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Ms. Sherrie Kinkle
California State Board of Equalization
Property and Special Taxes Department
450 N Street, MIC:72
Sacramento, CA 94279-0064

Dear Ms. Kinkle:

PROPOSED REVISIONS TO PROPERTY TAX RULE 133

This is to provide comments by the Los Angeles County Office of the Assessor (LACOA) regarding the proposed amendment to Property Tax Rule 133.

The LACOA objects to the proposed amendment on at least three grounds. The proposed rule exceeds the authority of the California State Board of Equalization (BOE), is inconsistent with the applicable statute governing business inventories, and conflicts with the BOE's previous instruction regarding the exemption.

The proposed amended rule exceeds the authority of the BOE. California Government Code section 15606(c), authorizes the BOE to enact rules and regulations "governing assessors when assessing." Implicit in this rulemaking authority is that the BOE will not usurp authority otherwise delegated to the legislature by the California Constitution.

The California Constitution empowers the legislature to classify personal property for differential assessment or exemption. (Cal.Const., art. XIII, § 2.) The BOE by its proposed rulemaking seeks to classify "space flight property" as exempt business inventory, but the property in question is not at all inventory. Participants in the civilian space launch industry sell a service (space transportation), and we understand that they do not sell the space launch equipment to their customers in the undertaking of their service. The proposed amendment seeking to classify space flight equipment as business inventory property is a transparent results-oriented effort to exempt such property from property tax. Unfortunately, the BOE's rulemaking power does not extend to classifying property as exempt unless it is consistent with existing law. The proposed rulemaking is not within the authority of existing law and impinges upon the legislature's constitutional authority to determine what categories of personal property are exempt from assessment.

The proposed amended rule is also inconsistent with Revenue and Taxation (R&T) Code section 129. This statute provides comprehensive guidance regarding the scope of the business inventory exemption:

"Business inventories" shall include goods intended for sale or lease in the ordinary course of business and shall include raw materials and work in process with respect to such goods. [. . .]

"Business inventories" shall not include any goods actually leased or rented on the lien date **nor shall "business inventories" include business machinery or equipment** or office furniture, machines or equipment, **except when such property is held for sale or lease in the ordinary course of business.** "Business inventories" shall not include any item held for lease which has been or is intended to be used by the lessor prior to or subsequent to the lease. **"Business inventories" shall not include goods intended for sale or lease in the ordinary course of business which cannot be legally sold or leased in this state.** If goods which cannot be legally sold or leased are not reported by the taxpayer pursuant to Section 441, it shall be conclusively presumed that the value of the goods when discovered is the value of the goods on the preceding lien date. . . . (Emphasis added.)

The space flight equipment that is the subject of the proposed rulemaking is machinery and equipment, and to the best of LACOA's knowledge is not offered for sale or lease in the ordinary course of business. Indeed, staff counsel's advice letter suggests that the property that is the subject of the proposed rule cannot be sold in the ordinary course of business pursuant to federal law. (Mr. Moon's letter of December 24, 2013, p. 4, 2nd full paragraph), ". . . it is clear that the governing federal statutes and regulations heavily regulate the space flight industry, creating a unique market in which the technical sale of goods is constrained to make the transfer of title of space flight equipment extremely difficult, if not practically impossible. . . ."

Notwithstanding the foregoing, BOE staff is undeterred stating, "Sections 219 and 129 were enacted in the late 1960's contemplating an open and free market, and not a market with barriers to sale placed by the federal government due to national security and foreign policy concerns. [Fn. omitted.] In our view, when SpaceX's business is viewed in light of the heavily regulated market in which it operates, the required relinquishment of control of its Equipment by SpaceX to federal authority at launch should qualify as a 'sale' within the meaning of the business inventory exemption."

The BOE can only take this position by ignoring the plain meaning of the term "sale." A sale is the transfer of title of property to a purchaser for a price. Industry participants do not sell title of their flight equipment to their customers in the ordinary course of business, let alone for consideration. The business inventory exemption is not applicable to this property type as revealed by the unambiguous text of R&T Code section 129. Staff's effort to shoehorn this property type into an exempt category is statutorily unauthorized. Section 129 is clear what the result must be when the property type at issue cannot be legally sold or transferred. "Business inventories" shall not include goods intended for sale or lease in the ordinary course of business which cannot be legally sold or leased in this state."

Finally, the BOE's proposed rule amendment is contrary to previous advice provided by BOE staff to county assessors. The BOE has previously advised that machinery and equipment that is held for use by a taxpayer does not qualify for the business inventory exemption. (LTA 80/69, p. 3, q. 2.) Further, goods transferred in connection with professional services are not eligible for exemption. (Id., p. 7, q. D.1.)

As discussed above, the property in question does not transfer to third parties, and BOE staff essentially concedes this point by reference to federal law. But even if the space flight property were deemed to transfer to an industry customer, it still would not qualify for exemption as the transfer would be incidental to a profession. (Id., "Examples of profession or professional service [include]: law, ministry, medicine, military service, engineering, chemistry, industrial designing, accountancy, economics, etc.")

The BOE's proposed rulemaking would establish a troubling precedent. Certificated air carrier property is ostensibly transferred to federal air control supervision for purposes of landings and takeoffs, and commercial aviation is subject to extensive federal regulation. Applying the BOE's proposed logic, the operation of this commercial flight equipment property is subject to extensive government controls and could be argued to satisfy the statutory requirement of "goods intended for sale or lease in the ordinary course of business" consistent with the BOE's apparent proposal of an "extensive federal regulation" exception to the business inventory statutory test. Such an extension of the exemption is unauthorized and illogical.

To summarize, the BOE's proposed amendment to Rule 133 usurps the legislature's constitutional prerogative to determine what classifications of personal property are exempt from property tax. The BOE's proposed classification of civilian flight equipment is contrary to the express terms of R&T Code section 129, and also creates a precedent that potentially puts in question the assessment of conventional certificated air carrier flight equipment. Further, the proposed amended rule is contrary to previous longstanding advice that the BOE has communicated to assessors further emphasizing the results-oriented approach of the proposed amendment to Rule 133.

The LACOA respectfully submits that the Rule 133 proposed rulemaking is contrary to law. The proponents efforts are directed to the wrong body, and their advocacy would be more appropriately redirected to the legislature.

Thank you for your consideration of our office's position.

Sincerely,



SHARON MOLLER

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