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Sent: Thursday, June 18, 2015 12:48 PM
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Cc: nhoward@ppmsllc.com; tobiasca15@aol.com
Subject: State Assessment Manual Revision Comments/changes

Dear Ms. Kindle:

Please find attached my proposed changes to the State Assessment Manual pursuant to LTA No. 2015/030 dated May 15, 2015. My comments and proposed changes are based upon recent intangible case law that supports my language. My clients and I believe that the manual needs to have more language for the intangible section as it would appear that the appraisal staff has NOT spent any time considering the current case law nor made any intangible adjustments. We believe that the case law is very clear on the intangible assets being excluded from the total overall valuation.

If you should have any questions please feel free to contact me. Please do confirm receipt of this email along with the attachment.

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21 Subdivision (d), (e), and (f) of section 110 address the treatment of intangible assets and rights.
22 Subdivision (d) provides that (1) the value of intangible assets and rights relating to the going
23 concern value of a business using taxable property shall not enhance or be reflected in the value
24 of the taxable property; (2) if the principle of unit valuation is used to value properties that are
25 operated as a unit, then the fair market value of the taxable property contained within the unit
26 shall be determined by removing from the value of the unit the fair market value of the intangible
27 assets and right contained within the unit; (3) the exclusive nature of a concession, franchise, or
28 similar agreement is an intangible asset that shall not enhance the value of the taxable property,
29 including real property.¹

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31 However, in applying the above principals, the Legislature stated at the beginning of subdivision
32 (d) than its provisions are expressly subject to the language in subdivision (e). Subdivision (e)
33 states: “Taxable property may be assessed and valued by assuming the presence of intangible
34 assets or rights necessary to put the property to beneficial or productive use.”

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36 Finally, subdivision (f) of section 110 provides that for the purpose of determining “full cash
37 value” or “fair market value,” any intangible attributes of real property shall be reflected in the
38 value of the real property, and that these attributes include zoning, locations, and other such
39 attributes that related directly to the real property involved.

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41 Although assessors can assume the presence of intangible assets and rights necessary to put
42 taxable property to beneficial or productive use, such intangibles cannot be taxed directly. The
43 Board’s appraisers must do their constitutional duty to assess taxable property at fair market

¹ For additional discussion of the market value concept, see Assessors’ Handbook Section 501, Basic Appraisal and Assessors’ Handbook Section 502, Advanced Appraisal.

1 value while making sure that the value of intangible assets is not improperly subsumed within
2 the value of taxable property.²

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4 In Elk Hills Power, the California State Board of Equalization was required to remove the
5 replacement cost for applied emission reduction credits that it added to the Board's replacement
6 cost value indicator for the assessment of a power plant.³

7
8 The value of intangible assets and rights cannot be removed by merely deducting the related
9 expense from the income stream to be capitalized. Allowing a deduction for the associated
10 expense does not allow for a return on the capital expenditure. For example, allowing the
11 deduction of wages paid to a skilled work force does not remove the value of the work force in
12 place from the income indicator, because the amount of the wages paid does not necessarily
13 represent a return of and on the work force in place, and further bears no relationship to the costs
14 associated with locating, interviewing, training, and otherwise acquiring the work force.
15 Similarly, the deduction of a management fee from the income stream does not recognize or
16 remove the value attributable to the business enterprise.⁴

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18 There are a list of California cases in conjunction with Rule 8, Income Approach to Value, that
19 recognize established, enterprise intangibles, e.g.: (1) name recognition (customer base,
20 relationships with local advertisers/vendors, subscriber list, systems/internal procedures, business
21 and technical procedures, accounting and billing systems, programming contracts, and
22 procedures for operating its business); (2) trained and experienced workforce (competent
23 management, a large cadre of employees, substantial experience, trained workforce in place, and
24 assembled workforce); (3) favorable contracts (favorable franchise terms, operating contracts,
25 franchise operating rights, lease, non-competition agreement, and exclusive rights); (4) working
26 capital; (5) goodwill (goodwill of a business, a going concern, and enterprise value); (6) licenses;
27 and (7) right to do business.⁵ Each of these enterprise intangibles shall be considered and cannot
28 be taxed directly or included in the value.

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30 Assessor's Handbook Section 502, Advanced Appraisal:

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32 Income Approach: If the income stream used by the appraiser is in part generated by
33 intangible assets and rights, the appraiser must either (1) attribute sufficient income to
34 provide a return of and on the intangible assets and rights, or (2) remove the value of the
35 intangible assets and rights from the income indicator (using any acceptable valuation
36 method) after the income stream has been capitalized or discounted to present value. A

² SHC Half Moon Bay, LLC v. County of San Mateo (2014) 226 Cal.App. 4th 471.

³ Elk Hills Power, LLC v. Board of Equalization (2013) 57 Cal. 4th 593.

⁴ SHC Half Moon Bay, LLC v. County of San Mateo (2014) 226 Cal.App. 4th 471, AH Section 502, Chapter 6, page 162.

⁵ California Portland Cement Co. v. State Bd of Equalization (1967) 67 Cal.2d 578; County of Stanislaus v. Assessment Appeals Bd. (1989) 213 Cal.App.3d 1445; De Luz Homes, Inc. v County of San Diego (1955) 45 Cal.2d 546; Elk Hills Power LLC v. Board of Equalization (2013) 57 Cal.4th 593; GTE Sprint Communications Corp. v. County of Alameda (1994) 26 Cal.App.4th 992; Kaiser Co. v. Reid (1947) 30 Cal.2d 610; Service America Corporation v. County of San Diego (1993) 15 Cal.App.4th 1232; SHC Half Moon Bay v. County of San Mateo (2014) 226 Cal.App.4th 471; Shubat v. Sutter County Assessment Appeals Board (1993) 13 Cal.App.4th 794; Sky River LLC v. County of Kern (2013) 214 Cal.App.4th 720.

1 business may have valuable intangible assets and rights (e.g. customized computer
2 software, patents, copyrights, customer base, vendor relationship, name recognition,
3 name reputation, etc.) even though the business may not generate sufficient income to
4 produce an adequate rate of return of and on the subject property.⁶
5

6 Service Company of America:
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8 A final factor of importance is the recognition that the gross income of Service America
9 is derived not only from its use of property but from its performance of a service. Service
10 America is a going business concern with (apparently) competent management, a large
11 cadre of employees, and substantial experience and “goodwill” in the area of food
12 service. The prices paid by its customers for its wares obviously bear a high relationship
13 to the ability of Service America to please the customers by the quality of comestibles
14 and the acceptability of personal service –factors which have little or no bearing upon the
15 use or occupancy of property.
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17 The conclusion, in applying the learning of these authorities to the facts of our case, is
18 that the assessor and the board were in error when they utilized Service America’s entire
19 income flow (even as adjusted for certain expense factors) as the basis for valuation.
20 Clearly, some “large part” of the income earned by Service America was based on its
21 “enterprise value” as distinguished from the value of its use of property.⁷
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⁶ Assessor’s Handbook 502; SHC Half Moon Bay, LLC v. County of San Mateo (2014) 226 Cal.App. 4th 471; Shubat, at 802 County of Stanislaus (1989) 213 Cal.Ap.3d 1445, 1454; Service Company of America Corporation v. County of San Diego (1993) 15 Cal.App 4th 1232, 1238.

⁷ Servie Company of America Corporation v. County of San Diego (1993) 15 Cal.App 4th 1232, 1238.