



September 3, 2015

Sherrie Kinkle, Tax Administrator II
County-Assessed Properties Division
Assessment Services Unit, MIC: 64
California State Board of Equalization
PO Box 942879
Sacramento, CA 94279-0064

Re: Revisions to *State Assessment Manual*

Dear Ms. Kinkle

In anticipation of the interested parties' meeting scheduled for September 9, 2015, the California Taxpayers Association has two primary concerns about proposed revisions to the Board's *State Assessment Manual*. CalTax believes that the updated manual must squarely address: (1) treatment of nontaxable software; and (2) treatment of nontaxable intangible assets and rights.

Nontaxable Software

The *State Assessment Manual* was originally published in 2003. Subsequently, in 2008, *Cardinal Health 301 Inc. v. County of Orange* was published (167 Cal.App.4th 219). At present, "software" is not once mentioned in the *State Assessment Manual* or in proposed revisions to the manual, even though software is an extremely significant component of most state-assessed property units.

Board staff did not accept proposed inclusion of a brief explanation of *Cardinal Health* because it is "not [a] state assessee case" (matrix item 61; at *Manual* page 78, line 10). It should be noted that, of the twenty-three (23) cases cited in the current version of the *State Assessment Manual*, only seven (7) are state-assessee cases, whereas sixteen (16) cases cited in the manual involve local assessees, like *Cardinal Health*.

It also should be observed that, for nontaxable application software, the exact same legal principles apply to state and to local assessees. Moreover, neither Assessors' Handbook 501 (*Basic Appraisal*, published in 2001) nor Assessors' Handbook 502 (*Advanced Appraisal*, published in 1998) has been updated since *Cardinal Health* was decided in 2008.

CalTax asserts that the following text should be included in the updated *State Assessment Manual*:

Cardinal Health v. County of Orange (2008) 167 Cal.App.4th 219 The issue in this case was whether application software was not subject to property taxation if it came “bundled” or “embedded” with taxable computer hardware. The assessment appeals board and the trial court agreed with the assessor that because the application software was bundled or embedded with taxable computer hardware, the assessor could ignore the taxpayer’s evidence of the value of its nontaxable application software and assess the total amount charged for the software and hardware bundle. The Court of Appeal reversed the decision of the trial court, and held that the fact that the nontaxable application software was bundled or embedded with taxable computer hardware did not excuse the assessor from his duty to make an informed judgment as to the value of taxable and nontaxable components of the bundled software and hardware.

Nontaxable Intangible Assets and Rights

Since publication of the *State Assessment Manual* twelve years ago, the California Supreme Court has established a legal precedent on treatment of intangible assets and rights held by state-assesseees (*Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593).

Board staff did not accept proposed characterizations of *Elk Hills Power* because those suggested descriptions of the Court’s holding ‘did not add clarity’ (matrix item 19, at *Manual* page 13, line 32; matrix item 62, page 78, line 45).

CalTax maintains that the following text should be added to the updated *State Assessment Manual*:

at *Manual* page 13, line 32:

Subdivision (e) states: "Taxable property may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the property to beneficial or productive use." This provision means that the appraiser assumes intangible assets and rights are in use as part of a going concern, but the value of those intangibles is not to be included in the final value of the taxable property. *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593 at 608.

CalTax asserts that the following text should be **substituted** and deleted from the updated *State Assessment Manual*:

at *Manual* page 78, line 45:

Elk Hills Power, LLC v. Board of Equalization (2013) 57 Cal.4th 593
The issue in this case was whether the Board properly **excluded the value of nontaxable intangible** ~~considered applied~~ emission reduction credits (ERCs) in determining the unitary value of Elk Hills' state-assessed electric power plant for purposes of property taxation under both the replacement cost less depreciation approach (RCLD) and the income approach. The Supreme Court concluded that "the Board directly and improperly taxed the power company's ERCs when it added their replacement cost to the power plant's taxable value." The Supreme Court, however, clarified that "[w]here the taxpayer does not proffer evidence that the Board included the fair market value of an intangible right or asset in the unit whole, the Board would not have to make a deduction prior to assessment." ~~With respect to the income approach, the Court distinguished between cases involving intangibles that are necessary for the beneficial and productive use of tangible property such as ERCs, and business enterprise intangibles.~~ The Court concluded that "the Board was not required to deduct a value attributable to the ERCs under an income approach" because "[t]here was no credible showing that there is a separate stream of income related to enterprise activity." Accordingly, the Court determined that the Board correctly "estimated the amount of income the property is expected to yield over its life and determined the present value of that amount."

These comments reflect current law, and there is no reason to exclude them from the manual. We thank you, in advance, for favorably considering CalTax's perspective.

Very truly yours,



Teresa Casazza, President
California Taxpayers Association

cc: Dean Kinnee, State Board of Equalization
Ken Thompson, State Board of Equalization
Benjamin Tang, State Board of Equalization