Petition to Amend Property Tax Rule 138

I. Issue
Should the Board authorize amendment of subsection (b) of Property Tax Rule 138, *Exemption for Aircraft Being Repaired, Overhauled, Modified or Serviced*, as proposed by the California Assessors' Association (CAA) in its petition? The CAA proposes to delete the last sentence of subsection (b) that reads, "Aircraft in California solely for the purposes described in subsection (b)(1) include any incidental and attendant storage" and to replace it with "Aircraft in California primarily for the purpose of storage may require incidental maintenance or servicing related to storage. Such aircraft do not qualify for the exemption."

II. Staff Recommendation
Staff recommends that the Board deny the petition to amend Property Tax Rule 138 because the proposed amendment is inconsistent with statutory provisions. In addition, it is within the Board's regulatory authority to provide uniform guidance on qualification for the exemption provided by section 220 of the Revenue and Taxation Code for specified aircraft.

III. Other Alternative(s) Considered
The Board could accept the CAA's petition to amend Property Tax Rule 138 and initiate the rulemaking process.
IV. Background

**BOARD’S RULEMAKING AUTHORITY.** Under Government Code section 15606, subdivision (c), the Board is given the authority to prescribe rules and regulations to govern local boards of equalization when equalizing and county assessors when assessing. The Administrative Procedure Act, codified in Government Code section 11340 et seq., prescribes a procedure in section 11340.6 for any interested person to petition a state agency to request the adoption, amendment, or repeal of a regulation. In response, the state agency may exercise its rulemaking authority and take the requested action or it may deny the petition.

**REQUEST FOR AMENDMENT.** On September 29, 2003, the Board received a petition from the Honorable Joan Thayer, President of the CAA, on behalf of the CAA, proposing that the Board commence the rulemaking process to amend Property Tax Rule 138, *Exemption for Aircraft Being Repaired, Overhauled, Modified or Serviced.* The petition recommends deletion of the following language in subsection (b):

\[
\text{Aircraft in California solely for the purposes described in subsection (b)(1) include any incidental and attendant storage.}
\]

The petition recommends that the language proposed for deletion be replaced with the following:

\[
\text{Aircraft in California primarily for the purpose of storage may require incidental maintenance or servicing related to storage. Such aircraft do not qualify for the exemption.}
\]

On December 4, 2003, the Board ordered staff to commence the Property Tax Committee interested parties process to discuss the issues that were raised in the petition. Board staff distributed the proposed petition amendments and invited interested parties to submit suggestions or comments. The interested parties included airlines operating in California, the Air Transport Association of America, Cal-Tax, and the companies currently maintaining and servicing aircraft in the desert airport locations of California. On September 9, 2004, staff met with interested parties in Sacramento to discuss the proposed language contained in the CAA petition.

**HISTORY.** Rule 138 was adopted following the September 11 terrorists’ attacks to provide that certificated aircraft owned by air carriers, temporarily out of revenue service and stored and maintained in California, are eligible for the exemption from property taxation provided by section 220 of the Revenue and Taxation Code. The rule was adopted by the Board on an emergency basis on November 28, 2001, and became effective on December 14, 2001. It was re-adopted March 27, 2002, again as an emergency rule and became effective April 3, 2002. The rule was permanently adopted on March 27, 2002 and became effective May 20, 2002.

Under California law, all property is taxable unless there is a specific constitutional or statutory exemption for the property. The Legislature has authority to exempt personal property from taxation in whole or in part under Article XIII A, section 2 of the California Constitution. Certificated aircraft owned by air carriers are personal property subject to taxation when in revenue service in California. However, the Legislature enacted section 220 to provide a property tax exemption for any aircraft that is in California on the lien date solely for the purpose of being repaired, overhauled, modified, or serviced. Section 220 provides:

\[
\text{Any aircraft which is in California on the lien date solely for the purpose of being repaired, overhauled, modified, or serviced is exempt from personal property taxation. This exemption does}
\]
not apply to aircraft normally based in California, or operated intrastate or interstate in and into California.

The stated purpose for the enactment of the exemption was to promote jobs in the aircraft service and repair industry in California, which competes with companies in other states with lower levels of taxation for such aircraft.

In the aftermath of the terrorist attacks, the airlines experienced a significant reduction in passenger flights and, as a result, cancelled between 25 and 30 percent of the scheduled flights, reducing their need for aircraft in revenue service by a similar percentage. While out of revenue service, the aircraft must continue to be serviced in accordance with Federal Aviation Administration (FAA) regulations to maintain the airworthiness of the aircraft.

During the rulemaking process for Rule 138, the CAA opposed the proposed rule because the CAA contended that its provisions are inconsistent with section 220. The CAA takes the position that the rule applies the exemption to aircraft primarily in the state for the purpose of storage, which is contrary to section 220. Thus, the CAA contends that the rule improperly expands the exemption to aircraft regularly operated in the state, either in intrastate or interstate commerce, that are taken out of service on the lien date.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that the Board deny the petition for amendment of Property Tax Rule 138. Staff’s position is that Rule 138 is consistent with section 220 by providing that aircraft that have been taken out of revenue service qualify for the exemption only if they are under contract for repair, overhaul, maintenance, or service, where such servicing is in accordance with FAA requirements. Section 220 does not prescribe any restrictions on the period of time during which the service maintenance occurs or any minimum requirement for the amount of maintenance performed.

B. Pros of the Staff Recommendation

By denying the CAA petition, the rule would remain consistent with section 220, which does not include any limitation on the time during which the maintenance and repair occur or the extent of the maintenance performed. Air carriers would continue to locate and maintain commercial aircraft in California and, thereby, provide employment and new investment in infrastructure in California, primarily at locations in Kern and San Bernardino Counties.

C. Cons of the Staff Recommendation

In the September 29, 2003 petition submitted by the CAA, the CAA contends that existing language of Rule 138 expands the section 220 exemption to stored aircraft which is not authorized by the statute.

D. Statutory or Regulatory Change

None
E. Administrative Impact
None

F. Fiscal Impact

1. Cost Impact
Rule amendments are routinely prepared and any associated costs are accommodated within the Board's existing budget. There are no other costs.

2. Revenue Impact
None, see attached Revenue Estimate

G. Taxpayer/Customer Impact
None

H. Critical Time Frames
None

VI. Alternative 1

A. Description of the Alternative
The Board could accept the CAA's petition to amend Rule 138 and initiate the rulemaking process.

B. Pros of the Alternative
The CAA contends that its petition language would make Rule 138 more consistent with section 220 of the Revenue and Taxation Code. The CAA position is that the rule applies the exemption to aircraft primarily in the state for the purpose of storage, which they consider contrary to section 220. Accepting the CAA's position would remove the exemption and would allow the two counties, where the aircraft are located, to assess those aircraft at 100 percent of market value.

C. Cons of the Alternative
Approval of the CAA petition would, in effect, remove the current aircraft exemption. Information provided by the industry representatives currently providing the maintenance and service contracts on the aircraft, and information provided by several airline companies, has indicated that amending Rule 138 to reflect the CAA's petition language would result in the removal of virtually all "non-business inventory exempt" aircraft from California.

The company representatives have also indicated that the removal of these aircraft would have a severe detrimental affect on their businesses, which could cause the dismissal of a significant portion of their workforce and could ultimately force them into closing down completely. Any investment in infrastructure at these desert county airport locations would be dramatically reduced, if not eliminated completely.
D. Statutory or Regulatory Change
   Action by the Board will amend section 138 of Title 18 of the California Code of Regulations, Subchapter 2.

E. Administrative Impact
   None

F. Fiscal Impact
   1. Cost Impact
      Rule amendments are routinely prepared and any associated costs are accommodated within the Board's existing budget. There are no other costs.
   2. Revenue Impact
      See attached Revenue Estimate

G. Taxpayer/Customer Impact
   If the Board grants the petition and Rule 138 is amended as requested by the CAA, the exemption would be eliminated for a large percentage of the aircraft located at the two primary California locations for aircraft servicing and repair.

   Mr. John White of Southern California Aviation in Victorville commented in a letter dated June 25, 2004:
   … We are disappointed that the Assessors continue to challenge the validity of 138 as it currently stands. They threaten to eliminate jobs and create a new economic down turn in aviation in California and simply give those opportunities and jobs to our neighbors to the east. The State and the people of the State of California simply lose if there is a change in ruling 138.

   Mr. Bob Ziegelaar of AVTEL Services, Inc., commented in a letter dated June 17, 2004:
   … If the Board should add to the owners' and operators' difficulties by excluding stored aircraft from the existing exemption for "aircraft not in economic use," the inevitable consequence would be the relocation of such aircraft to states where similar Property Taxes are not levied. With the departure of the aircraft, hundreds, if not thousands, of employment opportunities would again be lost to California, often in areas that can least afford such losses.…

H. Critical Time Frames
   Granting the petition in December 2004 would not give the airlines sufficient time to remove their aircraft from California prior to the 2005 lien date. Without the current Rule 138 exemption, the aircraft would be subject to property tax assessment for those aircraft not exempt as inventory. Any amendments to this rule should not take effect until lien date 2006 to allow the airlines to make other arrangements for the location of their non-revenue producing aircraft.

Prepared by: Property Taxes Department, Assessment Policy and Standards Division
             Legal Department, Property Taxes Section

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Staff Recommendation

Staff recommends that the Board deny the petition to amend Rule 138 because the current language is consistent with statutory provisions. In addition, it is within the Board’s regulatory authority to provide uniform guidance on qualification for the exemption provided by section 220 of the Revenue and Taxation Code for specified aircraft.

Background, Methodology, and Assumptions

Rule 138 was adopted following the September 11 terrorists attacks to provide that certificated aircraft owned by air carriers, temporarily out of revenue service and stored and maintained in California, are eligible for the exemption from property taxation provided by section 220 of the Revenue and Taxation Code. The rule was adopted by the Board on an emergency basis on November 28, 2001, and became effective on December 14, 2001. It was re-adopted March 27, 2002, again as an emergency rule and became effective April 3, 2002. The rule was permanently adopted on March 27, 2002, and became effective May 20, 2002.

Virtually all of the aircraft that would be potentially affected by this proposal are located in Kern and San Bernardino counties. Based on reports from the county assessors, the number of certificated aircraft not in revenue service is:

<table>
<thead>
<tr>
<th>Year</th>
<th>Kern County</th>
<th>San Bernardino</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>45</td>
<td>20</td>
</tr>
<tr>
<td>2000</td>
<td>45</td>
<td>65</td>
</tr>
<tr>
<td>2001</td>
<td>69</td>
<td>Up to 140</td>
</tr>
<tr>
<td>2002</td>
<td>251</td>
<td>216</td>
</tr>
<tr>
<td>2003</td>
<td>284</td>
<td>246</td>
</tr>
<tr>
<td>2004</td>
<td>148</td>
<td>169</td>
</tr>
</tbody>
</table>
Only a portion of these are "certificated aircraft owned by air carriers, temporarily out of revenue service and stored and maintained in California" that would be affected by this proposal. It is estimated that there are about 100 aircraft statewide which need Rule 138 to qualify for exemption. Assuming an average value of $5 million per aircraft, the estimated value of the aircraft is then 100 x $5 million, or $500 million. If foreign (non-government) owned aircraft that are stored and not being used in international commerce would be affected by this proposal, the value would increase by $394 million.

The maximum revenue impact under the CAA proposal is then:

<table>
<thead>
<tr>
<th></th>
<th>Estimated value</th>
<th>Revenue impact at 1 percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic aircraft</td>
<td>$500 million</td>
<td>$5.00 million</td>
</tr>
<tr>
<td>Foreign owned aircraft</td>
<td>$394 million</td>
<td>$3.94 million</td>
</tr>
<tr>
<td>Total</td>
<td>$894 million</td>
<td>$8.94 million</td>
</tr>
</tbody>
</table>

Nonetheless, it is very likely that this proposal will have no revenue effect since the aircraft can be moved out of California for this type of temporary storage.

**Revenue Summary**

The CAA proposal and the staff recommendation have no revenue effect.

**Qualifying Remarks**

It is estimated the revenue impact for any "certificated aircraft owned by air carriers, temporarily out of revenue service and stored and maintained" that remain in California on the lien date would be about $50,000 on average under the CAA proposal.

**Preparation**

This revenue estimate was prepared by Ms. Aileen Takaha Lee, Research and Statistics Section and reviewed by Mr. David E. Hayes, Manager, Research and Statistics Section. For additional information, please contact Ms. Lee at (916) 445-0840.