tax assessment resulting in a property tax liability that, presumably, the bill intends for the manager to pay the taxes on behalf of the fractional owners.

Use Tax and the Business Personal Property Tax

Revenue and Taxation Code §452

CURRENT LAW

Use Tax. Under the existing Use Tax Law, Chapter 3 (commencing with Section 6201) of Part 1 of Division 2 of the Revenue and Taxation Code, a use tax is imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless that purchaser pays the use tax to a retailer registered to collect the California use tax, the purchaser is liable for the tax, unless the use of that property is specifically exempted or excluded from tax. The use tax is the same rate as the sales tax and is required to be remitted to the Board on or before the last day of the month following the quarterly period in which the purchase was made, or to the Franchise Tax Board (FTB) via the income tax return. A use tax liability is primarily a result of a California consumer or business making a purchase of an item for their own use from an out-of-state retailer that is not registered with the Board to collect the use tax.

Business Personal Property Tax. Under existing property tax laws, an ad valorem tax is imposed every year on all assessable personal property used in a trade or business at its current fair market value. In making this annual assessment, taxpayers typically report the cost of their property holdings to the local county assessor on the "business property statement" as provided for in Section 441. The business property statement shows all taxable property, both real and personal, owned, claimed, possessed, controlled, or managed by the person filing the property statement. When the aggregate cost of the taxable personal property is $100,000 or more, the person is required to file a business property statement, signed under penalty of perjury, each year with the assessor.

Section 452 requires the Board to prescribe the content and detail of the business property statement used by assessors. Section 452 specifies that the property statement shall not include any question that is not germane to the assessment function and Section 451 requires the assessor to hold secret the information furnished in the statement.

PROPOSED LAW

This bill would amend Section 452 to require the Board to include in the business property statement it prescribes for the use of local county assessors:

- A brief statement about the obligation to pay use tax on taxable purchases if sales tax was not applicable.
- Information about how to pay use tax, which could be limited to the Board's phone number and web address where additional information and use tax returns could be accessed.
- A statement advising the taxpayer that information provided on the business property tax statement may be shared with the Board.

This bill also specifies that the Board is to implement these requirements in a manner that does not increase local costs.

BACKGROUND

The collection of use tax relies heavily on the voluntary compliance of purchasers of tangible personal property. However, due to the general misconception that purchases from outside this state are "tax free" and that audit resources are insufficient to pursue all purchasers, the voluntary compliance rate has been very low. Untaxed purchases from out of state retailers is the largest area of non-compliance the Board's audit staff encounters.

The Board is the state agency responsible for administering the provisions of the use tax. However, in an effort to increase voluntary compliance by purchasers not registered with the Board, legislation enacted in 2003, SB 1009, (Alpert, Ch. 718) requires the FTB to add a line to the state's income tax forms allowing taxpayers to self-report their use tax liabilities to the FTB.

In 2005, two bills were introduced in the Legislature, AB 911 (Chu) and AB 1618 (Klehs), to require business property statements filed with county assessors for property tax purposes to include information regarding the use tax on acquisitions of property identified on the statements. Neither bill was ultimately enacted with this provision.

This year's proposed Budget Bill for 2007-08, SB 77 (Ducheny), provides $400,000 for the Board to (1) contract with up to three selected county assessors offices on a pilot basis to include with their business property statements an additional message from the Board explaining the obligation to pay use tax on nonexempt purchases if sales tax was not paid and to provide, in electronic form, data to the Board from the business property statements on recent equipment purchases by businesses, and (2) for the Board to conduct discovery audits for the primary purpose of determining whether the problem of nonpayment of use tax by businesses is significant and to determine, if feasible, areas with the greatest noncompliance (for example, by type of business, size, or geographic area). The Board may seek the assistance of the selected county assessors in selecting and identifying businesses for potential discovery audits.

COMMENTS

1. **Purpose.** The purpose of this provision is to use the annual business property tax statement as an outreach tool in an effort to increase use tax education and compliance.
2. **Budget Bill Appropriation related to the business property statements and the use tax.** The Budget Bill provides $400,000 to the Board (Item 0860-001-0001) to contract with up to three local county assessors in a pilot project to provide electronic information from business property statements filed with those assessors that identify businesses with recent equipment purchases and for the Board to conduct discovery audits with a use tax emphasis.
3. **Enactment of this bill would "get the word out."** Collecting use tax relies heavily on voluntary compliance. This bill would assist in informing and advising those taxpayers most likely to be incurring a greater portion of use tax liabilities (i.e., those with tangible personal property holdings in excess of $100,000 that are used in a trade or business) of their use tax responsibilities under the law. It would also enable the Board and county assessors to share the information obtained from the business property statements to facilitate administration of the tax laws.
4. **Business Property Statements.** Proponents of closing the use tax gap have noted that local county assessors receive annual property tax statements from businesses related to their personal property holdings that could be used as a data mining source. However, in its present form, the business property statement is not a useful discovery tool. Taxpayers report their personal property holdings by year of acquisition in lump sum amounts that are broken down by a few broad category types. In addition, there are issues with the confidentiality of these property statements as well as their use for other tax purposes, which this bill would expressly address.
5. **Administrative efficiencies in using an existing taxpayer base.** Proponents note that the annual contact that assessors already have with businesses that own tangible personal property at the local level could be a cost effective means to educate and obtain voluntary use tax remittance from businesses as well as provide use tax leads for the Board to pursue.
6. **State and local government partnership and cooperation to facilitate administration of the tax laws and possible enhanced revenues.** The Board is the state agency responsible for administering the provisions of the use tax. However, local governments would receive a share of previously uncollected use tax as well as an increase in property tax revenues that may result due to the educational outreach that will occur with the business property statement.

COST ESTIMATE

Costs associated with this bill related to the fractional aircraft provisions are expected to be absorbable. Additionally, with respect to the use tax provisions, the Budget Act includes $400,000 to contract with the assessors and perform discovery audits.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The Los Angeles County Assessor's office prepared an estimate of assessable value for fractionally owned aircrafts covering calendars years 2002-2006. The Los Angeles County Assessor estimates that the annual revenue from assessments on fractional aircraft totaled $3.2 million in 2006. Aircrafts operating in the County of Los Angeles represents one-third of the total assessed value on aircrafts operating in California. Therefore, we estimate that this bill would provide $9.6 million in annual property tax revenue in California beginning in fiscal year 2007-08. In addition, for fractionally owned aircraft that have not been annually assessed during the four fiscal years prior to fiscal year 2007-08, assessment under this bill applies to those fiscal years for which an assessment was not made. Based on information provided by the Los Angeles County Assessor's office, we estimate that for prior fiscal years, this bill would provide $37.8 million in statewide property tax revenue from prior fiscal years for which an assessment was not made.

Revenue Summary

Fractionally Owned Aircraft. Beginning in fiscal year 2007-08, the annual statewide property tax revenue from assessments on fractionally owned aircrafts would amount to $9.6 million.

Additionally, with respect to prior fiscal years for which an assessment was not made, the revenues would amount to $37.8 million in statewide property tax revenue.

Use Tax. With respect to the use tax provisions of this bill, it is anticipated that this bill could increase state and local revenues by an unknown amount.

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position