

Rulemaking File Index
Title 18. Public Revenue

Property Tax Rules 133, *Business Inventory Exemption*

OAL Approval

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OFFICE OF ADMINISTRATIVE LAW

300 Capitol Mall, Suite 1250
Sacramento, CA 95814
(916) 323-6225 FAX (916) 323-6826



DEBRA M. CORNEZ
Director

MEMORANDUM

TO: Richard Bennion
FROM: OAL Front Desk *JD*
DATE: 8/26/2014
RE: Return of Approval Rulemaking Materials
OAL File No. 2014-0710-01S

OAL hereby returns this file your agency submitted for our review (OAL File No. 2014-0710-01S regarding Business Inventory Exemption).

If this is an approved file, it contains a copy of the regulation(s) stamped “ENDORSED APPROVED” by the Office of Administrative Law and “ENDORSED FILED” by the Secretary of State. The effective date of an approved regulation is specified on the Form 400 (see item B.5). **Beginning January 1, 2013**, unless an exemption applies, Government Code section 11343.4 states the effective date of an approved regulation is determined by the date the regulation is filed with the Secretary of State (see the date the Form 400 was stamped “ENDORSED FILED” by the Secretary of State) as follows:

- (1) **January 1** if the regulation or order of repeal is filed on September 1 to November 30, inclusive.
- (2) **April 1** if the regulation or order of repeal is filed on December 1 to February 29, inclusive.
- (3) **July 1** if the regulation or order of repeal is filed on March 1 to May 31, inclusive.
- (4) **October 1** if the regulation or order of repeal is filed on June 1 to August 31, inclusive.

If an exemption applies concerning the effective date of the regulation approved in this file, then it will be specified on the Form 400. The Notice of Approval that OAL sends to the state agency will contain the effective date of the regulation. The history note that will appear at the end of the regulation section in the California Code of Regulations will also include the regulation’s effective date. Additionally, the effective date of the regulation will be noted on OAL’s Web site once OAL posts the Internet Web site link to the full text of the regulation that is received from the state agency. (Gov. Code, secs. 11343 and 11344.)

Please note this new requirement: Unless an exemption applies, Government Code section 11343 now requires:

1. **Section 11343(c)(1):** Within 15 days of OAL filing a state agency’s regulation with the Secretary of State, the state agency is required to post the regulation on its Internet Web site in an easily marked and identifiable location. The state agency shall keep the regulation posted on its Internet Web site for at least six months from the date the regulation is filed with the Secretary of State.
2. **Section 11343(c)(2):** Within five (5) days of posting its regulation on its Internet Web site, the state agency shall send to OAL the Internet Web site link of each regulation that the agency posts on its Internet Web site pursuant to section 11343(c)(1).

OAL has established an email address for state agencies to send the Internet Web site link to for each regulation the agency posts. Please send the Internet Web site link for each regulation posted to OAL at postedregslink@oal.ca.gov.

NOTE ABOUT EXEMPTIONS. Posting and linking requirements do not apply to emergency regulations; regulations adopted by FPPC or Conflict of Interest regulations approved by FPPC; and regulations not subject to OAL/APA review. However, an exempt agency may choose to comply with these requirements, and OAL will post the information accordingly.

DO NOT DISCARD OR DESTROY THIS FILE

Due to its legal significance, you are required by law to preserve this rulemaking record. Government Code section 11347.3(d) requires that this record be available to the public and to the courts for possible later review. Government Code section 11347.3(e) further provides that "...no item contained in the file shall be removed, altered, or destroyed or otherwise disposed of." See also the State Records Management Act (Government Code section 14740 et seq.) and the State Administrative Manual (SAM) section 1600 et seq.) regarding retention of your records.

If you decide not to keep the rulemaking records at your agency/office or at the State Records Center, you may transmit it to the State Archives with instructions that the Secretary of State shall not remove, alter, or destroy or otherwise dispose of any item contained in the file. See Government Code section 11347.3(f).

Enclosures

RECEIVED

AUG 22 2014

by EXECUTIVE DIRECTOR'S OFFICE
STATE BOARD OF EQUALIZATION

**State of California
Office of Administrative Law**

In re:
Board of Equalization

NOTICE OF APPROVAL OF REGULATORY
ACTION

Regulatory Action:

Government Code Section 11349.3

Title 18, California Code of Regulations

OAL File No. 2014-0710-01 S

Adopt sections:
Amend sections: 133
Repeal sections:

The Board of Equalization proposed to amend section 133 of title 18 of the California Code of Regulations to include certain space flight property, not operationally reusable, the control over which is relinquished by the owner on launch, as business inventory eligible for exemption from taxation under section 219 of the Revenue and Taxation Code.

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 10/1/2014.

Date: 8/21/2014



Craig S. Tarpenning
Assistant Chief Counsel

For: DEBRA M. CORNEZ
Director

Original: Cynthia Bridges
Copy: Richard Bennion

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER Z-2014-0325-02	REGULATORY ACTION NUMBER 2014-0710-015	EMERGENCY NUMBER
For use by Office of Administrative Law (OAL) only		2014 JUL 10 AM 11:28	
NOTICE		REGULATIONS	

ENDORSED FILED TO THE OFFICE OF

2014 AUG 21 PM 2:15

Debra Bowen
DEBRA BOWEN
SECRETARY OF STATE

AGENCY WITH RULEMAKING AUTHORITY State Board of Equalization	AGENCY FILE NUMBER (if any)
---	-----------------------------

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE	TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
3. NOTICE TYPE <input type="checkbox"/> Notice re Proposed <input type="checkbox"/> Regulatory Action <input type="checkbox"/> Other	4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
OAL USE ONLY	ACTION ON PROPOSED NOTICE <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn	NOTICE REGISTER NUMBER 2014, 142	PUBLICATION DATE 7/4/2014

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S) Business Inventory Exemption	1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)		
2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)			
SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)	ADOPT		
	AMEND 133		
TITLE(S) 18	REPEAL		
3. TYPE OF FILING			
<input checked="" type="checkbox"/> Regular Rulemaking (Gov. Code §11346) <input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3; 11349.4) <input type="checkbox"/> Emergency (Gov. Code, §11346.1(b))			
<input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §511346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute. <input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)			
<input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h)) <input type="checkbox"/> File & Print <input type="checkbox"/> Other (Specify) _____			
<input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100) <input type="checkbox"/> Print Only			
4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)			
5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)			
<input checked="" type="checkbox"/> Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a)) <input type="checkbox"/> Effective on filing with Secretary of State <input type="checkbox"/> §100 Changes Without Regulatory Effect <input type="checkbox"/> Effective other (Specify) _____			
6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY			
<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660) <input type="checkbox"/> Fair Political Practices Commission <input type="checkbox"/> State Fire Marshal <input type="checkbox"/> Other (Specify) _____			
7. CONTACT PERSON Richard E. Bennion	TELEPHONE NUMBER (916) 445-2130	FAX NUMBER (Optional) (916) 324-3984	E-MAIL ADDRESS (Optional) rbennion@boe.ca.gov

8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

SIGNATURE OF AGENCY HEAD OR DESIGNEE <i>Joann Richmond</i>	DATE July 9, 2014
TYPED NAME AND TITLE OF SIGNATORY Joann Richmond, Chief, Board Proceedings Division	

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

AUG 21 2014

Office of Administrative Law

**Text of Proposed Amendments to
California Code of Regulations, Title 18, Section 133**

133. Business Inventory Exemption.

(a) Scope of Exemption.

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase "control over which is relinquished by the owner upon launch" means the transfer of control to a federal launch safety authority for space flight termination purposes.

(b) Exclusions. Property eligible for the "business inventories" exemption does not include:

(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased. Examples of property excluded from business inventories are office supplies, furniture, machines and equipment and manufacturing machinery, equipment and supplies such as dies, patterns, jigs, tooling or chemicals used to produce a chemical or physical reaction, and contractors' supplies, tools, concrete forms, and other items that will not be incorporated into and become a part of the property. Also ineligible are materials that a contractor is holding to incorporate into real property that will be retained for his own use.

(2) Property being used by its owner for any purpose not directly associated with the prospective sale or lease of that property.

(3) Property actually leased or rented on the lien date.

(4) Property which has been used by the holder prior to the lien date, even though held for lease on the lien date.

(5) Property intended to be used by the lessor after being leased or during intervals between leases even though held for lease on the lien date.

(6) Property in the hands of a lessor who, with intent to enjoy the benefits of the inventory exemption, had leased the property for a period that expired shortly before the lien date but who renewed, extended or renegotiated the lease shortly thereafter.

(c) Service Enterprises. Property held by a person in connection with a profession which is primarily a service activity such as medicine, law, architecture or accountancy is not "business inventories" held for sale or lease even though such property may be transferred to a patient or client incidental to the rendition of the professional service. Property held by enterprises rendering services of a nonprofessional type such as dry cleaners, beauty shop operators and swimming pool service companies is to be regarded as "business inventories" held for sale if such property is delivered as an item regularly included in the service.

(d) Repairers and Reconditioners. Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and materials shall be regarded as holding said parts and materials as “business inventories.”

(e) Agricultural Enterprises. Animals, crops and feed held primarily for sale or lease in the ordinary course of business are included in the term “business inventories,” as are animals used in the production of food or fiber and feed for such animals.

(1) “Animals used in the production of food and fiber” includes all animals customarily employed in the raising of crops or for the feeding, breeding and management of livestock, or for dairying, or any other confined animals whose products are normally used as food for human consumption or for the production of fiber useful to man. Excluded are animals held by an owner or lessee principally for sport, recreation or pleasure such as show animals, horses held for racing or horses and other animals kept as pets.

(2) The term “crops” means all products grown, harvested, and held primarily for sale, including seeds held for sale or seeds to be used in the production of a crop which is to be held primarily for sale. It does not include growing crops exempted pursuant to Article XIII, section 3(h), of the California Constitution or fruit trees, nut trees, and grapevines exempted by section 223 of the Revenue and Taxation Code.

(3) The term “food” means property normally considered as food for human consumption.

(4) Feed for animals held primarily for sale or lease or for animals used in the production of food or fiber constitutes “business inventories” subject to exemption. It includes every type of natural-grown or commercial product fed to animals except medicinal commodities intended to prevent or cure disease unless the medicinal commodities are purchased as a component part of feed for such animals.

Note: Authority cited: Section 15606, Government Code. Reference: Sections 129 and 219, Revenue and Taxation Code.

Memorandum

To : Craig Tarpenning
Office of Administrative Law
300 Capitol Mall, Suite 1250
Sacramento, CA 95814

Date: August 21, 2014

From : Richard Bennion
Regulations Coordinator
Board Proceedings Division, MIC: 80

Subject : *OAL File No. 2014-0710-01S*
Regulations 133, Business Inventory Exemption

The Office of Administrative Law (OAL) is authorized to make the following substitutions and corrections in connection with the above-referenced rulemaking file:

1. Behind tab 15, add the attached Agenda .
2. Replace the Index and Verification with the attached document.

If you have any questions or comments, please notify me at (916) 445-2130 or email at Richard.Bennion@boe.ca.gov .

REB

60040–60053, of Subchapter 1.25 that governed the procedures for adjudicatory hearings for purposes of reviewing executive officer decisions covered by section 60040(a) issued prior to 10/1/1999. Article 2 of Subchapter 1.25 governs adjudicatory hearings for purposes of reviewing executive officer decisions issued on or after 10/1/1999.

Title 17
 California Code of Regulations
 REPEAL: 60040, 60041, 60042, 60043, 60044, 60045, 60046, 60047, 60048, 60049, 60050, 60051, 60052, 60053
 Filed 08/21/2014
 Agency Contact: Amy Whiting (916)322–6533

File# 2014–0717–02
 BOARD OF EDUCATION
 LCFF Kindergarten–3 Grade Span Adjustment

This rulemaking action is the Certificate of Compliance action which makes permanent emergency regulations implementing California Education Code section 42238.02 and the Local Control Funding Formula for Kindergarten through third grade Grade Span Adjustment purposes. The regulations specify how average class enrollment of not more than 24 students is calculated, including in situations such as combined classes, new school sites, and reorganized districts, so as to establish an auditable methodology for calculating these averages and measuring progress toward class size reduction objectives and the granting of Grade Span Adjustments to local education agencies.

Title 5
 California Code of Regulations
 ADOPT: 15498, 15498.1, 15498.2, 15498.3
 Filed 08/25/2014
 Effective 08/25/2014
 Agency Contact: Hillary Wirick (916)319–0644

File# 2014–0717–03
 BOARD OF EDUCATION
 Charter Revocation

The State Board of Education repeals section 11968.5 of title 5 of the California Code of Regulations, which is no longer consistent with recently–amended Education Code sections.

Title 5
 California Code of Regulations
 REPEAL: 11968.5
 Filed 08/27/2014
 Effective 10/01/2014
 Agency Contact: Hillary Wirick (916)319–0644

File# 2014–0716–04
 BOARD OF EDUCATION
 Measurement of Academic Performance & Progress

The State Board of Education submitted this timely certificate of compliance to make permanent the emergency regulations adopted in OAL file no. 2014–0124–04E and re–adopted in OAL file no. 2014–0716–03EE. The emergency rulemaking amended and repealed sections of Title 5 of the California Code of Regulations commencing with section 850 and ending with section 868 to implement Education Code section 60640, which deleted provisions that established the Standardized Testing and Reporting Program and established California Assessment of Student Performance and Progress. Changes were made to the emergency regulations during the permanent rulemaking process.

Title 5
 California Code of Regulations
 ADOPT: 853.7 AMEND: 850, 851, 852, 853, 853.5, 855, 857, 858, 859, 861, 862, 862.5, 863, 864 REPEAL: 854, 864.5, 865, 866, 867, 867.5, 868
 Filed 08/27/2014
 Effective 08/27/2014
 Agency Contact: Hillary Wirick (916)319–0644

File# 2014–0710–01
 BOARD OF EQUALIZATION
 Business Inventory Exemption

The Board of Equalization amended section 133 of title 18 of the California Code of Regulations to include certain space flight property, not operationally reusable, the control over which is relinquished by the owner on launch, as business inventory eligible for exemption from taxation under section 219 of the Revenue and Taxation Code.

Title 18
 California Code of Regulations
 AMEND: 133
 Filed 08/21/2014
 Effective 10/01/2014
 Agency Contact:
 Richard E. Bennion (916)445–2130

File# 2014–0711–02
 BOARD OF VOCATIONAL NURSING AND PSYCHIATRIC TECHNICIANS
 Permissive Site Visits

This regulatory action amends sections 2526 and 2581 of the California Code of Regulations to allow the Board to inspect or review all vocational nursing and psychiatric technician programs within the state.

Rulemaking File Index
Title 18. Public Revenue

Property Tax Rules 133, *Business Inventory Exemption*

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2. [Updated Informative Digest](#)
3. [Property Tax Committee Minutes, February 25, 2014](#)
 - Minutes and Revised Attachment A
 - Formal Issue Paper 14-002
 - Attachment A, Text
 - Attachment B, Comments from Interested Parties
 - Attachment C, Additional Comments from after the Interested Parties Meeting
4. [Reporter's Transcript Property Taxes Committee, February 25, 2014](#)
5. [Estimate of Cost or Savings, April 11, 2014](#)
6. [Economic and Fiscal Impact Statements, March 25, 2014](#)
7. [Notice of Publications](#)
 - Form 400 and Notice, Publication Date April 4, 2014
 - Email sent to Interested Parties, April 4, 2014
 - CA Regulatory Notice Register 2014, Volume No. 14-Z
8. [Notice to Interested Parties, April 4, 2014](#)

The following items are exhibited:

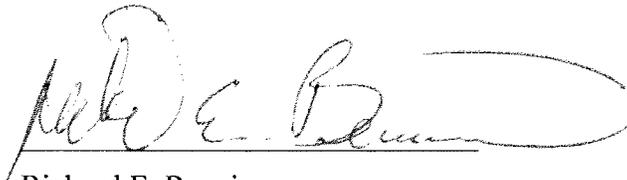
 - Notice of Hearing
 - Initial Statement of Reasons
 - Proposed Text of Rule 133
 - Regulation History
9. [Statement of Compliance](#)
10. [Public Comment, Lawrence E. Stone, April 9, 2014](#)
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14. [Reporter's Transcript, Item F3, May 22, 2014](#)
15. [Minutes, May 22, 2014, and Exhibits](#)
 - Agenda May 22, 2014 Board Meeting
 - Chief Counsel memo dated May 8, 2014
 - Notice of Proposed Regulatory Action
 - Initial Statement of Reasons
 - Proposed Text of Rule 133
 - Regulation History

VERIFICATION

I, Richard E. Bennion, Regulations Coordinator of the State Board of Equalization, state that the rulemaking file of which the contents as listed in the index is complete, and that the record was closed on July 9, 2014 and that the attached copy is complete. The file was reopened on August 21, 2014 to add the May 22, 2014 Agenda notice requested by OAL and the file was closed on August 21, 2014, and that the attached copy is complete.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

August 21, 2014

A handwritten signature in black ink, appearing to read "Richard E. Bennion", written over a horizontal line.

Richard E. Bennion
Regulations Coordinator
State Board of Equalization

**Final Statement of Reasons for
Adoption of Proposed Amendments to California Code of Regulations,
Title 18, Section 133, *Business Inventory Exemption***

Update of Information in the Initial Statement of Reasons

The factual basis, specific purpose, and necessity for, and the anticipated benefits from, the proposed amendments to California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, are the same as provided in the initial statement of reasons (ISR). The State Board of Equalization (Board) held a public hearing regarding the proposed amendments to Property Tax Rule 133 on May 22, 2014. After considering the public comments described below, the Board unanimously voted to adopt the proposed amendments to Property Tax Rule 133 without making any changes.

The Board received public comments in support of the proposed amendments, which are consistent with the factual basis provided in the ISR and discussed in more detail below. The Legislature enacted and the Governor signed Assembly Bill No. (AB) 777 (Stats. 2014, ch. 13.), which is discussed in the ISR and discussed further below. The Board received objections to the proposed amendments from the Los Angeles County Assessor's Office (LACAO) and Mr. Lawrence E. Stone, the Santa Clara County Assessor, which are summarized and responded to below. The Board also added to the anticipated benefits described in the ISR, as provided below.

The adoption of the proposed amendments to Property Tax Rule 133 was not mandated by federal law or regulations and there is no federal regulation that is identical to Property Tax Rule 133.

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing the amendments to Property Tax Rule 133 that was not identified in the ISR, or which was otherwise not identified or made available for public review prior to the close of the public comment period. In addition, the factual basis has not changed for the Board's initial determination that the proposed regulatory action will not have a significant adverse economic impact on business, the Board's determination that the proposed regulatory action is not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, and the Board's economic impact analysis, which determined that the Board's proposed regulatory action:

- Will neither create nor eliminate jobs in the State of California;
- Nor result in the elimination of existing businesses;
- Nor create or expand business in the State of California; and
- Will not affect the benefit of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state's environment.

The proposed amendments may affect small business.

Notice of Correction

The Statement of Specific Purpose and Necessity in the ISR and the Informative Digest in the notice of proposed regulatory action both contain a typographical error in the following paragraph, which incorrectly states that Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), instead of the correct subdivision (a)(2)(E):

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)(1):

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase “control over which is relinquished by the owner upon launch” means the transfer of control to a federal launch safety authority for space flight termination purposes.

Board staff noted the typographical error for the record during the public hearing regarding the proposed amendments to Property Tax Rule 133 on May 22, 2014.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 does not impose a mandate on local agencies or school districts.

Public Comments in Support of the Proposed Amendments

In relevant part, the ISR provided that:

The transfer of control of space flight property to the federal government is required by Air Force Space Command (AFSPC).¹ AFSPC directs

¹ Authority over space flight property launch is granted to the Air Force via the Commercial Space Launch Act of 1984, as amended in 1988 (49 U.S.C. §§ 2601-23, October 30, 1984) which grants regulatory authority over space flight property to the Department of Transportation, which through the Federal Aviation Administration Office for Commercial Space Transportation entered into an agreement with the United States Air Force regarding the implementation of procedures for commercial space transportation

safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch.² The federal launch safety authority, in its sole discretion, may terminate the flight.³ Termination of the flight would result in destruction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

Prior to December 2013, the Board had provided general guidance regarding the business inventory exemption and specific guidance regarding its application to various types of property; however, the previous Board guidance had not specifically discussed the application of the business inventory exemption to space flight property. By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also noted that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory "goods intended for sale . . . in the ordinary course of business." The Property Tax Law (RTC § 50 et seq.) does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that, "The phrase 'ordinary course of business' . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor." Due to the unique nature of the space flight industry, the determination of whether space flight property is a "good intended for sale in the ordinary course of business" must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property.⁴ Within that context, the Board's

and range activities. (See Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities, at https://www.faa.gov/about/office_org/headquarters_offices/ast/media/moa.pdf (as of March 18, 2014).)

² Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91-711 (February 1, 2007) (AFSPC Manual 91-711) provide mission flight control officers with power to issue flight termination commands.

³ AFSPC Manual 91-711, § 7.1.1.1.

⁴ The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles. (22 U.S.C. § 2278, subd. (a)(1).) The Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List. (22 C.F.R. §§ 120-130.)

Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a “sale” and makes space flight property “goods intended for sale in the ordinary course of business” within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board’s Legal Department also based its determination that space flight property is business inventory, under such circumstances, on that fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board’s Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer’s reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement⁵]; See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts – held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer’s gross receipts from each “retail sale,” which is defined as “a sale for any purpose other than resale in the regular course of business.” (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was “sold” in a retail sale and that same property was necessarily, prior to sale, property that was “intended for sale in the ordinary course of business” (i.e., business inventory). Thus, the courts recognize that the definition of “goods intended for sale in the ordinary course of business” must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term “sale” means any transfer of title to or possession of property for a consideration and the term “transfer of possession” includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession

⁵ Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers as provided in Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*. (Cal. Code Regs., tit. 18, § 1700.)

(control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for a specific exemption, space flight property companies would owe sales tax on such transfers.⁶ Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO2 containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller's control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer's direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that "[w]hile statutes granting property tax exemptions are generally construed strictly, that approach 'does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].'" (*Id.* at p. 716.) Therefore, based upon the heavy federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board's Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219. ([Footnotes in original])

⁶ RTC section 6380 exempts qualified property for use in space flight from sales and use tax.

The Board received written comments from Mr. Mardiros H. Dakessian, on behalf of Space Exploration Technologies Corporation (SpaceX), by letter dated May 19, 2014, expressing support for the adoption of the Board's proposed amendments to Property Tax Rule 133, and responding to comments from Mr. Stone's letter dated April 9, 2014 (discussed below). In his letter, Mr. Dakessian agrees that it is necessary to adopt the proposed amendments to Property Tax Rule 133 to clarify how existing law applies to space flight property. Mr. Dakessian agrees with the Board's analysis "with respect to the responsibilities and authority of the Air Force (Range Safety) and the Mission Flight Control Officer's role as the sole decision-making authority and initiator of the flight termination system." Mr. Dakessian explains that a SpaceX vehicle is "preprogrammed and autonomous and the Range User (such as SpaceX) has no ability to control the vehicle from launch to reaching orbital space." Mr. Dakessian also explains that because "the Range User has no ability to control the vehicle from launch to reaching orbital space," the "Range Safety control for safety purposes is in fact the *only* control that exists during the mission [and] . . . range safety is of paramount importance to any launch. Ceding control to federal authorities is required by the federal system to ensure public safety and cannot be minimized." (Emphasis in original.)

The Board also received written comments from Mr. David Flaks, on behalf of the Los Angeles County Economic Development Corporation (LAEDC), by letter dated May 19, 2014, offering support for the Board's proposed amendments to Property Tax Rule 133 because they are rational, objectively fair, and provide for equitable treatment of businesses in California.

In addition, Ms. Debra Reynolds Clark appeared at the public hearing on behalf of United Launch Alliance (ULA) and expressed support for the adoption of the Board's proposed amendments to Property Tax Rule 133. Ms. Reynolds Clark stated that ULA, Boeing, and Lockheed have been subject to property tax audits over the past 15 years, for which rockets have always been treated as business inventory by county assessors. (Transcript of May 22, 2014, public hearing, p. 16, lines 26-28, and p. 17, lines 1-3.) Further, in her oral testimony, Ms. Reynolds Clark restated the factual basis for the proposed amendments to Property Tax Rule 133, as provided in the ISR (and restated above). Ms. Reynolds Clark emphasized that the launch vehicles at issue are 100 percent non-reusable. (Transcript of May 22, 2014, public hearing, p. 17, lines 9-16.) Further, to emphasize that commercial space flight companies completely relinquish control over the space flight property upon launch, Ms. Reynolds Clark reiterated that at the Vandenberg Air Force Base, the range safety officer of the federal government takes control over the rocket even before take-off. The range safety officer has the authority to destroy the vehicle on the launch pad, as well as during flight, for safety reasons. Even during flight, the commercial space flight companies have no control over the course of the vehicle, because directives to steer and deliver its payload are programmed prior to launch. (Transcript of May 22, 2014, public hearing, p. 17, lines 17-28, and p. 18, lines 1-24.) Ms. Reynolds Clark also emphasized that, in her opinion, "being able to destroy a rocket is the ultimate sign of ownership [and] . . . ultimate sign of control." (Transcript of May 22, 2014, public hearing, p. 18, lines 5-7.)

Furthermore, Mr. Dennis Loper appeared at the public hearing, on behalf of SpaceX, and expressed support for the proposed amendments to Property Tax Rule 133, emphasizing that the space flight property at issue is not currently reusable. Also, Mr. Dakessian appeared at the public hearing, on behalf of SpaceX, and expressed support for the adoption of the proposed amendments to Property Tax Rule 133. Mr. Dakessian reiterated Ms. Reynolds Clark's testimony that all meaningful control of space flight property is relinquished to the range safety officer prior to and upon launch. Mr. Dakessian also responded to Mr. Albert Ramseyer's testimony (discussed below) by stating that SpaceX is in fact a manufacturer.

AB 777

When the Board initially voted to propose to adopt the amendments to Property Tax Rule 133, the Board was aware that the Legislature was considering enacting AB 777 to add section 242 to the Revenue and Taxation Code (RTC) to provide a property tax exemption for "qualified property used in space flight." The ISR explained that the proposed amendments to Property Tax Rule 133 are more limited than the exemption afforded by AB 777 "because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all space flight property whether inventory or not."

Since the publication of the notice of proposed regulatory action for the proposed amendments to Property Tax Rule 133, the Legislature enacted and the Governor signed AB 777. As a result, RTC section 242 now provides a property tax exemption for "qualified property for use in space flight." However, RTC section 242, subdivisions (d) and (g), provide that RTC section 242 is only operative from the January 1, 2014, lien date to, and including, the January 1, 2024, lien date, and section 242 is repealed by its own terms effective July 1, 2025. Furthermore, in section 6 of AB 777, the legislature explicitly stated that:

An inference shall not be drawn from this act with respect to whether space flight property qualifies as "business inventories" as defined or described by Sections 129 and 219 of the Revenue and Taxation Code, or Board of Equalization Property Tax Rule 133.

Summary of and Responses to Objections to the Proposed Amendments

The Board received written objections regarding the proposed amendments to Property Tax Rule 133 from Mr. Lawrence E. Stone, Santa Clara County Assessor, via a letter dated April 9, 2014. In his letter, Mr. Stone opposed amending Property Tax Rule 133 to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. This is because, in his opinion, there is always an insufficient ceding of control of the space flight property to a range safety officer. However, as stated in the ISR and as explained further above, because the federal launch safety authority receives sufficient control, so that it may, in its sole discretion, destroy the space flight property due to safety concerns, the Board has determined that all meaningful control over such property

is in fact ceded to the federal launch safety authority. This determination is further supported by the written comments from Mr. Dakessian and the testimony from Ms. Reynolds Clark (discussed above), which indicate that commercial space flight companies relinquish control of their space flight vehicles prior to launch and have no control over the pre-programmed course of their space flight vehicles in flight.

Mr. Stone further states in his April, 8, 2014, letter that he opposes the proposed amendments to Property Tax Rule 133 because, in his opinion, the amendments would preclude the assessment of reusable, or potentially reusable, space flight property. However, this statement is inconsistent with the plain language of the proposed amendments to Property Tax Rule 133, which state explicitly that the business inventory exemption applies to spaceflight property that is “not operationally reusable.”

The Board also received written comments from John F. Krattli, County Counsel for the LACAO, via a letter dated May 20, 2014. In the letter, Mr. Krattli opposed amending Property Tax Rule 133, stating that: (1) there is no need for the Board to clarify the application of the business inventory exemption to space flight property because the clarification would only apply retroactively after the enactment of RTC section 242; (2) the Board does not have authority to adopt the proposed amendments because Property Tax Rule 133 did not previously address space flight property; and (3) it is for the legislature to decide whether to exempt property from assessment.

However, as indicated above, RTC section 242, subdivision (d), expressly provides that RTC section 242 only applies from the “January 1, 2014, lien date to, and including, the January 1, 2024, lien date, and is inoperative for any lien date thereafter.” Therefore, the exemption for qualified property for use in space flight provided by RTC section 242 will no longer apply after January 1, 2024, and such property may be subject to assessment, on a prospective basis, unless the business inventory exemption applies. As a result, there is still a need to clarify whether the business inventory exemption applies to space flight property, on a prospective basis, after the addition of section 242 to the RTC.

In addition, as indicated above, the Legislature has stated that the enactment of RTC section 242 is not intended to create any “inference” as to whether space flight property qualifies as business inventory. Also, Government Code section 15606, subdivision (c), authorizes the Board to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f), authorizes the Board to prescribe “rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures.” As stated in the ISR, the Board has previously made substantive amendments to Property Tax Rule 133 regarding the qualification of specific property, including clarifying in 2002 that oak wine barrels used in the wine manufacturing process qualify for the business inventory exemption. Therefore, the Board does have the authority to amend Property Tax Rule 133 to address the application of the business inventory exemption to specific types of property, and the Legislature has not expressed any intent to preempt or supersede that authority with regard to the application of the business inventory exemption to space flight property.

In his letter, Mr. Krattli further argues that the proposed amendments to Property Tax Rule 133 are substantively wrong because, in his opinion, the true object of the contracts to provide space flight property is a service, the service providers (as he characterizes them) merely contract with the government for use of its range safety systems, and there is no sale of space flight property because the customer never takes delivery of the property.

However, the Board disagrees and has concluded that the information provided in the ISR and the comments in support of the proposed amendments more fairly support the determination that there is a sale when a provider of space flight property relinquishes possession (control) of that property to a third party, for a consideration. As stated in the ISR, due to the unique nature of the space flight industry, the Board's Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. Since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

On May 22, 2014, the Board held a public hearing regarding the adoption of the proposed amendments to Property Tax Rule 133. Mr. Stone appeared at the public hearing and restated his opposition, as expressed in his written comments described above, to the proposed amendments to Property Tax Rule 133. Mr. Stone added that Board staff has not answered the question of who owns the space vehicles after launch. He further asserted that SpaceX has indicated plans for creating reusable space vehicles, concluding that "[t]his rule would likely preclude assessing that property." (Transcript of May 22, 2014, public hearing, p. 8, lines 16-17.)

For space flight property that returns to Earth, in some cases, ownership of the non-reusable vehicle is held by the commercial space flight company. However, as explained above, ownership of a non-reusable spaceflight vehicle after a commercial space flight company transfers possession (control) of the vehicle to the federal government at (or just prior to) launch, for a consideration paid to the company by its customer, is irrelevant; and Property Tax Rule 133 requires only that control is transferred. Further, as explicitly stated in Property Tax Rule 133 and stated in Formal Issue Paper 14-002 and in the ISR, the proposed amendments to Property Tax Rule 133 will not apply to reusable spaceflight property. As such, to the extent that space flight property is reusable, it would not qualify for the business inventory exemption based upon the proposed amendments.

Mr. Albert Ramseyer also appeared at the public hearing on behalf of LACAO, and expressed opposition to the proposed amendments to Property Tax Rule 133, restating the written comments by Mr. Krattli that the Board does not have authority to provide an

argument for the retroactive exemption of space flight property. As stated above, the proposed amendments to Property Tax Rule 133 will have a prospective application. Also, as stated above, the legislature's statement in section 6 of AB 777 confirms that the rulemaking authority of the Board in this respect is not superseded. Government Code section 15606, subdivision (c), authorizes the Board to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f), authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures." As stated in the ISR, the Board has previously made substantive amendments to Property Tax Rule 133 regarding the qualification of specific property, including clarifying in 2002 that oak wine barrels used in the wine manufacturing process qualify for the business inventory exemption. Therefore, the Board does have the authority to amend Property Tax Rule 133 to address the application of the business inventory exemption to specific types of property, and the Legislature has not expressed any intent to preempt or supersede that authority with regard to the application of the business inventory exemption to space flight property.

At the public hearing, Mr. Ramseyer further opposed the proposed amendments to Property Tax Rule 133 because he states that they are based on the false premise that companies like ULA and SpaceX are engaging in a manufacturing business, when in fact they are a launch business. Because, in his opinion, the rockets are not built to be held for sale, but rather to provide launch services, Mr. Ramseyer asserts that they should be subject to assessment.

As in the response to the written statement from Mr. Krattli (for LCAO) described above, the Board disagrees and has concluded that the information provided in the ISR and the comments in support of the proposed amendments more fairly support the determination that there is a sale when a provider of space flight property relinquishes possession (control) of that property to a third party, for a consideration. As stated in the ISR, due to the unique nature of the space flight industry, the Board's Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. Since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

No other interested parties submitted written comments regarding the proposed amendments to Property Tax Rule 133 and no other interested parties asked to speak at the public hearing.

May 8, 2014, Chief Counsel Memorandum

The ISR explained that, after voting to propose the adoption of the amendments to Property Tax Rule 133, at the conclusion of the Board's February 25, 2014, Property Tax Committee meeting, the Board Members also requested that staff provide additional clarification regarding the "ceding of control" and additional analysis of the federal authority requiring the transfer of control, which was provided in the ISR. Subsequently, a May 8, 2014, Chief Counsel memorandum was distributed to the Board Members with slightly more detailed information regarding the "ceding of control" and a similar analysis of the federal authority requiring the transfer of control. Also, on May 9, 2014, the Board posted and distributed the Public Agenda Notice for its May 22, 2014, Board meeting, which included the public hearing regarding the proposed amendments to Property Tax Rule 133. Therefore, in order to increase openness and transparency, the Board made the May 8, 2014, memorandum available to the public as an attachment to the Public Agenda Notice, along with additional copies of the notice of proposed regulatory action, ISR, and text of the proposed amendments to Property Tax Rule 133. However, the Board did not rely on the May 8, 2014, Chief Counsel memorandum in proposing the amendments to Property Tax Rule 133, and the memorandum is only being identified in the final statement of reasons and included in the rulemaking file for completeness.

Determinations Regarding Alternatives

By its motion on May 22, 2014, the Board determined that no alternative to the proposed amendments to Property Tax Rule 133 would be more effective in carrying out the purposes for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.

Furthermore, the Board did not reject any reasonable alternatives to the proposed amendments to Property Tax Rule 133 that would lessen any adverse impact the proposed amendments may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed amendments. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

In the ISR, the Board indicated that it anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch. In addition, the Board's proposed amendments are anticipated to provide the following benefits:

1. Give needed guidance to county assessors as to whether space flight property qualifies as “business inventory” in California; and
2. Ensure that Property Tax Rule 133 is interpreted and administered consistently with RTC sections 129 and 219.

Updated Informative Digest for
Adoption of Proposed Amendments to California Code of Regulations,
Title 18, Section 133, *Business Inventory Exemption*

On May 22, 2014, the State Board of Equalization (Board) held a public hearing on and unanimously voted to adopt the original text of the proposed amendments to California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, described in the notice of proposed regulatory action. There have not been any changes to the applicable laws or the effects and objectives of the adoption of the proposed amendments to Property Tax Rule 133 described in the informative digest included in the notice of proposed regulatory action.

The Board received public comments in support of the proposed amendments, which are consistent with the factual basis for the proposed amendments provided in the informative digest included in the notice of proposed regulatory action and discussed in more detail below. The Legislature enacted and the Governor signed Assembly Bill No. (AB) 777 (Stats. 2014, ch. 13.), which is discussed in the informative digest included in the notice of proposed regulatory action and discussed further below. The Board received objections to the proposed amendments from the Los Angeles County Assessor's Office (LACAO) and Mr. Lawrence E. Stone, the Santa Clara County Assessor, which are summarized and responded to below. The Board also added to the anticipated benefits described in the informative digest included in the notice of proposed regulatory action, as provided below.

The informative digest included in the notice of proposed regulatory action provides:

Current Law

California Constitution, article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. All property includes tangible personal property. However, RTC section 219 provides that, "For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories."

Under Government Code section 15606, subdivision (c), the State Board of Equalization (Board) is authorized to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f) authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures." The Board adopted California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, pursuant to Government Code section 15606, to

implement, interpret, and make specific the provisions, under article XIII of the California Constitution and the RTC, applicable to the exemption of business inventories.

In particular, Property Tax Rule 133 implements, interprets, and makes specific RTC sections 129 and 219. RTC section 129 defines “business inventories” as follows:

“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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

“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.

“Business inventories” shall also include goods held by a licensed contractor and not yet incorporated into real property.

As relevant here, subdivision (a)(1) of Property Tax Rule 133 further defines the term “business inventories” and also defines the phrases “ordinary course of business” and “goods intended for sale or lease,” as used in RTC section 129. The Board added the current provisions of subdivision (a)(2)(A), (C), and (D) to Property Tax Rule 133, in 2000, in order to provide a list of the specific types of property that the Board had previously determined are included within the meaning of the term “business inventories” prior to 2000. And, the Board added subdivision (a)(2)(B) to Property Tax Rule 133, in 2000, to clarify that the Board had recently determined that new and used oak barrels are business inventories, under specific circumstances.

Effects, Objectives, and Benefits of the Proposed Amendments

The transfer of control of space flight property to the federal government is required by Air Force Space Command (AFSPC). Authority over space

flight property launch is granted to the Air Force via the Commercial Space Launch Act of 1984, as amended in 1988 (49 U.S.C. §§ 2601-23, October 30, 1984) which grants regulatory authority over space flight property to the Department of Transportation, which through the Federal Aviation Administration Office for Commercial Space Transportation entered into an agreement with the United States Air Force regarding the implementation of procedures for commercial space transportation and range activities. (See Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities, at https://www.faa.gov/about/office_org/headquarters_offices/ast/media/moa.pdf (as of March 18, 2014).)

AFSPC directs safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch. (Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91-711 (February 1, 2007) (AFSPC Manual 91-711) provide mission flight control officers with power to issue flight termination commands.)

The federal launch safety authority, in its sole discretion, may terminate the flight. (AFSPC Manual 91-711, § 7.1.1.1.) Termination of the flight would result in destruction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

Prior to December 2013, the Board had provided general guidance regarding the business inventory exemption and specific guidance regarding its application to various types of property; however, the previous Board guidance had not specifically discussed the application of the business inventory exemption to space flight property. By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also opined that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory "goods intended for sale . . . in the ordinary course of business." The Property Tax Law (RTC § 50 et seq.) does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that,

“The phrase ‘ordinary course of business’ . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.” Due to the unique nature of the space flight industry, the determination of whether space flight property is a “good intended for sale in the ordinary course of business” must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property. (The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles (22 U.S.C. § 2278, subd. (a)(1)); and the Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List (22 C.F.R. §§ 120-130).) Within that context, the Board’s Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a “sale” and makes space flight property “goods intended for sale in the ordinary course of business” within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board’s Legal Department also based its determination that space flight property is business inventory, under such circumstances, on that fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board’s Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer’s reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement under Cal. Code Regs., tit. 18, § 1700]; See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts – held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer’s gross receipts from each “retail sale,” which is defined as “a sale for any purpose other than resale in the regular course of business.” (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was “sold” in a retail sale and that same property was necessarily, prior to sale, property that was “intended for sale in the ordinary course of business” (i.e.,

business inventory). Thus, the courts recognize that the definition of “goods intended for sale in the ordinary course of business” must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term “sale” means any transfer of title to or possession of property for a consideration and the term “transfer of possession” includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for the specific exemption for qualified property for use in space flight provided by RTC section 6380, space flight property companies would owe sales tax on such transfers. Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO2 containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller’s control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer’s direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that “[w]hile statutes granting property tax exemptions are generally construed strictly, that approach ‘does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable

interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].” (*Id.* at p. 716.) Therefore, based upon the heavy federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board’s Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219.

In Letter to Assessors (LTA) 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, the Board’s Property and Special Taxes Department advised interested parties that a project had been initiated to proposed revisions to Property Tax Rule 133 due to “inquiries as to whether the business inventory exemption applies to certain space flight property regulated under the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR)” (footnotes omitted). The LTA also noted the Legal Department’s December 24, 2013, letter regarding space flight property (discussed above), provided a link to a redacted copy of the letter posted on the Board’s website, and gave the interested parties an opportunity to provide comments and suggestions by January 31, 2014.

Board staff conducted an interested parties meeting on February 6, 2014, to discuss the proposed revisions to Property Tax Rule 133. Staff subsequently prepared Formal Issue Paper 14-002, which included as attachments the comments received in support of and in opposition to Board staff’s proposed amendment to Property Tax Rule 133, and submitted it to the Board for consideration during its February 25, 2014, Property Tax Committee meeting.

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)[(2)](E),¹ to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)[(2)]:²

¹ The informative digest in the notice of proposed regulatory action contained a typographical error which caused it to incorrectly state that Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), instead of the correct subdivision (a)(2)(E). Board staff noted the typographical error for the record during the public hearing regarding the proposed amendments to Property Tax Rule 133 on May 22, 2014.

² See footnote 1.

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase “control over which is relinquished by the owner upon launch” means the transfer of control to a federal launch safety authority for space flight termination purposes.

In addition, in the formal issue paper, Board staff summarized the comments in support of and in opposition to its proposed amendments to Property Tax Rule 133. Board staff responded to the comments in opposition. Board staff also specifically explained that the proposed amendments clarifying the definition of “business inventories” will not apply to “reusable” space flight property. Board staff specifically explained that its proposed amendments are “very narrowly tailored to interpret [RTC] sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch.” Board staff specifically explained that the proposed amendments are more limited than the exemption afforded by Assembly Bill No. (AB) 777 (2013-2014 Reg. Sess.) because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all spaceflight property whether inventory or not. And, Board staff specifically explained that “[because the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of rulemaking.”

At the conclusion of the Board’s discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is necessary to amend Property Tax Rule 133, as recommended by staff, to have the effect and accomplish the objective of addressing the application of the business inventory exemption to space flight property. Therefore, the Board agreed with staff’s recommendation and the Board Members unanimously voted to propose the amendments to Property Tax Rule 133 recommended by staff, and requested that staff provide additional clarification regarding the “ceding of control” and additional analysis of the federal authority regarding the transfer of control, which is provided above and in the initial statement of reasons.

The Board anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

The Board has performed an evaluation of whether the proposed amendments to Property Tax Rule 133 are inconsistent or incompatible with existing state regulations. The Board has determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Property Tax Rule 133 is the only regulation implementing RTC sections 129 and 219, and the proposed amendments make Property Tax Rule 133 consistent with the statutes as discussed above. In addition, the Board has determined that there are no comparable federal regulations or statutes to Property Tax Rule 133 or the proposed amendments to Property Tax Rule 133.

Public Comments in Support of the Proposed Amendments

The Board received written comments from Mr. Mardiros H. Dakessian, on behalf of Space Exploration Technologies Corporation (SpaceX), by letter dated May 19, 2014, expressing support for the adoption of the Board's proposed amendments to Property Tax Rule 133, and responding to comments from Mr. Stone's letter dated April 9, 2014 (discussed below). In his letter, Mr. Dakessian agrees that it is necessary to adopt the proposed amendments to Property Tax Rule 133 to clarify how existing law applies to space flight property. Mr. Dakessian agrees with the Board's analysis "with respect to the responsibilities and authority of the Air Force (Range Safety) and the Mission Flight Control Officer's role as the sole decision-making authority and initiator of the flight termination system." Mr. Dakessian explains that a SpaceX vehicle is "preprogrammed and autonomous and the Range User (such as SpaceX) has no ability to control the vehicle from launch to reaching orbital space." Mr. Dakessian also explains that because "the Range User has no ability to control the vehicle from launch to reaching orbital space," the "Range Safety control for safety purposes is in fact the *only* control that exists during the mission [and] . . . range safety is of paramount importance to any launch. Ceding control to federal authorities is required by the federal system to ensure public safety and cannot be minimized." (Emphasis in original.)

The Board also received written comments from Mr. David Flaks, on behalf of the Los Angeles County Economic Development Corporation (LAEDC), by letter dated May 19, 2014, offering support for the Board's proposed amendments to Property Tax Rule 133 because they are rational, objectively fair, and provide for equitable treatment of businesses in California.

In addition, Ms. Debra Reynolds Clark appeared at the public hearing on behalf of United Launch Alliance (ULA) and expressed support for the adoption of the Board's proposed amendments to Property Tax Rule 133. Ms. Reynolds Clark stated that ULA, Boeing,

and Lockheed have been subject to property tax audits over the past 15 years, for which rockets have always been treated as business inventory by county assessors. (Transcript of May 22, 2014, public hearing, p. 16, lines 26-28, and p. 17, lines 1-3.) Further, in her oral testimony, Ms. Reynolds Clark restated the factual basis for the proposed amendments to Property Tax Rule 133, as provided in the informative digest (and quoted above). Ms. Reynolds Clark emphasized that the launch vehicles at issue are 100 percent non-reusable. (Transcript of May 22, 2014, public hearing, p. 17, lines 9-16.) Further, to emphasize that commercial space flight companies completely relinquish control over the space flight property upon launch, Ms. Reynolds Clark reiterated that at the Vandenberg Air Force Base, the range safety officer of the federal government takes control over the rocket even before take-off. The range safety officer has the authority to destroy the vehicle on the launch pad, as well as during flight, for safety reasons. Even during flight, the commercial space flight companies have no control over the course of the vehicle, because directives to steer and deliver its payload are programmed prior to launch. (Transcript of May 22, 2014, public hearing, p. 17, lines 17-28, and p. 18, lines 1-24.) Ms. Reynolds Clark also emphasized that, in her opinion, “being able to destroy a rocket is the ultimate sign of ownership [and] . . . ultimate sign of control.” (Transcript of May 22, 2014, public hearing, p. 18, lines 5-7.)

Furthermore, Mr. Dennis Loper appeared at the public hearing, on behalf of SpaceX, and expressed support for the proposed amendments to Property Tax Rule 133, emphasizing that the space flight property at issue is not currently reusable. Also, Mr. Dakessian appeared at the public hearing, on behalf of SpaceX, and expressed support for the adoption of the proposed amendments to Property Tax Rule 133. Mr. Dakessian reiterated Ms. Reynolds Clark’s testimony that all meaningful control of space flight property is relinquished to the range safety officer prior to and upon launch. Mr. Dakessian also responded to Mr. Albert Ramseyer’s testimony (discussed below) by stating that SpaceX is in fact a manufacturer.

AB 777

When the Board initially voted to propose to adopt the amendments to Property Tax Rule 133, the Board was aware that the Legislature was considering enacting AB 777 to add section 242 to the Revenue and Taxation Code (RTC) to provide a property tax exemption for “qualified property used in space flight.” The informative digest (quoted above) explained that the proposed amendments to Property Tax Rule 133 are more limited than the exemption afforded by AB 777 “because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all space flight property whether inventory or not.”

Since the publication of the notice of proposed regulatory action for the proposed amendments to Property Tax Rule 133, the Legislature enacted and the Governor signed AB 777. As a result, RTC section 242 now provides a property tax exemption for “qualified property for use in space flight.” However, RTC section 242, subdivisions (d) and (g), provide that RTC section 242 is only operative from the January 1, 2014, lien date to, and including, the January 1, 2024, lien date, and section 242 is repealed by its

own terms effective July 1, 2025. Furthermore, in section 6 of AB 777, the legislature explicitly stated that:

An inference shall not be drawn from this act with respect to whether space flight property qualifies as “business inventories” as defined or described by Sections 129 and 219 of the Revenue and Taxation Code, or Board of Equalization Property Tax Rule 133.

Summary of and Responses to Objections to the Proposed Amendments

The Board received written objections regarding the proposed amendments to Property Tax Rule 133 from Mr. Lawrence E. Stone, Santa Clara County Assessor, via a letter dated April 9, 2014. In his letter, Mr. Stone opposed amending Property Tax Rule 133 to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. This is because, in his opinion, there is always an insufficient ceding of control of the space flight property to a range safety officer. However, as stated in the informative digest and as explained further above, because the federal launch safety authority receives sufficient control, so that it may, in its sole discretion, destroy the space flight property due to safety concerns, the Board has determined that all meaningful control over such property is in fact ceded to the federal launch safety authority. This determination is further supported by the written comments from Mr. Dakessian and the testimony from Ms. Reynolds Clark (discussed above), which indicate that commercial space flight companies relinquish control of their space flight vehicles prior to launch and have no control over the pre-programmed course of their space flight vehicles in flight.

Mr. Stone further states in his April, 8, 2014, letter that he opposes the proposed amendments to Property Tax Rule 133 because, in his opinion, the amendments would preclude the assessment of reusable, or potentially reusable, space flight property. However, this statement is inconsistent with the plain language of the proposed amendments to Property Tax Rule 133, which state explicitly that the business inventory exemption applies to spaceflight property that is “not operationally reusable.”

The Board also received written comments from John F. Krattli, County Counsel for the LCAO, via a letter dated May 20, 2014. In the letter, Mr. Krattli opposed amending Property Tax Rule 133, stating that: (1) there is no need for the Board to clarify the application of the business inventory exemption to space flight property because the clarification would only apply retroactively after the enactment of RTC section 242; (2) the Board does not have authority to adopt the proposed amendments because Property Tax Rule 133 did not previously address space flight property; and (3) it is for the legislature to decide whether to exempt property from assessment.

However, as indicated above, RTC section 242, subdivision (d), expressly provides that RTC section 242 only applies from the “January 1, 2014, lien date to, and including, the January 1, 2024, lien date, and is inoperative for any lien date thereafter.” Therefore, the exemption for qualified property for use in space flight provided by RTC section 242 will

no longer apply after January 1, 2024, and such property may be subject to assessment, on a prospective basis, unless the business inventory exemption applies. As a result, there is still a need to clarify whether the business inventory exemption applies to space flight property, on a prospective basis, after the addition of section 242 to the RTC.

In addition, as indicated above, the Legislature has stated that the enactment of RTC section 242 is not intended to create any “inference” as to whether space flight property qualifies as business inventory. Also, Government Code section 15606, subdivision (c), authorizes the Board to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f), authorizes the Board to prescribe “rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures.” As stated in the informative digest, the Board has previously made substantive amendments to Property Tax Rule 133 regarding the qualification of specific property, including clarifying in 2002 that oak wine barrels used in the wine manufacturing process qualify for the business inventory exemption. Therefore, the Board does have the authority to amend Property Tax Rule 133 to address the application of the business inventory exemption to specific types of property, and the Legislature has not expressed any intent to preempt or supersede that authority with regard to the application of the business inventory exemption to space flight property.

In his letter, Mr. Krattli further argues that the proposed amendments to Property Tax Rule 133 are substantively wrong because, in his opinion, the true object of the contracts to provide space flight property is a service, the service providers (as he characterizes them) merely contract with the government for use of its range safety systems, and there is no sale of space flight property because the customer never takes delivery of the property.

However, the Board disagrees and has concluded that the information provided in the informative digest and the comments in support of the proposed amendments more fairly support the determination that there is a sale when a provider of space flight property relinquishes possession (control) of that property to a third party, for a consideration. As stated in the informative digest, due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. Since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

On May 22, 2014, the Board held a public hearing regarding the adoption of the proposed amendments to Property Tax Rule 133. Mr. Stone appeared at the public hearing and restated his opposition, as expressed in his written comments described above, to the

proposed amendments to Property Tax Rule 133. Mr. Stone added that Board staff has not answered the question of who owns the space vehicles after launch. He further asserted that SpaceX has indicated plans for creating reusable space vehicles, concluding that “[t]his rule would likely preclude assessing that property.” (Transcript of May 22, 2014, public hearing, p. 8, lines 16-17.)

For space flight property that returns to Earth, in some cases, ownership of the non-reusable vehicle is held by the commercial space flight company. However, as explained above, ownership of a non-reusable spaceflight vehicle after a commercial space flight company transfers possession (control) of the vehicle to the federal government at (or just prior to) launch, for a consideration paid to the company by its customer, is irrelevant; and Property Tax Rule 133 requires only that control is transferred. Further, as explicitly stated in Property Tax Rule 133 and stated in Formal Issue Paper 14-002 and in the informative digest, the proposed amendments to Property Tax Rule 133 will not apply to reusable spaceflight property. As such, to the extent that space flight property is reusable, it would not qualify for the business inventory exemption based upon the proposed amendments.

Mr. Albert Ramseyer also appeared at the public hearing on behalf of LACAO, and expressed opposition to the proposed amendments to Property Tax Rule 133, restating the written comments by Mr. Krattli that the Board does not have authority to provide an argument for the retroactive exemption of space flight property. As stated above, the proposed amendments to Property Tax Rule 133 will have a prospective application. Also, as stated above, the legislature’s statement in section 6 of AB 777, that RTC section 242 is not intended to create any “inference” as to whether space flight property qualifies as business inventory, confirms that the rulemaking authority of the Board in this respect is not superseded. Government Code section 15606, subdivision (c), authorizes the Board to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f), authorizes the Board to prescribe “rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures.” As stated in the informative digest, the Board has previously made substantive amendments to Property Tax Rule 133 regarding the qualification of specific property, including clarifying in 2002 that oak wine barrels used in the wine manufacturing process qualify for the business inventory exemption. Therefore, the Board does have the authority to amend Property Tax Rule 133 to address the application of the business inventory exemption to specific types of property, and the Legislature has not expressed any intent to preempt or supersede that authority with regard to the application of the business inventory exemption to space flight property.

At the public hearing, Mr. Ramseyer further opposed the proposed amendments to Property Tax Rule 133 because he states that they are based on the false premise that companies like ULA and SpaceX are engaging in a manufacturing business, when in fact they are a launch business. Because, in his opinion, the rockets are not built to be held for sale, but rather to provide launch services, Mr. Ramseyer asserts that they should be subject to assessment.

As in the response to the written statement from Mr. Krattli (for LACAO) described above, the Board disagrees and has concluded that the information provided in the informative digest and the comments in support of the proposed amendments more fairly support the determination that there is a sale when a provider of space flight property relinquishes possession (control) of that property to a third party, for a consideration. As stated in the informative digest, due to the unique nature of the space flight industry, the Board's Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. Since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

No other interested parties submitted written comments regarding the proposed amendments to Property Tax Rule 133 and no other interested parties asked to speak at the public hearing.

Anticipated Benefits

In the informative digest included in the notice of proposed regulatory action (quoted above) and in the ISR, the Board indicated that it anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch. In addition, the Board's proposed amendments are anticipated to provide the following benefits:

1. Give needed guidance to county assessors as to whether space flight property qualifies as "business inventory" in California; and
2. Ensure that Property Tax Rule 133 is interpreted and administered consistently with RTC sections 129 and 219.



BOARD OF EQUALIZATION
PROPERTY TAX COMMITTEE MEETING MINUTES
HONORABLE GEORGE RUNNER, COMMITTEE CHAIR
5901 GREEN VALLEY CIRCLE, CULVER CITY
FEBRUARY 25, 2014 - 9:30 A.M.

ACTION ITEM

Agenda Item No: 1

Title:

Property Tax Rule 133, *Business Inventory Exemption*

Issue:

Should the State Board of Equalization authorize publication of amendments to Property Tax Rule 133, *Business Inventory Exemption*?

Committee Discussion:

Committee Chair Runner opened the Committee meeting by introducing the agenda item and asked staff to give a report on the issue.

Dean Kinnee, Chief, County-Assessed Properties Division, gave the Committee an overview of the interested parties process for the proposed revisions to the rule. Mr. Kinnee explained that subsequent to the distribution of the Issue Paper for this item, additional suggested revisions were made to the rule language, and that the Committee Members had been provided with those changes in a separate handout. The revised proposed language for Rule 133, subdivision (a)(2)(E), reads:

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase "control over which is relinquished upon launch" means the transfer of control to a federal launch safety authority for space flight termination purposes.

Speakers making a presentation in opposition to the rule revision language were:

Sharon Moller, Chief Deputy Assessor, County of Los Angeles
Honorable Larry Stone, Assessor, County of Santa Clara

Honorable Larry Ward, President, California Assessors' Association
Albert Ramseyer, Deputy County Counsel, County of Los Angeles

Speakers making presentations in support of the rule revision language were:

Dennis Loper, SpaceX
Marty Dakessian, Reed Smith
Joe Vinatieri, Bewley, Lassleben & Miller
Debra Reynolds-Clark, United Launch Alliance

Member Yee expressed concern about the lack of clarity of who actually has control of the equipment during a launch and the legal federal authority relating to relinquishing control.

Member Horton reiterated that action to initiate the rulemaking process was not a final decision on the proposed language, and indicated that the rulemaking process does not have to be expedited.

Committee Action:

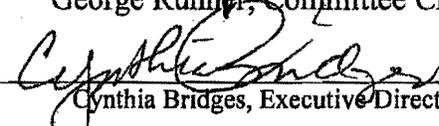
Member Yee made a motion to recommend publication of proposed revisions to Rule 133 with two provisions:

1. More information must be obtained regarding the factual control of the equipment before, during, and after a launch.
2. More information must be obtained regarding the legal control of the equipment, with emphasis and discussion about the federal statutes and authorities involved in a launch.

The motion was seconded by Member Horton. Without objection, the motion passed.

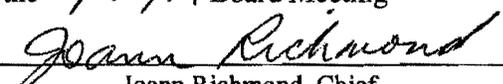
Approved:


George Runner, Committee Chair


Cynthia Bridges, Executive Director

BOARD APPROVED

At the 2/25/14 Board Meeting


Joann Richmond, Chief
Board Proceedings Division

RULE 133. BUSINESS INVENTORY EXEMPTION.

Authority Cited: Section 15606, Government Code.
Reference: Sections 129 and 219, Revenue and Taxation Code.

(a) SCOPE OF EXEMPTION.

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property, not operationally reusable for space flight under federal law, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1) as a defense article on the United States Munitions List, the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel by a space vehicle, satellite, space facility, or space station of any kind.

(ii) The phrase "control over which is relinquished by the owner upon launch" means the transfer of control to a federal launch safety authority for space flight termination purposes the Range Safety Officer pursuant to federal law.

(b) EXCLUSIONS. Property eligible for the "business inventories" exemption does not include:

(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased. Examples of property excluded from business inventories are office supplies, furniture, machines and equipment and manufacturing machinery, equipment and supplies such as dies, patterns, jigs, tooling or

chemicals used to produce a chemical or physical reaction, and contractors' supplies, tools, concrete forms, and other items that will not be incorporated into and become a part of the property. Also ineligible are materials that a contractor is holding to incorporate into real property that will be retained for his own use.

(2) Property being used by its owner for any purpose not directly associated with the prospective sale or lease of that property.

(3) Property actually leased or rented on the lien date.

(4) Property which has been used by the holder prior to the lien date, even though held for lease on the lien date.

(5) Property intended to be used by the lessor after being leased or during intervals between leases even though held for lease on the lien date.

(6) Property in the hands of a lessor who, with intent to enjoy the benefits of the inventory exemption, had leased the property for a period that expired shortly before the lien date but who renewed, extended or renegotiated the lease shortly thereafter.

(c) SERVICE ENTERPRISES. Property held by a person in connection with a profession which is primarily a service activity such as medicine, law, architecture or accountancy is not "business inventories" held for sale or lease even though such property may be transferred to a patient or client incidental to the rendition of the professional service. Property held by enterprises rendering services of a nonprofessional type such as dry cleaners, beauty shop operators and swimming pool service companies is to be regarded as "business inventories" held for sale if such property is delivered as an item regularly included in the service.

(d) REPAIRERS AND RECONDITIONERS. Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and materials shall be regarded as holding said parts and materials as "business inventories."

(e) AGRICULTURAL ENTERPRISES. Animals, crops and feed held primarily for sale or lease in the ordinary course of business are included in the term "business inventories," as are animals used in the production of food or fiber and feed for such animals.

(1) "Animals used in the production of food and fiber" includes all animals customarily employed in the raising of crops or for the feeding, breeding and management of livestock, or for dairying, or any other confined animals whose products are normally used as food for human consumption or for the production of fiber useful to man. Excluded are animals held by an owner or lessee principally for sport, recreation or pleasure such as show animals, horses kept for racing or horses and other animals kept as pets.

(2) The term "crops" means all products grown, harvested, and held primarily for sale, including seeds held for sale or seeds to be used in the production of a crop which is to be held primarily for sale. It does not include growing crops exempted pursuant to Article XIII, section 3 (h), of the California Constitution or fruit trees, nut trees, and grapevines exempted by section 223 of the Revenue and Taxation Code.

(3) The term "food" means property normally considered as food for human consumption.

(4) Feed for animals held primarily for sale or lease or for animals used in the production of food or fiber constitutes "business inventories" subject to exemption. It includes every type of natural-grown or commercial product fed to animals except medicinal commodities intended to prevent or cure disease unless the medicinal commodities are purchased as a component part of feed for such animals.

History: Adopted November 20, 1968, effective December 21, 1968.
Amended January 7, 1970, effective February 8, 1970.
Amended January 6, 1971, effective February 18, 1971.
Amended February 5, 1975, effective March 20, 1975.
Amended August 20, 1980, effective November 14, 1980.
Amended October 10, 1984, effective February 21, 1985.
Amended January 5, 2000, effective July 26, 2000.
Amended and effective April 6, 2001.

Issue Paper Number **14-002**



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Property Tax Rule 133, *Business Inventory Exemption*

I. Issue

Whether the State Board of Equalization (Board) should initiate the rulemaking process to amend Property Tax Rule 133, *Business Inventory Exemption*, to clarify that the business inventory exemption applies to non-reusable, space transportation equipment (space flight property) fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch under federal law to a Range Safety Officer.

II. Alternative 1 - Staff Recommendation

Staff recommends that the Board authorize publication of the proposed amendments to Rule 133, as set forth in Attachment A, to initiate the formal rulemaking process.

III. Other Alternatives Considered

Alternative 2 – Conduct Additional Interested Parties Meetings

The Board could direct staff to initiate further interested party discussions on the proposed amendments to Rule 133 before proceeding with the official rulemaking process.

Alternative 3 – Do Not Amend Rule 133

The Board could deny authorization to amend Rule 133 as proposed.

IV. Background

Under Government Code section 15606, subdivision (c), the Board is given the power and duty to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Additionally, Government Code section 15606, subdivision (f), authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures." In compliance with this duty, the Board adopted Rule 133 to provide guidance on the exemption of business inventories as mandated by Revenue and Taxation Code¹ sections 129 and 219.

Section 219 provides that, "For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories." Section 129 contains the following definition of *business inventories*:

"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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

"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.

"Business inventories" shall also include goods held by a licensed contractor and not yet incorporated into real property.

V. Discussion

In a letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch, and that Rule 133 should be amended to specifically address space flight property governed by federal statutes and regulations. Revisions to Rule 133 were proposed to clarify that such space flight property qualifies for the business inventory exemption.

The United States regulates the export of certain goods and technologies broadly related to national defense, including space flight property, through a number of laws and regulations that involve multiple federal agencies including the Department of State, the military, NASA and the intelligence agencies. Chief among those laws and regulations are the Arms Export Control Act (AECA) (22 U.S.C. § 2778) and the International Traffic in Arms Regulations (ITAR) (22 C.F.R. parts 120-130). The December 24 letter explained that the space flight industry is heavily regulated by relevant federal statutes and regulations including the AECA and ITAR, creating a unique market in which the technical sale of goods

¹ All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

is constrained to make the transfer of title of space flight equipment extremely difficult, if not practically impossible. Such a situation was not contemplated by sections 129 and 219 which were enacted 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. In such an environment, the relinquishment of control to federal authority at launch should qualify as a *sale* within the meaning of the business inventory exemption.

In Letter To Assessors 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, interested parties were advised that a project had been initiated to propose revisions to Rule 133. Interested parties were given the opportunity to provide comments by January 31, 2014, and several submissions both in support of and in opposition to the proposed amendments were received and are summarized below. All comments received are included as attachments to this issue paper in Attachment B. At an interested parties meeting held on February 6, 2014, various comments in support of and in opposition to the proposed amendments were discussed.

Comments in Support

- *Capitol Strategies Group.* The proposed amendments are a proper exercise of the Board's authority to prescribe rules and regulations and will promote uniformity. The proposed amendments are faithful to Rule 133's spirit and intent and reflect the proper interpretation of the governing statute.
- *United Launch Alliance.* United Launch Alliance supports the proposed amendments and suggested several revisions to the language. As a result of the interested parties meeting, one revision was made to the amendments that staff believes is responsive to United Launch Alliance's suggestions.
- *Reliance Machine Products.* The proposed amendments are a proper exercise of the Board's authority to prescribe rules and regulations, will ensure the rule's equitable application throughout the state, and will contribute to maintaining a prosperous aerospace industry in California.
- *Wesco Aircraft.* The proposed amendments are a proper exercise of the Board's authority to prescribe rules and regulations, will ensure the rule's equitable application throughout the state, and will contribute to maintaining a robust aerospace sector in California.
- *Commercial Spaceflight Federation.* The proposed amendments are supported by the Commercial Spaceflight Federation, a trade organization with over 45 members, as a proper classification of space-related inventory which would help ensure California's space technology innovators stay in business in California.

Comments in Opposition

- *California Assessors' Association.* The California Assessors' Association requested a delay in the deadline for comments to the proposed amendments due to the noted progress of Assembly Bill 777 and concerns about a rulemaking process being opened concurrently with an active assessment appeal addressing the same issue.
- *Los Angeles County Assessor's Office.* The Los Angeles County Assessor's Office objects to the proposed rule on the grounds that the proposed rule exceeds the Board's authority, is inconsistent with the applicable governing statute, and conflicts with the Board's previous instructions regarding the business inventory exemption.

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- *Santa Clara County Assessor's Office.* The Santa Clara County Assessor's Office objects to the proposed rule for the same reasons expressed by the Los Angeles County Assessor's Office and also objects based on staff initiating a rulemaking process impacting the entire state based on what appears to be a single anonymous inquiry, on the possibility that spaceflight companies are creating reusable spaceflight property that would not properly be business inventory, and on not offering a compelling state interest for providing a company with an ongoing appeal matter a "very special benefit" exempting it from normal due process.

As noted above, on February 6, 2014, Board staff held an interested parties meeting in Sacramento to discuss the proposed revisions to the rule and to address issues presented by interested parties. Staff explained that it was responsible for initiating the informal discussion regarding a potential rulemaking process and that the formal rulemaking process cannot begin unless the Board authorizes such action. Because the issue of the qualification of spaceflight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of potential rulemaking. Staff further explained that the proposed amendments to Rule 133 were more narrow than the exemption afforded by AB 777. Rule 133 applies only to business inventory, while AB 777 would exempt all spaceflight property whether inventory or not. Responses to additional objections raised by the Los Angeles County Assessor's Office and the Santa Clara Assessor's Office are provided below:

- ***The proposed amendments to Rule 133 do not exceed the Board's authority.*** Government Code section 15606, subdivision (c), authorizes the Board to "[p]rescribe rules and regulations to govern . . . assessors when assessing," and to promote uniformity of assessment throughout the state. Additionally, Government Code section 15606, subdivision (f), authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures."
- ***The proposed amendments to Rule 133 are not inconsistent with applicable statutes governing business inventories.*** Sections 129 and 219 exempt and define business inventories. Together, the statute exempts certain goods that are for *sale*. Although the California Uniform Commercial Code defines *sale* as the passage of title, the term *sale* has been more broadly defined in other tax contexts (e.g., for sales and use tax purposes). In fact, but for the fact that there is a specific exemption for sale of spaceflight property in the Sales and Use Tax Law,² such a transaction contemplated by the proposed Rule 133 amendments would have been subject to sales tax. The proposed Rule 133 amendments are very narrowly tailored to interpret sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch under federal law. Finally, section 129's prohibition against the inclusion as business inventory of goods that cannot be legally sold was intended to apply to goods that are sold in criminal activity. (See Letter To Assessor (LTA) 86/90.)
- ***The proposed amendments to Rule 133 are not counter to prior Board-issued advice.*** Rule 133 was enacted in 1968 to interpret section 129. Since that time, the Board has issued guidance on what property qualifies for the business inventory exemption, including LTAs discussing goods transferred with nonprofessional services (LTA 2000/59), goods transferred with professional services (LTA 80/69), and goods which cannot be legally sold (LTA 86/90). Further, in the past, the Board has amended Rule 133 to clarify the treatment of specific property. Specifically, Rule 133 was amended substantively in 2000 to allow oak wine barrels used in the wine manufacturing process to qualify for the business inventory exemption. No previous guidance,

² Section 6380.

however, has been issued regarding space flight property that is the subject of this proposed amendment.

- ***The initiation of the rulemaking process was not based on a single anonymous inquiry.*** Staff initiated discussion regarding a potential rulemaking process because the issue of the qualification of spaceflight property as exempt business inventory is one that has potential statewide significance, and such rulemaking would be interpretative of and consistent with existing statutes. Therefore, it is the proper subject of potential rulemaking.
- ***The proposed amendments to Rule 133 would not allow reusable property to qualify as business inventory.*** The proposed Rule 133 amendments do not contemplate that reusable spaceflight property would qualify as business inventory. As discussed below, additional revisions were made to the amendments to clarify this point.
- ***The proposed amendments to Rule 133 do not provide a special benefit to a particular taxpayer.*** The proposed Rule 133 amendments have potential statewide significance and comments were received from multiple taxpayers, including the Commercial Spaceflight Federation—a trade organization representing more than 45 members including many in California. The proposed amendments to Rule 133 do not offer a special benefit, but is rather the proper exercise of the Board's rulemaking authority to prescribe rules and regulations for a unique industry to facilitate uniformity. Further, in any potential controversy, a taxpayer must demonstrate that its property qualifies under the amendments to Rule 133.

As a result of the February 6, 2014 interested parties meeting, agreement was reached on two amendments to the proposed rule. As mentioned above, the first clarifies that only space flight property that may not be reused under federal law could qualify as business inventory. The second defines the phrase "control over which is relinquished by the owner upon launch" as the transfer of control to the Range Safety Officer pursuant to federal law. Both amendments are reflected in Attachment A.

On February 11, 2014, interested parties were provided a copy of the revised rule language (as shown in Attachment A). Subsequent comments received are contained in Attachment C.

Because all potential interested parties were notified, objections answered, and agreed upon revisions made to the proposed amendments, staff does not believe additional interested parties meetings can be expected to result in the receipt of additional new information or in any changes to staff's recommendation. Finally, any continuing objections or new information may be presented to and considered by the Board as part of the public hearing that is required as part of the formal rulemaking process.

VI. Alternative 1 - Staff Recommendation

Authorize publication of revisions to Rule 133 to initiate the formal rulemaking process.

A. Description of Alternative 1

Staff recommends that the Board authorize publication of amendments to Rule 133, as set forth in Attachment A, to initiate the formal rulemaking process.

B. Pros of Alternative 1

Authorizing publication of amendments to Rule 133 and initiating the formal rulemaking process will expedite clarification of Rule 133 to help ensure that all county assessors are uniformly applying the provisions of the business inventory exemption to spaceflight property fabricated and used to

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transport satellites and cargo to locations in outer space and over which the owner must relinquish ultimate control under federal law to a Range Safety Officer at launch. Such amendments are consistent with the governing statutes and the Board's rulemaking authority as exercised in past amendments to Rule 133. Further, while previous Board guidance has generally discussed the business inventory exemption, the specific treatment of space flight property is not contained in any previous guidance issued by the Board. The proposed amendments to Rule 133 would clarify the treatment of such property.

C. Cons of Alternative 1

Interested parties raised a number of objections which are discussed and responded to in the Discussion section above.

D. Statutory or Regulatory Change for Alternative 1

Action by the Board to adopt revisions to Property Tax Rule 133 will amend title 18 of the California Code of Regulations, chapter 1, subchapter 3, section 133.

E. Operational Impact of Alternative 1

None

F. Administrative Impact of Alternative 1

1. Cost Impact

Development of Property Tax Rules is within the scope of the statutory duties of the Property and Special Taxes Department and will be absorbed by existing staff.

2. Revenue Impact

None

G. Taxpayer/Customer Impact of Alternative 1

County assessors will be provided with guidance in order to help ensure that the business inventory exemption is uniformly applied to all taxpayers relative to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner must relinquish ultimate control at launch under federal law to a Range Safety Officer.

H. Critical Time Frames of Alternative 1

None

VII. Alternative 2 – Initiate an Interested Parties Process

A. Description of Alternative 2

Initiate an interested parties process to further consider amendments to Rule 133.

B. Pros of Alternative 2

Directing staff to initiate an interested parties process to discuss issues and draft revisions to Rule 133 may result in a broader consensus of the interested parties who participate in the process.

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C. Cons of Alternative 2

Initiating an interested parties process will delay any eventual revisions to Rule 133. Further, since potential interested parties were notified, objections answered, and revisions made to the proposed amendments, a delay in authorization of the formal rulemaking process may yield no new information, and, if such additional information exists, it may still be presented and considered during the formal rulemaking process.

D. Statutory or Regulatory Change for Alternative 2

None

E. Operational Impact of Alternative 2

None

F. Administrative Impact of Alternative 2

1. Cost Impact

Conducting an interested parties process to discuss proposed changes to a Property Tax Rule is within the scope of the duties of the Property and Special Taxes Department and will be absorbed by existing staff.

2. Revenue Impact

None

G. Taxpayer/Customer Impact of Alternative 2

Taxpayers and other interested parties will be given the opportunity to provide additional input on any proposed revisions to Rule 133.

H. Critical Time Frames of Alternative 2

None

VIII. Alternative 3 – Do Not Amend Rule 133

A. Description of Alternative 3

Do not approve authorization to amend Rule 133 as proposed.

B. Pros of Alternative 3

The Board would not incur the workload associated with processing and publicizing the amended regulation.

C. Cons of Alternative 3

Rule 133 would not be clarified to include certain space flight property as qualifying business inventory.

D. Statutory or Regulatory Change for Alternative 3

None

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G. Operational Impact of Alternative 3

None

H. Administrative Impact of Alternative 3

1. Cost Impact

None

2. Revenue Impact

None

G. Taxpayer/Customer Impact of Alternative 3

Without amendment to Rule 133, there may be confusion as to whether space flight property that is the subject of the amended rule qualifies as business inventory.

H. Critical Time Frames of Alternative 3

None

Preparer/Reviewer Information

Prepared by: Legal Department

Current as of: February 14, 2014

RULE 133. BUSINESS INVENTORY EXEMPTION.

Authority Cited: Section 15606, Government Code.
Reference: Sections 129 and 219, Revenue and Taxation Code.

(a) SCOPE OF EXEMPTION.

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property, not reusable for space flight under federal law, listed in the International Traffic in Arms Regulations (22 CFR § 121.1) as a defense article on the United States Munitions List, the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel by a space vehicle, satellite, space facility, or space station of any kind.

(ii) The phrase "control over which is relinquished by the owner upon launch" means the transfer of control to the Range Safety Officer pursuant to federal law.

(b) EXCLUSIONS. Property eligible for the "business inventories" exemption does not include:

(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased. Examples of property excluded from business inventories are office supplies, furniture, machines and equipment and manufacturing machinery, equipment and supplies such as dies, patterns, jigs, tooling or chemicals used to produce a chemical or physical reaction, and contractors' supplies, tools, concrete forms, and

other items that will not be incorporated into and become a part of the property. Also ineligible are materials that a contractor is holding to incorporate into real property that will be retained for his own use.

(2) Property being used by its owner for any purpose not directly associated with the prospective sale or lease of that property.

(3) Property actually leased or rented on the lien date.

(4) Property which has been used by the holder prior to the lien date, even though held for lease on the lien date.

(5) Property intended to be used by the lessor after being leased or during intervals between leases even though held for lease on the lien date.

(6) Property in the hands of a lessor who, with intent to enjoy the benefits of the inventory exemption, had leased the property for a period that expired shortly before the lien date but who renewed, extended or renegotiated the lease shortly thereafter.

(c) SERVICE ENTERPRISES. Property held by a person in connection with a profession which is primarily a service activity such as medicine, law, architecture or accountancy is not "business inventories" held for sale or lease even though such property may be transferred to a patient or client incidental to the rendition of the professional service. Property held by enterprises rendering services of a nonprofessional type such as dry cleaners, beauty shop operators and swimming pool service companies is to be regarded as "business inventories" held for sale if such property is delivered as an item regularly included in the service.

(d) REPAIRERS AND RECONDITIONERS. Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and materials shall be regarded as holding said parts and materials as "business inventories."

(e) AGRICULTURAL ENTERPRISES. Animals, crops and feed held primarily for sale or lease in the ordinary course of business are included in the term "business inventories," as are animals used in the production of food or fiber and feed for such animals.

(1) "Animals used in the production of food and fiber" includes all animals customarily employed in the raising of crops or for the feeding, breeding and management of livestock, or for dairying, or any other confined animals whose products are normally used as food for human consumption or for the production of fiber useful to man. Excluded are animals held by an owner or lessee principally for sport, recreation or pleasure such as show animals, horses kept for racing or horses and other animals kept as pets.

(2) The term "crops" means all products grown, harvested, and held primarily for sale, including seeds held for sale or seeds to be used in the production of a crop which is to be held primarily for sale. It does not include growing crops exempted pursuant to Article XIII, section 3 (h), of the California Constitution or fruit trees, nut trees, and grapevines exempted by section 223 of the Revenue and Taxation Code.

(3) The term "food" means property normally considered as food for human consumption.

(4) Feed for animals held primarily for sale or lease or for animals used in the production of food or fiber constitutes "business inventories" subject to exemption. It includes every type of natural-grown or commercial product fed to animals except medicinal commodities intended to prevent or cure disease unless the medicinal commodities are purchased as a component part of feed for such animals.

History: Adopted November 20, 1968, effective December 21, 1968.
Amended January 7, 1970, effective February 8, 1970.
Amended January 6, 1971, effective February 18, 1971.
Amended February 5, 1975, effective March 20, 1975.
Amended August 20, 1980, effective November 14, 1980.
Amended October 10, 1984, effective February 21, 1985.
Amended January 5, 2000, effective July 26, 2000.
Amended and effective April 6, 2001.

Comments from Interested Parties



January 23, 2014

Ms. Sherrie Kinkle
State Board of Equalization
Property and Special Taxes Department
450 N Street
P.O. Box 942879
Sacramento, California 94279-0064

Re: Property Tax Rule 133, Business Inventory Exemption

Dear Ms. Kinkle:

On behalf of my client, Space Exploration Technologies Corporation, or SpaceX, I am writing this letter in support of the Board of Equalization's proposed amendments to Property Tax Rule 133, *Business Inventory Exemption*. Board staff correctly concluded that the business inventory exemption should apply to space flight property, control over which is relinquished at launch.

Government Code Section 15606(c) authorizes the Board to "[p]rescribe rules and regulations to govern ... assessors when assessing." Moreover, the statute empowers the Board to provide "instructions to assessors designed to promote uniformity throughout the state," and the Board "may adapt the instructions to varying local circumstances and to differences in the character and conditions of property subject to taxation as in its judgment is necessary to attain this uniformity." (*Id.*, § 15606(e).) I applaud the Board's proper exercise of its authority and judgment in this circumstance.

Space flight property undoubtedly represents challenges for the property tax system due to government restrictions stemming from national security concerns and the nuances involved in properly assessing the property. The Board's careful revision of Rule 133 is an important step in promoting uniformity and correctly accounting for the intricacies and customs inherent in space-related endeavors and contracts, while remaining faithful to Rule 133's spirit and intent.

Once again, we believe that the Board's revision of the business inventory exemption reflects the proper interpretation of the governing statute.

Sincerely,

Dennis Loper



January 23, 2014

Ms. Sherrie Kinkle
State Board of Equalization
450 N. Street
Sacramento, CA 94279-0064

RE: Proposed Revisions to Property Tax Rule 133

Dear Ms. Kinkle,

We appreciate the effort that the State Board of Equalization is making in helping space launch companies secure the business inventory exemption under Rule 133. United Launch Alliance has been launching space vehicles from Vandenberg since 2007. We are very concerned about the County of Los Angeles's efforts to tax the launch vehicles and parts as "supplies" rather than treating them as business inventory.

To that end, we have some suggested modifications to the language of Rule 133, which I have attached. The first change we would like to see is the removal of the phrase "as a defense vehicle". Our reasoning is twofold:

- First, it is redundant as space flight property is already defined as "a defense article" within 22CFR 121.1,
- Second, and more importantly, often the average person who reads the Rule in a literal sense does not perform the research necessary to vet out the true meaning of the language used such as going on to read, in detail, 22CFR121.1(a) Category IV and XV.

In this instance, we believe that taxpayers and county auditors alike will see the phrase "as a defense vehicle" and interpret this phrase as excluding commercial launch vehicles from the exemption as they will not look to 22CFR 121.1 (a) Category IV and XV. This could create another round of misunderstanding which could be avoided by relying on the language in 22 CFR 121.1.

We also believe the Rule should be broad enough to include future space vehicles and hope to prevent any future debate over what type of vehicle would qualify, so we made a few changes to the definition of "space flight".

Our last recommendation is to include a definition of the phrase "control over which is relinquished at launch" to prevent any debate over the intended meaning of this phrase.

If you would like to discuss our proposed modification, please feel free to contact me at 303-26-5183(direct) or via my email: debra.k.reynolds-clark@ulalaunch.co,



I would like to be included as an interested party along with our outside legal counsel Joseph Vinatieri. We would like to attend the Feb 6 meeting of interested parties.

If you need to contact me via mail my address is:

United Launch Alliance, LLC
c/o Debra Reynolds-Clark
P.O. Box 5076
Centennial, CO 80155

We appreciate your assistance with this matter.

Best Regards,

A handwritten signature in black ink that reads "Debra Reynolds-Clark". The signature is written in a cursive, flowing style.

Debra Reynolds-Clark
Senior Tax Manager

RULE 133. BUSINESS INVENTORY EXEMPTION.

Authority Cited: Section 15606, Government Code.

Reference: Sections 129 and 219, Revenue and Taxation Code.

(a) SCOPE OF EXEMPTION.

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property listed in the International Traffic in Arms Regulations (22 CFR section 121.1) ~~as a defense article on the United States Munitions List, the control over which is relinquished by the owner upon launch.~~ "Space flight" means any flight of a launch vehicle designed for suborbital, orbital, or interplanetary travel ~~by~~ a involving any type of space vehicle, satellite, space facility, or space station of any kind.

i) For the purposes of (E) above, †The phrase, "control over which is relinquished upon launch" . is intended to mean the transfer of control to the Range Safety Officer pursuant to federal law.

RELIANCE

MACHINE PRODUCTS, INC.

4265 Solar Way • Fremont, CA 94538 • 510.438.6760 • Fax 510.438.6770

January 29, 2014

Ms. Sherrie Kinkle
State Board of Equalization
Property and Special Taxes Department
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0064

Re: Property Tax Rule 133, Business Inventory Exemption

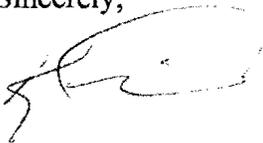
Dear Ms. Kinkle:

On behalf of Reliance Machine Products, I would like to express our support of the Board of Equalization's recent decision that space flight property should be categorized as exempt business inventory. The proposed amendments to Property Tax Rule 133 ensure the rule's equitable application throughout the state. This action is consistent with the authority vested in the Board under Government Code Section 15606(c), and will contribute to maintaining a prosperous aerospace industry in California.

We understand that commercial space launch is an evolving and challenging issue for the property tax system. While launch providers sell services, they relinquish control over space flight property upon launch. Therefore, as a California aerospace supplier, we support the important distinction that launch vehicles should not be subject to property tax. This tax, if improperly applied, would have a negative impact on the entire industry.

Thank you again.

Sincerely,



Kelly Hill
President and Chief Executive Officer
Reliance Machine Products, Inc.
4265 Solar Way
Fremont, California 94538



January 30, 2014

Ms. Sherrie Kinkle
State Board of Equalization
Property and Special Taxes Department
450 N Street
P.O. Box 942879
Sacramento, CA 94279-0064

Re: Property Tax Rule 133, Business Inventory Exemption

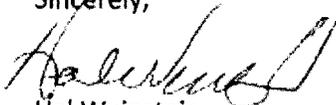
Dear Ms. Kinkle:

On behalf of Wesco Aircraft Hardware Corp., I wish to express our strong support of the Board of Equalization's recent conclusion that space flight property should be categorized as exempt business inventory. The proposed amendments to Property Tax Rule 133 properly ensure the rule's uniform application throughout the state. This action is consistent with the authority vested in the Board under Government Code Section 15606(c), and will contribute to maintaining a robust aerospace sector in California.

We recognize that commercial space launch is an emerging and challenging issue for the property tax system. While launch providers sell services, they relinquish control over space flight property upon launch. Therefore, as a proud California aerospace supplier, we applaud this important clarification that launch vehicles should not be subject to property tax. This tax, if improperly applied, would have added significant burden to the entire industry.

Thank you again.

Sincerely,


Hal Weinstein
Executive Vice President



Hal Weinstein | Executive Vice President | 27727 Avenue Scott, Valencia, California, US 91355
Office: 661-775-7279 | Email: Hal.Weinstein@wescoair.com | Web: www.wescoair.com



444 N. Capitol St. NW, Suite 837
Washington, DC 20001
31 January 2014

Ms. Sherrie Kinkle
CA State Board of Equalization
450 N. Street
Sacramento, CA 94279-0064

Dear Ms. Kinkle,

On behalf of the Commercial Spaceflight Federation, a trade organization with over 45 company members in the commercial spaceflight business, including many in California, I am pleased to see that the State Board of Equalization is making an effort to ensure that space launch vehicles and parts are properly classified as business inventory for the purposes of California tax provisions.

Commercial spaceflight promises to expand the nation's space capabilities to enable new and improved missions for commerce, science, defense and exploration. By using technical and business developments pioneered by NASA and a number of high-tech industries, commercial space is now offering spaceflight services at affordable prices and new services that have never been possible before. A large amount of this commercial space activity currently takes place in California.

California aerospace firms are not only creating the most advanced space vehicles, they are also significantly contributing to the state's economy and local communities. In 2009, California aerospace companies generated \$27 billion in revenue, ranging from the sale of aircraft parts to space satellite research and development. California's significant contribution in aerospace represents 15% of the overall U.S. aerospace industry.

A ruling to properly classify space-related inventory would help ensure that California's space technology innovators stay in business in California, and we support your effort to do so.

Sincerely,

A handwritten signature in black ink, appearing to read "Alexander Saltman".

Alexander Saltman
Executive Director



CALIFORNIA ASSESSORS' ASSOCIATION

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 Calaveras County

***Past President**

January 24, 2014

David Gau
 Deputy Director
 Property and Special Taxes Department
 State Board of Equalization
 450 N Street Sacramento, California
 PO Box 942879, Sacramento, California 94279-0064

Re: Proposed Revisions to Property Tax Rule 133

Dear Deputy Director Gau:

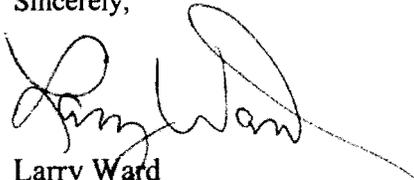
The California Assessors' Association requests that the date for comments regarding the proposed revisions to Property Tax Rule 133, as described in LTA no. 2014/004, be moved forward to April 30, 2014. This extension is requested due to the noted progress of Assembly Bill 777 (Muratsuchi), as well as concerns about a rulemaking process being opened concurrently with an active assessment appeal addressing the same issues.

While we are not privy to the details of how the process to revise Rule 133 was started, it seems likely that it was in response to the apparent stalling of AB 777 in the Legislature several months ago. However, it now appears that the bill is making new progress. It was just voted out of committee unanimously on January 23rd, and is very likely to be in the Senate by the end of the month. We understand there is significant support for the bill, including a positive outlook from the Governor's office.

Additionally, Los Angeles County has four years of pending assessment appeals cases concerning the type of property described in LRA 2014/004. In the past, the rulemaking process has been held back when there is related litigation, and this is a similar situation.

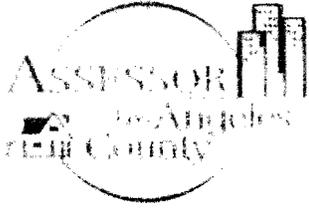
With these conditions in mind, it would be in the best interests of all parties to provide additional time for initial comments, and request that the deadline be extended until April 30, 2014.

Sincerely,



Larry Ward
 President, California Assessors' Association
 Riverside County Assessor-County Clerk-Recorder

cc: CAA Executive Committee



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SHARON MOLLER
CHIEF DEPUTY ASSESSOR

January 27, 2014

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."

Ms. Sherrie Kinkle

January 27, 2014

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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

AR:AC

Office of the Assessor

County of Santa Clara

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Website: www.sccassessor.org



Lawrence E. Stone, Assessor

February 3, 2014

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

Re: Proposed Revision to Property Tax Rule 133

Dear Ms. Kinkle:

I write to oppose staff's suggested revision to Property Tax Rule 133, which exempts space flight equipment as business inventory. In addition, I want to strongly echo the comments submitted by the Los Angeles County Assessor's Office in their letter to the State Board of Equalization (BOE) dated January 27, 2014. Finally, I write to express a number of other concerns with this proposal.

INITIATION OF RULE-MAKING PROCESS SETS BAD PRECEDENT

I strongly object to the BOE staff initiating a rule-making process, which would impact the entire state, based on what appears to be a single anonymous inquiry sent to the BOE legal staff. Historically, staff has limited their authority to initiate changes in rules to non-controversial issues. Changing this practice and allowing a single company to effectively initiate the rule-making sets a very bad precedent for the BOE.

My Assistant Assessor initiated a formal California Public Records Act (CPRA) request on January 9, for a copy of the letter that initiated the proposed ruling. The BOE's legal staff did not provide the requested information on the basis that the letter contained confidential information pursuant to a loose interpretation of Government Code Section 15619. The CPRA is strongly worded in favor of the production of records for the purpose of open government and transparency. If a single letter from an anonymous company can trigger a rule-making process, then I believe it is the BOE's responsibility to release the requested documents in their entirety. This action is especially troubling as assessors and the BOE routinely share confidential information.

RULE IS INCONSISTENT WITH REVENUE & TAXATION CODE SECTION 129

The proposed rule is inconsistent with Revenue & Taxation Code Section 129 which defines "business inventories" as all tangible personal property, whether raw materials, work in process or finished goods, that will become a part of or are themselves items of personalty held for sale

or lease in the ordinary course of business. The space flight equipment that is the subject of the proposed ruling is machinery and equipment, and is not offered for sale or lease in the ordinary course of business. The code section thereby explicitly disqualifies space flight equipment from being classified as business inventory.

The Assessor's Handbook reiterates the law's intent when it directs assessors to consider the key phrases "ordinary course of business and goods intended for sale or lease." It goes on to state that these phrases "must apply for the property to qualify for the business inventory exemption." The Handbook provides an example: "If a copier leasing company holding machines for lease uses one of the machines prior to the lien date or intends to use the copier after the lien date, that copier is no longer part of the goods intended for sale or lease and would not qualify for the business inventory exemption even if it is held for lease on the lien date."

SPACE JUNK OR REUSABLE SPACESHIP

In the "anonymous" company's letter to the BOE Legal Department, the author claims that after the delivery of the equipment's payload, it is generally burned up in space or becomes space junk. Yet SpaceX, the leading proponent of this tax break, notes on its company website that their spacecraft (called "Dragon") delivered cargo to and from space multiple times, and was able to return safely to earth. The website also states that the company has been providing regular cargo resupply missions to NASA. There is serious contradiction between what SpaceX is advertising on its website and the information provided by the company in the letter to the BOE. Either companies like SpaceX are creating an inventory of space junk or, more likely, are manufacturing a fleet of space vehicles that they intend to use much as UPS and FedEx use aircraft to deliver packages.

PROPOSAL EXCEEDS BOE AUTHORITY

The State Assembly has passed to the State Senate AB 777 which was introduced with the clear, singular purpose to exempt the same space equipment that the proposed rule seeks to exempt. The legislature has initiated that change in policy as they would like to provide this tax break to SpaceX and similar companies. While I oppose AB 777, the Constitution grants the State Legislature the authority to provide such exemptions. The proposed change exceeds the BOE's authority, and since the matter is currently before the State Senate, there is no need to test the boundaries of the BOE's constitutional authority. Doing so would certainly invite the California Assessors' Association to file a 538 action challenging the BOE authority.

NO URGENCY FOR INTERVENTION IN AN APPEAL

As the BOE is aware, the issue in dispute concerns a single company that has appropriately sought redress through the assessment appeals process. Intervening on behalf of a single taxpayer before the matter is adjudicated at the local assessment appeals board sets a very bad precedent. Moreover, neither the BOE nor the taxpayer has offered a compelling state interest for providing this company with a very special benefit exempting it from the normal due process afforded all other taxpayers.

Sherrie Kinkle
February 3, 2014
Page three

In summary, the proposed ruling is contrary to law and to previous advice provided by the BOE to county assessors. Allowing the revision to occur will set a bad precedent and encourage other companies to seek the same exemption. I urge the BOE staff to halt further discussion of this ill-conceived proposal.

Sincerely,



Lawrence E. Stone
Assessor

Cc: Members of the California Assessors' Association
Brian Donnelly, Los Angeles County Assessor's Office
Dean Kinnee, Board of Equalization
Rob Grossglauser and Gregg Cook, Government Affairs Consulting

LES:dhl

**Additional Comments
Received
after the
Interested Parties
Meeting**



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SHARON MOLLER
CHIEF DEPUTY ASSESSOR

February 13, 2014

Ms. Sherrie Kinkle
State Board of Equalization
450 N Street, MIC:72
Sacramento, CA 94279-0064

Dear Ms. Kinkle:

COMMENTS TO THE REVISED PROPOSED AMENDMENT OF PROPERTY TAX RULE 133

This is to provide the comments of the Los Angeles County Office of the Assessor to the proposed amendment of Rule 133, and are made in advance of the Property Tax Committee meeting scheduled for February 25, 2014.

We continue to insist that the effort by the Board of Equalization (Board) to amend Rule 133 to exempt space flight property as non-assessable business inventory is inconsistent with Revenue and Taxation Code Section 129. (Please see our letter of January 27, 2014, comments of which have been reiterated herein.) The Board's rulemaking must be consistent with statute (Gov. Code § 11342.2).

The proposed rule purports to override, for purposes of the space launch industry, the statutory definition of business inventory as "property intended for sale or lease in the ordinary course of business." The Board, however, does not have legal authority to redefine categories of business property as exempt from assessment. The authority to exempt personal property from assessment resides in the legislature and the proposal should be redirected to that body.

California law requires regulations to be consistent with statute and with an agency's rulemaking authority. The proposed amendment apparently seeks to define the transfer of control of certain property to a Range Safety Officer as the functional equivalent of the sale or lease of property in the ordinary course of business. This is a non sequitur, and does not meet the "consistency" standard for rulemaking. (See Govt. Code 11349(d).) The operation of property subject to government regulation is entirely distinct from a transfer of property to a third party for their own beneficial use.

We further object to the proposed language of the rule amendment because it is unclear. What exactly is "space flight property"? Does this include ground-based flight controls? The

Ms. Sherrie Kinkle
February 13, 2014
Page 2

tax administrator should not be put in the position of having to guess what the proposed text means.

The general references to "federal law" in the proposed amendment are also vague. We respectfully request that the proposed amendment identify where in federal law the distinction is found between property that is and is not "reusable for space flight," a distinction that will be important in administering the proposed amended rule. The same observation holds true with regard to the "transfer of control to the Range Safety Officer. . . ." Where is this reference found in federal law? The Board's proposed amendment is apparently predicated upon the notion that a transfer of control of operations to a Range Safety Officer in a space launch is equivalent to the "sale or lease of property in the ordinary course of business." We respectfully request that the Board identify the federal law which serves as the basis for this proposed distinction.

One final point. We would advise the Board that we understand that with regard to spacecraft systems and related items the ITAR list is under review and, according to the trade press, the list is expected to be amended in spring or early summer with regard to this type of property.

We thank the Board and its Property Tax Committee for its consideration of these comments.

Sincerely,



SHARON MOLLER

AR:AC

February 13, 2014

I write on behalf of Santa Clara County to let you know that in the short window provided, we have quickly reviewed the proposed changes to the rule. We remain opposed for the reasons outlined in our letter of February 3, 2014. Fundamentally, only property that is “intended for sale or lease” can constitutionally be exempted from assessment. SpaceX’s website (and its founder, Elon Musk) has repeatedly made clear that its intention is to build and operate a fleet of space capsules much like any other cargo transportation company. As noted in a January 29 Reuters article about the passage of AB 777, the competing effort to provide this tax break, SpaceX “along with Virginia-based Orbital Sciences Corp, have NASA contracts worth a combined \$3.5 billion for a total of 20 cargo flights to the International Space Station...SpaceX is preparing for its third cargo run to the space station on Feb. 22. Other private space exploration companies have also set up shop in California, including Virgin Galactic...”

Larry Stone
Assessor

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CALIFORNIA STATE AND LOCAL TAX GROUP

JOSEPH A. VINATIERI JEFFREY S. BAIRD
JASON C. DEMILLE PATRICIA VERDUGO
RICHARD L. DEWBERRY

February 13, 2014

Sent Via Email (Sherrie.Kinkle@boe.ca.gov) and U.S. Mail

Sherrie Kinkle
Tax Administrator
County-Assessed Properties Division
State Board of Equalization
PO Box 942879
Sacramento, California 94279-0064

Re: Property Tax Rule 133

Dear Sherrie:

This letter is written to follow up you email of February 11, 2014 as well as the recently held Interested Parties meeting on February 6, 2014. The undersigned is outside tax counsel for United Launch Alliance, LLC (“ULA”). ULA provides, inter alia, the launch vehicle as found in Category IV – Launch Vehicles, Guided Missiles, Ballistic Missiles, Rockets, etc. on the United States Munitions List, Section 121.1 of ITAR (22 CFR 121.1). We appreciated the opportunity to present comments at the meeting and want to follow up on those comments.

First, it is important to understand that Rule 133 affects more than one party. The space industry continues to evolve and we suspect that there are other parties who are also affected by the rulemaking process of Rule 133 that aren’t even aware of the applicability of the Rule to their particular situation. We appreciate the fact that the Board is taking a leadership role in this matter which bodes well for the growth of the space industry in California and the jobs the industry provides.

Second, there was much discussion regarding transfer of title as the final attribute of a sale. However, as we discussed at the meeting, under the Sales and Use Tax Law, transfer of possession and/or control can be utilized as a surrogate for title. Pursuant to federal law, the actions of the Range Officer, with no recourse from the launch provider, show the ultimate in control vested in that Range Officer. This is made clear in (E)(ii) of the proposed language.

There was criticism at the Interested Parties meeting regarding whether the State Board of Equalization has the power to amend Rule 133. There can be no question that this Board possesses said power as that rulemaking authority is found in the Government Code. We applaud the staff and Board for utilizing said power and responsibility.



CALIFORNIA ASSESSORS' ASSOCIATION

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Calaveras County

***Past President**

February 21, 2014

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:

On February 20, 2014, the Executive Committee of the California Assessors' Association (CAA) voted unanimously to oppose the changes to Property Tax Rule 133, as outlined most recently in Formal Issue Paper 14-002. This letter outlines two of our significant objections.

Business inventories, goods intended for sale or lease in the ordinary course of business, are, clearly, exempt from taxation. We disagree that the transient assignment of temporary safety oversight, in the form of the Range Safety Officer's responsibility, is equivalent to a sale or lease. However, it is this very leap of logic that the Board has chosen to use as the basis for this proposed amendment. The CAA is in strong opposition to this position.

Secondly, the Board is usurping the Legislature's constitutional prerogative to determine what classifications of personal property are exempt from property tax. 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. The authority to exempt personal property from assessment resides solely in the Legislature, where Assembly Bill 777 is making significant progress at this time. This bill proposes to exempt the same type of property covered by the proposed amendments to Rule 133, making these changes unnecessary.

Thank you for consideration of the California Assessors' Association's position.

Sincerely,

Larry Ward
President, California Assessors' Association
Riverside County Assessor-County Clerk-Recorder

February 24, 2014

The Honorable Jerome Horton
Chair, Board of Equalization
621 Capitol Mall, Ste. 975
Sacramento, CA 95814

Re: Revisions to Board of Equalization Rule 133 – SUPPORT

Dear Chairman Horton:

On behalf of the Los Angeles County Economic Development Corporation, an organization dedicated to promoting job growth, economic expansion, and preserving the overall global competitiveness of California and Los Angeles County, I am pleased to offer our support for the proposed Board of Equalization (BOE) amendments to Rule 133. We believe the revised BOE Rule 133, which classifies equipment used in space travel as a “business inventory” thus providing a property tax exemption, is not only the normatively “equitable” thing to do, but it is also critically important to retaining, expanding and attracting new entrants into California’s fast growing space commercialization industry – a “homegrown” California industry that is not only carrying on the state’s aerospace dominance, but continuing to push the creative limits by changing the contours of the aerospace industry and expanding the creative bounds of what is possible in privately-supported space travel.

The public policy rationale for the revisions to BOE Rule 133 is simple: it’s about fairness and equitable treatment of businesses across all industries and sectors. Although California does not have a so-called “inventory tax,” which levies a tax on inventories without regard to profitability, the current property tax on equipment used in space travel is for “all intents and purposes” tantamount to an inventory tax, making California significantly less appealing for these space commercialization firms and creating a strong disincentive for these companies to locate their inventories in-state, where they’d be subject to the tax.

Making this inequitable treatment of California’s space sector even more troubling is that the state can – and must – do even more to support its fast-emerging, innovation sectors – as the future job generators. Moreover, we know that the state’s space sector is taking off in California through privately-supported space commercialization. However, we must not take it for granted and, in doing so, work hard to ensure it stays here. The space industry’s decision – meaning, it’s a choice – to be in our state is a great distinction and of great value, not only for our economy but also for our communities that benefit from the thousands of well-paying, high-skilled jobs, as well as the induced and indirect jobs, output, tax and investment impacts that flow to our regions.

Yet, the “newness” of this industry comes with its own set of challenges. For example, SpaceX, a Southern California stalwart in this emerging private space commercialization industry, employing more than 3,000 workers, received an unexpected and sizeable multi-million dollar tax bill for back property taxes on its propulsion systems (rockets)—chattel that was previously untaxed when space exploration and travel was a government-dominated field. At its core, the revisions to BOE Rule 133 exempt from property taxes this and other types of equipment for use in space flight.

However, the revisions to Rule 133 mean much more than that.

The revised BOE Rule 133 is a friendly reminder that in today's global economy, location is not permanent, but companies – especially those at the forefront of innovation and the technology revolution – have many opportunities to locate outside of California. We have already seen California's aerospace employment decrease by more than two-thirds from over 321,000 in 1990 due to combination of factors. And here in Los Angeles County, we've witnessed first-hand the destructive effects that the industry's decline from 189,000 workers in 1990 to fewer than 60,000 in 2011 has wreaked on our local communities. Not to mention the ancillary – but enormous - repercussions that the loss of aerospace programs has had on our nation-leading manufacturing base, as well as the state and local tax dollars lost due to these severe job declines – tax dollars that help fund critical community services and social programs.

Still, make no mistake; aerospace remains an incredibly vital industry to the economies and communities of California, Southern California, and Los Angeles County. So while the industry has suffered staggering job losses during the past 20+ years, the aerospace industry has also brought forth some incredible advances with companies like Northrop, Boeing, AeroVironment and SpaceX, which is not only revolutionizing space travel and leading – dare I say: “winning” – this generation's space race, but designing and building over 70 percent of its vehicles in-house, making their Hawthorne, California headquarters one of the few places in the world where you can view an entire rocket or spacecraft being manufactured. And again, this is all being done right here, in California's very own backyard. This should not be a business we slam with a very costly, past-due notice on a previously never taxed piece of equipment.

For all of the above reasons, the LAEDC commends your leadership on this and other important tax issues that help make California a better place to do business and offers its strong support for the revisions to BOE Rule 133—a much-needed business inventory classification that is not only rooted in notions of rational public policy, objective fairness and equitable treatment of businesses across sectors, but it will help secure our state's position as the home to the burgeoning space commercialization sector while simultaneously sending a message to all current and future space companies that “California is open for business.”

Sincerely,



David Flaks, Chief Operating Officer
Los Angeles County Economic Development Corporation

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

5901 GREEN VALLEY CIRCLE

CULVER CITY, CALIFORNIA

REPORTER'S TRANSCRIPT

FEBRUARY 25, 2014

PROPERTY TAX COMMITTEE

Reported by: Juli Price Jackson

No. CSR 5214

1 MR. KINNEE: Thank you.

2 The issue before the Board today is whether
3 the State Board of Equalization should initiate the
4 rulemaking process to amend Property Tax Rule 133,
5 business inventory exemption, to clarify the
6 business inventory exemption applies to non-usable
7 space transportation equipment, fabricated and used
8 to transport satellite and cargo to locations in
9 outer space and over which the owner relinquishes
10 ultimate control at launch under federal law to a
11 range safety officer.

12 Staff issued a letter to assessors on
13 January 8th with proposed language amending the
14 rule. Staff felt the proposed -- proposed language
15 was appropriate, necessary to clarify the treatment
16 of certain unique property involved in a highly
17 regulated marketplace.

18 Staff held an interested parties meeting on
19 February 8th, where we discussed numerous issues and
20 concerns the parties brought forth.

21 Those issues are laid forth in issue paper
22 14-002 in front of you. We won't go into them in
23 detail right now. There's numerous speakers and
24 we'll be happy to address the issues at the time of
25 the speakers, if the Board wishes.

26 On February 21st, staff issued some revised
27 language, which I believe is before all the Board
28 Members and that's the language that is up for

1 discussion today.

2 Staff recommends that the Board authorize
3 publication of the proposed amendments to Rule 133
4 as set forth in the language forwarded to Board
5 Members on February 21st and to interested parties.

6 Other alternatives the Board may consider
7 is the Board could direct staff to continue to have
8 further discussions with interested parties before
9 commencing the official rulemaking process or the
10 Board could deny the authorization to amend Rule
11 133.

12 At this time we're ready for any questions
13 the Board may have.

14 MR. RUNNER: Okay, thank you.

15 We do have some cards on this. And the
16 way, I think, we will handle this, is I have four --
17 four speakers in favor, four speakers in opposition.
18 We're going to limit the time for each speaker to
19 three minutes.

20 But what I'd like them to do is I'd like
21 them to come up as a panel. So, I am going to ask
22 those are in opposition to come up first -- that
23 would be assessor Larry Stone, Sharon Moller from LA
24 County Assessor's Office, Albert Ramseyer from LA
25 County Council and Larry Ward, Assessor from
26 Riverside County. If you all come up and take
27 chairs there?

28 And I want to do it this way in light of

1 the fact that you may want to quickly decide, in
2 order to not be redundant, how much time each person
3 wants to take, who's going to anchor the discussion.

4 And let me tell the -- those who are in
5 favor of this, we'll do the same thing.

6 So, divide up your time how you would like
7 to and we'll do a total then of 12 minutes and we'll
8 go ahead and begin now.

9 And go ahead and introduce yourself as you
10 -- as you -- to remind as you're speaking, who
11 you're representing.

12 MR. RAMSEYER: Good morning, Albert
13 Ramseyer, Deputy County Counsel, I'm with -- I
14 generally represent the Assessor's Office. I've
15 been doing this work for a long, long time.

16 MR. STONE: I'm Larry Stone, the County
17 Assessor of Santa Clara County.

18 MS. MOLLER: Sharon Moller, Chief Deputy
19 Assessor for Los Angeles County.

20 MR. WARD: Good morning, Larry Ward,
21 Assessor for Riverside County, also the President of
22 the California Assessors' Association.

23 ---o0o---

24 SHARON MOLLER

25 ---o0o---

26 MS. MOLLER: I guess I will start it off.
27 And I will try to -- probably have to speak very
28 quickly in order to meet that -- that time

1 requirement, but I will do my best.

2 From the moment our auditor arrived at the
3 SpaceX facility several years ago for a routine
4 audit and came across the dragon capsule that had
5 not been previously reported by the taxpayer, we
6 knew we had an assessment challenge that was not
7 routine and a property type that we had not dealt
8 with before.

9 But as you are well aware, we -- the -- we
10 considered the property taxable, all tax -- all
11 property is taxable unless exempt by constitution.

12 So, we assessed the taxes on this property
13 for the tax years 2008 through 2011. SpaceX
14 challenged that assessment by filing an appeal,
15 requesting an opinion from the BOE.

16 And as was stated, on December 24th of last
17 year, the BOE issued an opinion letter that was
18 nonbinding and an advisory nature. This opinion
19 raised immediate concerns with our office due to
20 conflicting information and an overall disagreement
21 with the conclusions drawn.

22 Within two weeks following the distribution
23 of the opinion and with an apparent assumption of
24 factual accuracy, the process swiftly moved beyond
25 the opinion letter, which was believed to have been
26 sufficient, which we believe had not been
27 sufficiently vetted, to the specific wording of the
28 Property Tax Rule revision.

1 As you know, Section 129 and Property Tax
2 Rule 133 clearly states the business inventories,
3 goods intended for sale or lease in the ordinary
4 course of business, are exempt for taxation.

5 As stated on page 2 of the BOE legal
6 opinion, SpaceX contracts with their customers to
7 provide for fabrication of equipment and launch
8 services, there is no transfer of title.

9 The opinion goes on to state,

10 "SpaceX does not structure its
11 contracts as a sale or lease of the
12 equipment."

13 And assumes that that's because federal
14 constraints. But our research indicates that the
15 selling of their equipment is not part of their
16 business model, which primarily consists of delivery
17 of satellites to locations in space and cargo to the
18 international space station.

19 The BOE letter concedes that SpaceX's
20 property is not for sale, but concludes it should be
21 eligible for the business inventory exemption,
22 nonetheless, because it relinquishes control to a
23 federal authority at launch and concludes that this
24 relinquishment of control is effectively
25 transferring the rights of ownership.

26 The sale is not to a customer, who
27 presumably is gaining the benefit of their service,
28 but to the safety authority that may or may not have

1 control, but has the authority to terminate it if
2 goes off course.

3 We believe the ceding of control at launch
4 is strictly for safety purposes and temporary.
5 Unlike what is expected in a sale, there is no
6 exchange of consideration and no expectation of
7 beneficial use.

8 We are concerned about the possible
9 implications of expanding the definition of "sale"
10 to the relinquishment of control to federal
11 authorities.

12 What about the air traffic controller who
13 guides the takeoff and landing of aircraft or a
14 federal inspector who has the authority to restrict
15 equipment use or facility operations if certain
16 safety requirements are not met?

17 Is there a distinction that should be made
18 and maintained regarding whether control is ceded on
19 a temporary basis and for strictly safety purposes?

20 And there is still a question of whether
21 control is transferred. According to the BOE
22 opinion, which is carried forward into the language
23 of the Property Tax Rule, ultimate control of the
24 equipment is ceded at launch.

25 However, there is conflicting information
26 indicating that SpaceX maintains mission control
27 centers and has control for the duration of the
28 mission.

1 MS. RICHMOND: Time's expired.

2 MS. MOLLER: Including the ability to
3 relight the engines during a mission and correct
4 problems that arise.

5 With all due respect to this Board, we
6 question the legality of exempting personal property
7 via a rule as it is the legislature's prerogative to
8 determine what classification of personal property
9 are exempt from taxation.

10 AB 777 is currently moving through the
11 legislature --

12 MR. RUNNER: Let me see if I can move you
13 to --

14 MS. MOLLER: -- and appears likely to pass.

15 MR. RUNNER: -- to conclusion pretty
16 quickly there 'cause you've got other folks who want
17 to make comments also.

18 MS. MOLLER: Okay. If I have made that.
19 Well, let me just -- let me just say,
20 that -- that we have been taking a neutral position
21 on AB 777 --

22 MR. RUNNER: I am sorry, I misunderstood.
23 The panel gets 12. You guys can divide it up how
24 you want.

25 You can continue. And the panel, as a
26 whole, gets 12. So, go ahead and continue and just
27 know that you had gone over three, but the panel
28 gets 12. So --

1 MS. MOLLER: Thank you.

2 MR. RUNNER: -- you can continue.

3 MS. MOLLER: Thank you very much.

4 MR. RUNNER: The whole panel gets 12.

5 MS. MOLLER: As I was saying, AB 777 is
6 currently moving through the legislature and appears
7 likely to pass.

8 So, we have the legislature attempting to
9 pass a new law and simultaneously we have the BOE
10 trying to grant the same or similar exemption,
11 assuming the property is already covered under
12 existing law.

13 We believe the legislature's involvement
14 supports our position that the exemption of this
15 property is not covered by existing law.

16 Although our office did not advocate for
17 this legislation, we recognize that AB 777 provides
18 guidance that the proposed language change and
19 Property Tax Rule 133 simply does not.

20 AB 777 contains -- contains language
21 describing the space flight property. The property
22 tax rule does not. It requires the taxpayer to
23 provide evidence of the property meets the bill's
24 definition upon assessor request.

25 The property tax rule carries no reporting
26 requirement. Given the lack of reporting of this
27 property from SpaceX, we believe the reference to
28 space flight property within the proposed revision

1 will be difficult to determine and verify.

2 And with the most current version of the
3 rule change, we now have the added burden of
4 defining operational -- operationally reusable
5 property.

6 Finally, AB 777 specifies a limited
7 exemption period, January 2014 through January 2024.

8 The property tax rule takes it a step
9 further by extending this exemption before and after
10 this period, in essence, granting an exemption that
11 exceeds the proposed law.

12 In conclusion, the BOE has an oversight
13 role in clarifying existing law. We respect this
14 oversight role and the responsibility that goes wit
15 it.

16 However, we -- this most recent rulemaking
17 proposal and the reasoning used as a basis has
18 strained credibility to the point that the CAA
19 Executive Committee voted unanimously to oppose it.

20 We have a property tax system based on
21 equal treatment and transparency. If, indeed, space
22 flight property is covered under existing law, the
23 proper place to resolve it is at the Assessment
24 Appeals Board, for which SpaceX currently has
25 unresolved applications.

26 MR. RUNNER: Okay.

27 MS. MOLLER: Thank you.

28 MR. RUNNER: Mr. Stone.

1 ---o0o---

2 LARRY STONE

3 ---o0o---

4 MR. STONE: I'm here today to urge the
5 Board to oppose initiating the rulemaking process to
6 exempt what NASA describes as commercial space
7 transportation systems.

8 I want to urge the Board to step back and
9 reconsider the very premise upon which your legal
10 counsel is recommending the proposed rule.

11 That premise is straightforward. The space
12 transport industry has requested the special
13 exemption because they claim they are forced to,
14 "relinquish ultimate control at launch under federal
15 law to a range safety officer."

16 That is not true. The conclusion which
17 your legal counsel rests this opinion on states, and
18 I quote,

19 "Contracts are drafted as required by
20 federal law, such as the company cedes
21 ultimate control of the equipment at launch
22 to a federal safety range officer."

23 That also is not true. The problem is
24 nobody's questioned the facts.

25 If your staff had had met with
26 representatives of NASA, as I did, or bothered to
27 contact a range safety officer, as we did, they
28 would have learned that companies like SpaceX no

1 more turn their control over their vehicles to a
2 range safety officer than United Airlines turns over
3 control of its aircraft to the FAA.

4 The job of a range safety officer -- and it
5 is their only job -- is safety. Just as the FAA has
6 authority to ground any and all aircraft, as they
7 did during 9/11, so too does the range safety
8 officer have the authority to destroy SpaceX's cargo
9 vehicles based upon safety alone.

10 Please don't take my word for it. We came
11 to this conclusion by doing a lot of research. We
12 examined the 2013 Range Safety Manual for the
13 Goddard Space Flight Center. This 66-page document
14 states that the range safety officer is an authority
15 only for range safety, policy, processes and
16 requirements.

17 There is nothing to indicate that the range
18 safety officer has any more control than an air
19 traffic controller. And if there is any doubt, we
20 reviewed the 2011 NASA and Federal Aviation
21 Administration Joint Program Management Plan, the
22 PMP, published by NASA's International Space Station
23 Program. That 50-page document details the
24 partnership between NASA, SpaceX and the FAA.

25 The management plan states and I quote,
26 "The contractor or licensee," in this
27 case SpaceX, "is responsible for its launch
28 and vehicle operations throughout the

1 mission."

2 Appendix C of that document is even more
3 specific and removes any ambiguity. In it NASA
4 states, and I quote,

5 "SpaceX or the Orbital Science
6 Corporation," which is SpaceX, "always,"
7 underscore always, "has prime
8 responsibility."

9 And, finally, yesterday we had contract
10 (verbatim) through the Associate Center Director at
11 NASA in Mountain View, with the Associate Center
12 Director at the Kennedy Space Center in Florida and
13 that Director stated, and I quote,

14 "The RSO has only possession of a
15 spacecraft purely for safety reasons."

16 The entire premise of this rule is based
17 upon the unmitigated temerity that because this
18 issue was complex and sounded plausible, that you
19 would not question those facts.

20 But we urge you to question those facts.
21 Do not proceed with the rulemaking process. Take
22 the time to question the range safety officer, which
23 you did not do, but I have.

24 Take the time to meet with the NASA
25 officials, which I have.

26 And once you have done that, I believe you
27 will come to the same conclusion that control never
28 leaves the maker of these cargo transportation

1 vehicles and, thus, they should be treated just like
2 United Airlines, or, for that matter, Southern
3 Pacific with regard to taxation of their vehicles.

4 Practically everything that SpaceF --
5 SpaceX representatives have told you and your staff
6 is not true. It is not supported by the facts.

7 MR. RUNNER: Mr. Ward.

8 ---o0o---

9 LARRY WARD

10 ---o0o---

11 MR. WARD: Thanks, Mr. Chairman.

12 Rule 133 exists to define and clarify
13 existing law, namely Revenue and Taxation Code 129
14 that exempts goods intended for sale and lease in
15 the ordinary course of business -- otherwise known
16 as the business inventory exemption.

17 Space flight property is not intended for
18 sale or lease in the ordinary course of business.
19 Ordinary is a key word in the plain language of
20 R & T Code Section 129.

21 There's also the question of legality.
22 Could it even be sold or leased legally, the key
23 concept in R & T Code Section 129.

24 With the Board introducing the concept of
25 relinquishing control into the meaning of business
26 inventory, they are redefining what it means to have
27 goods intended for sale or lease and leaves the door
28 open for all kinds of claims for the business

1 inventory exemption.

2 The Board's proposed changes to add item
3 A(2)(e) to Rule 133 are in contact -- are in
4 conflict with the entirety of Section 129 and
5 existing Rule 133.

6 And we oppose any changes.

7 Thank you.

8 MR. RUNNER: Thank you.

9 Mr. Ramseyer?

10 ---o0o---

11 ALBERT RAMSEYER

12 ---o0o---

13 MR. RAMSEYER: Thank you.

14 The general rule is that personal property
15 is subject to tax, unless otherwise exempt.

16 The power to exempt property from tax, the
17 power to exempt personal property from tax is the
18 purview of the legislature.

19 The plain intent of the proposed amended
20 rule is to expand the business inventory exemption
21 to exempt this specialized property from taxation.
22 But the problem is that effort, that idea, that
23 concept goes beyond the plain reading of Revenue and
24 Taxation Code 129 that defines business inventory.

25 Business inventory is specially defined in
26 Section 129 as property held for sale or lease.

27 What we have in this proposed rule is a
28 proposed special exception for this specialized

1 property to redefine property held for sale or lease
2 to mean property that's -- for which control is
3 transferred for safety purposes.

4 And that's not a fair interpretation of
5 what property held for sale or lease is. We know
6 what property held for sale or lease is. Property
7 is sold or leased for consideration, for transfer
8 of -- for transfer of money or for something of
9 great value.

10 We want to redefine that in this case
11 because, frankly, it would be good for the State's
12 business climate.

13 And, you know, we all understand that. But
14 that isn't -- that -- that policy is not really
15 fairly bef -- fairly within this Board's
16 jurisdiction. That is something that is within the
17 legislature's jurisdiction.

18 And the reason I'm here to speak on this is
19 because if this proposed amendment goes through, I'm
20 going to be asked to challenge it in court and I
21 would -- I would dearly love to avoid that, if
22 possible -- if at all possible.

23 And I think the Board should really
24 reconsider whether it wants to go through with this
25 proposed amendment. Because in my view this has a
26 very unlikely chance of withstanding judicial
27 review.

28 How can you redefine sale and lease to mean

1 transfer of property for safety purposes? It's --
2 it's crazy. You know, if I had an opportunity to
3 speak with Mr. Moon about it, I would have told him
4 the same thing. It doesn't really make sense.

5 Other problems with the rule include that
6 the concept "space flight property" is not clearly
7 defined. The term "operationally reusable" is not
8 clearly defined.

9 I represent a tax administrator. They need
10 to be able to know what this language means so they
11 can do their job. It's not clear. It's entirely
12 vague.

13 You know, Mr. Kelly was here a few minutes
14 ago beating the drum about rule of law. The rule of
15 law also applies in a situation like this.

16 Section 129 tells us what business
17 inventory means. We should be -- we should be
18 reasonably faithful to that language. The proposed
19 amendment does not do that.

20 So, I would urge either that rule -- that
21 the proposed rulemaking not go forward or that if --
22 if we are dead set to go forward on this that we
23 have another interested parties meeting so we could
24 hash out the proposed language.

25 Thank you for your time.

26 MR. RUNNER: Okay, thank you.

27 What I'm going to ask is, go ahead and take
28 -- we'll let the pro side go ahead and take seats.

1 What we'll do is after they are done, if
2 maybe you all could choose which two of you would
3 like to come forward. And we'll let two of the pro
4 side stay forward and then we'll go ahead and have
5 discussion back with staff and also the Board.

6 So, those coming forward now are Mary
7 Dakessian, Dennis Loper, Debra Clark --
8 Reynolds-Clark and Joe Vinatieri.

9 And you have 12 minutes and it looks like
10 Mr. Loper is raising his pen like he's supposed to
11 go first.

12 MR. LOPER: I'm going first, yes.

13 MR. RUNNER: Okay.

14 ---o0o---

15 DENNIS LOPER

16 ---o0o---

17 MR. LOPER: Mr. Chairman, Board Members,
18 Dennis Loper for SpaceX.

19 SpaceX strongly believes that rockets and
20 space vehicles are business inventory and that the
21 Board staff correctly concluded that business
22 inventory exemption should apply to space flight
23 where control is relinquished at launch.

24 I listened to some anecdotal information
25 about speaking to somebody, but what was not pointed
26 out is that range controls, when and if there is a
27 launch, not -- not that -- not just the safety, they
28 -- they dictate the date. They dictate the time of

1 the launch.

2 So, we believe that everything we've done
3 to date meets those criteria. And we agree with the
4 staff's conclusion.

5 One of the things that I find interesting
6 is that we're being told that this should be done by
7 the legislature. But in the legislature both the
8 Assessors' Association, for which everybody seems to
9 accede authority to, opposed the legislation and had
10 Assembly Member Ting, a former assessor, say on the
11 floor that the proper place to deal with this was at
12 the Board of Equalization.

13 I would also point out that AB 777 is
14 substantially different and would not even
15 control -- be controlled under Rule 133.

16 Further, I would point out if you -- this
17 Board will remember that LA County's had a history
18 of -- of -- of assessing space flight and ten years
19 ago, approximately, this Board had to issue a rule
20 because of an assessment that LA County had put on
21 satellites in geosync orbit.

22 And I find it interesting that it's the
23 same county that we now have the same issue with.

24 SpaceX thinks it's appropriate for the
25 Board to do this. We appreciate the staff's hard
26 work on this.

27 And I will turn over the rest of my time to
28 Mr. Dekassian. Thank you.

1 the Board's existing rule, Rule 133.

2 The second point that I wanted to address
3 relative to case law is that when you have the
4 purchase price of property that is -- that takes up
5 a large part of the service that's being provided or
6 is a large part of the overall package, that is a
7 factor that weighs in favor of business inventory
8 treatment.

9 Another factor that weighs in favor of
10 business inventory treatment is whether the property
11 is advertised or displayed.

12 Another factor that weighs in favor of
13 business inventory treatment is how the taxpayer is
14 treating the property for financial accounting
15 purposes and for federal and State income tax
16 purposes.

17 I'm not here to litigate the SpaceX case,
18 unlike the previous panel. There will be an
19 appropriate time and an appropriate place to do that
20 and that is not here and that is not today.

21 What I can tell you is that the factors
22 that are articulated in the cases support business
23 inventory treatment for SpaceX. And I'm familiar
24 with SpaceX's facts, but I suspect, as Mr. Vinatieri
25 will confirm, probably for the rest of the space
26 transportation industry, okay.

27 The other thing I wanted to commend staff
28 on, very important point, very important point,

1 which is the uniqueness of the space transportation
2 industry. Just because circumstances are unique
3 does not mean that the Board does not have authority
4 to regulate that. Or that the case -- the same
5 county that was before you lobbying heavily for the
6 passage of Rule 474, would not have succeeded in
7 their efforts. The Board clearly has authority to
8 do this.

9 The unique nature of the space
10 transportation industry and the federal regulatory
11 overlay is an important fact that Board staff picked
12 up on, drilled down on and made its proposed
13 regulatory amendments based on. That was a very
14 important consideration and Board staff is to be
15 commended for that.

16 I'll just conclude my remarks with saying
17 that we strongly urge this Board to adopt the
18 proposed amendments that staff has put before you
19 and to move this regulatory process forward.

20 Thank you.

21 ---o0o---

22 DEBRA REYNOLDS-CLARK

23 ---o0o---

24 MS. REYNOLDS-CLARK: Okay, my name is Debra
25 Reynolds-Clark. I'm Senior Tax Manager for United
26 Launch Alliance.

27 And, as opposed to everybody else here at
28 this panel, I actually work for a company that

1 right. And if you're familiar with spy
2 satellites -- believe me, the NRO is sitting right
3 there at the control panels and at a certain point
4 we just have to step away because we're not privy to
5 what's going to happen after a certain point when
6 the rocket gets to a certain height.

7 So, I am -- strongly believe that transfer
8 of control is transfer of title. The ultimate, I
9 guess, trade of ownership is being able to destroy
10 something. And, so, the government being able to
11 take over that -- that rocket and destroy it, to me
12 is a transfer of ownership.

13 The other issue that I'd like to bring up
14 is is that I don't understand how the counties can
15 say that if the government transfers possession of
16 real property to a taxpayer that's a taxable event
17 just as if we had purchased it -- if you're familiar
18 with possessory interest -- but yet they won't give
19 us the same benefit of a transfer of possession,
20 meaning that it's a transfer of title and being able
21 to get the exemption for personal property tax.

22 And I want to point out to the Board here
23 that in Florida, where all -- where probably the
24 majority of our launches happen, it's -- the rockets
25 are exempt totally from personal property tax --
26 every part of it.

27 And I think that if California wants to
28 stay in play here, they really need to look at this.

1 So, again, like I said, I came here to let
2 you know that United Launch Alliance is in support
3 of your change to the rule. We're pleased with the
4 language. And we'll do whatever we can to support
5 the approval of this -- of this rule change.

6 MR. RUNNER: Okay. Mr. Vinatieri.

7 ---o0o---

8 JOSEPH VINATIERI

9 ---o0o---

10 MR. VINATIERI: Thank you. Good morning,
11 it's so good to see you. I am actually wearing two
12 hats this morning.

13 I do represent United Launch Alliance, ULA,
14 and Debra's just talked to you a little bit about
15 what they do.

16 I -- and as she's indicated, we're pleased
17 to be in complete agreement with what has been
18 proposed for the Board. We want to thank the staff
19 for their responsiveness and we want to thank the
20 Board for leadership on this.

21 And that brings me to my second hat. As
22 you know, I'm an elected official, a member of the
23 City Council of the City of Whittier. And as a
24 member of that Council, I am also on the Los Angeles
25 County Economic Development Corporation Aerospace
26 Defense Jobs Council. That's a -- that's a big,
27 long title, but the long and the short of it is that
28 LAEDC, which is part of the County of Los Angeles, I

1 might add, and is associated with the County of Los
2 Angeles, is very concerned about this situation.
3 They're the largest and leading economic development
4 and forecasting organization in Southern California.

5 I have a letter of support here for the
6 Rule 133 changes. And I want to commend it to your
7 attention. I'm going to read a couple selected
8 sentences for you because Debra just brought it up,
9 but there is a big picture issue here.

10 Mr. Dekassian has given you some of the
11 technicality aspects of why what you are
12 contemplating is completely inappropriate for you to
13 do.

14 But there's a policy issue here. And let
15 me just read this to you, a portion of it. It
16 says -- and you can see, it's on the letterhead. It
17 says,

18 "We note the State's space sector is
19 taking off in California through privately
20 supported space commercialization.

21 "However, we must not take it for
22 granted and in doing so worked hard to
23 insure that it stays here -- that it stays
24 here."

25 The revised Rule 133 is a friendly reminder
26 that in today's global economy, location is not
27 permanent. But companies, especially those at the
28 forefront of innovation and the technology

1 revolution have many opportunities to locate outside
2 of California.

3 Debra just told you what they do in Florida
4 with this industry. We've already seen California's
5 aerospace employment decrease by more than
6 two-thirds and here in Los Angeles County we
7 witnessed firsthand the destructive effects that the
8 industry's decline from 189,000 workers in 1990 --
9 189,000 very good paying jobs -- to fewer than
10 60,000 -- 60,000 in 2011 and what it's done to our
11 local communities -- and I will speak to that as a
12 member of the City Council, the City of Whittier --
13 not to mention the enormous repercussions that the
14 loss of aerospace programs has had on our nation
15 leading manufacturing base, as well as State and
16 local tax dollars lost due to these severe job
17 declines. Tax dollars that help fund our local and
18 community services and social programs.

19 For all of the above reasons, LAEDC
20 commends your leadership on this and other important
21 tax issues that help make California a better place
22 to do business and offers its strong support for the
23 revisions to BOE Rule 133.

24 This is signed by David Flaks, the Chief
25 Operating Officer of the Los Angeles County Economic
26 Development Corporation.

27 So, there are the technical aspects of this
28 that are -- you are completely in sync and your

1 staff has properly analyzed it, but there are some
2 policy issues here that are very important.

3 And in this day and age, to be candid with
4 you, it's all about jobs, good paying jobs, and
5 that's what we're talking about here. There is a
6 huge public sector -- excuse me, public policy
7 aspect of this.

8 MR. RUNNER: Okay, thank you.

9 I'm going to go ahead and ask if two of you
10 stay forward and I'll ask two of the opposition
11 panel, if you'll come up -- forward and take some
12 seats.

13 And if any of the others need to answer a
14 question, you certainly are going to be able to be
15 called up and do that.

16 I just -- and I'm just going to go over to
17 Board Members and become -- start the discussion.

18 Member Yee.

19 MS. YEE: Thank you, Mr. Chairman. And I
20 very much appreciate the testimony from both sides.

21 I don't think -- and I'll venture to speak
22 on behalf my colleagues -- we share in the -- the
23 importance of the industry and its contributions to
24 the economy here in California.

25 And I'll just say personally I don't
26 believe the Board ought to delve into trying to
27 litigate the SpaceX case either. There is an
28 appropriate venue for that.

1 But I do have some questions with respect
2 to the underlying authority for this particular
3 rule. I want to be sure we get it right. I am not
4 interested in having further litigation on this
5 topic. And I guess maybe as a threshold question,
6 if I could, and for clarification.

7 Obviously, you have a bill moving through,
8 AB 777, which is moving through quite well. Was
9 there a reason why this didn't get addressed in the
10 legislation, just at least to have the legislative
11 authority to move in this direction?

12 MR. DAKESSIAN: We'll let Mr. Loper answer
13 that.

14 MR. LOPER: Simple answer is that
15 legislation is generally prospective, not during the
16 existing years.

17 And it was -- and there were some things
18 that we didn't believe were a part of Rule 133 that
19 we put in the legislation.

20 The two are not -- they're similar, but
21 they're clearly not the same thing.

22 MS. YEE: Okay, all right.

23 So, as I look at this rule, and I -- I
24 think that I want to just highlight, perhaps, some
25 inconsistencies within the rule itself that may not
26 necessarily get at the outcome that the proponents
27 think they want.

28 And it really has to do with how assessors

1 are going to look at applying the business inventory
2 exemption tests that are currently in the rule. And
3 let's say this rule before us does get promulgated.
4 It becomes effective. But we still have the test of
5 ordinary course of business and goods intended for
6 sale or lease.

7 So, that on that -- on those bases, the
8 exemption could still be disallowed. So, I'm not
9 sure -- I need some help in terms of -- is this an
10 ambiguity or is there going to be clear direction?

11 MR. MOON: Well, the way that we view this
12 rule is that Section 1 -- Sections 129 and 219
13 define what business inventories are. It does not
14 -- it does say goods intended for sale or lease.
15 However, sale -- the word "sale" is not defined.

16 And, so, what Rule 133 does in this
17 section, it states that particular items
18 specifically include business inventories. You
19 know, it says containers or oak barrels used in the
20 manufacturing process. And as an added item to
21 that, we would be including space flight property,
22 which would mean that it is a good intended for sale
23 or lease in the ordinary course of business.

24 MS. YEE: And I guess to the assessors, I
25 mean, how would you -- when you --

26 MS. MOLLER: Well, I think what we've --
27 we're having a little bit of a problem getting our
28 head around the logic.

1 It's -- it becomes a situation of -- a
2 definition of inventory that applies until it
3 doesn't. Either this -- this equipment is available
4 for sale or lease or it is not.

5 Now, granted, I'm -- I'm an appraiser from
6 more of a real property background, but I've always
7 considered that a sale includes some level of
8 consideration and a -- and a beneficial use.

9 I understand that when we start introducing
10 sale and use tax that -- that we start getting into
11 more issues of -- of control -- who controls the
12 equipment at any particular time.

13 Even with some type of relinquishment of
14 control, though, we have a problem with the -- with
15 the concept of relinquishing control temporarily to
16 a safety authority.

17 So, we still have a hard time with the
18 underlying logic that's going into this. We -- we
19 understand that there is a strong interest in this
20 and a very strong desire, in essence, to get it
21 done.

22 I would like to correct one thing that was
23 stated previously. The California Assessors'
24 Association has come out with a neutral position on
25 the passing of AB 777, not opposed.

26 I think we've understood that there is a
27 very strong desire and a -- to -- to afford some
28 type of recognition of this as an emergent --

1 emerging business industry that is helpful to
2 California.

3 We took the approach primarily as tax
4 administrators. And I think that's why we looked at
5 AB 777 in terms of how can we make this more
6 clearly -- how can we implement this in a more clear
7 manner?

8 And I thought -- we thought that was the
9 direction that we were going with the legislation.
10 And, so, the property tax rule, frankly, has just
11 been a little bit more difficult to us because it's
12 been inconsistent with our prior understanding of
13 the definitions used in the property
14 classifications.

15 MS. YEE: Okay.

16 MR. VINATIERI: May I respond?

17 MS. YEE: Mr. Vinatieri.

18 MR. VINATIERI: Yes. One of the important
19 things that I know you, as Board Members, work on
20 this all the time and that is to be consistent and
21 to harmonize the whole body of tax law in
22 California.

23 I remember other Board Members sitting up
24 here talking about the inconsistency between
25 property tax classification and sales tax and income
26 tax overtones.

27 One of the issues here that Ms. Moller has
28 raised is this concept of sale or lease. Well,

1 obviously, what's going on here, there's no leasing
2 of the -- of the launch vehicle, the rocket.

3 The question is is there a sale? We know
4 in California sales tax law there is a whole series
5 of cases where title doesn't pass. If you recall,
6 Section 606 talks about -- in the sales tax law --
7 talks about transfer of title or possession in lieu
8 of title. The cases, there are, as I say, a series
9 of cases where title -- quote, unquote -- did not
10 pass, but beneficial possession more or less did.

11 And the fact of the matter is the
12 relinquishment of the possession tends to be in lieu
13 of that title clause.

14 So, the question becomes -- for the
15 situation here -- if this were sales tax, obviously,
16 it's exempt. But for sales tax purposes there would
17 be a relinquishment. And the question becomes,
18 well, is there a direct possession or an indirect
19 possession? Is there a control -- direct control or
20 is there an indirect control?

21 And the point that's being made is that
22 there's no question that if we want to be consistent
23 among the various laws between sales tax and
24 property tax, you are able to say that under these
25 circumstances there's a sale.

26 The only issue becomes is the fact that
27 once the button gets pushed -- and I've never been
28 there and no one's cleared it around here to be

1 there -- in there when they do it.

2 But the question becomes when the button is
3 pushed and that launch vehicle is this far off the
4 ground (indicating), who is in control?

5 Is it SpaceX? Is it United Launch
6 Alliance? Or is it the federal government? Or is
7 it the United States Air Force?

8 Well, we will tell you that at Vandenberg
9 it's not NASA, it's the United States Air Force.
10 And there's one very good reason for that, it's
11 their Air Force base. They understand the safety
12 concerns. And they basically take over.

13 And if something goes wrong, if there's any
14 issue at all, we have nothing to say. They do
15 whatever they're going to do, including the rocket
16 and the multimillion dollar -- or whatever the cost
17 is -- of the -- of the satellite or satellites that
18 that are top.

19 So, the question becomes is that control,
20 that, in essence, is ceded to the range officer or
21 the launch capability center at that point in
22 time -- is that the type of control that we're
23 talking about in terms losing control that would be
24 consistent with sales tax law?

25 Now, I admit we are in -- we are in the
26 property tax law. This is a unique situation -- no
27 question about it.

28 But I would just say that for purposes of

1 what we're talking about here today, I think that
2 control is, in essence, seceded and they are in
3 charge.

4 And that should be enough to take care of
5 the issue.

6 MS. YEE: Yeah, I guess I see two --
7 there's two approaches for looking at the issue of
8 control.

9 There's certainly the -- yeah, the facts of
10 what actually happens. So, what we're contemplating
11 here is relinquishing of control upon launch, which
12 then, I guess, as a practical matter, would beg the
13 question does the commercial space launcher, at that
14 point in time, have any other responsibilities over
15 activities after the launch?

16 I mean just kind of from a -- from a
17 factual basis, I don't -- I'm not an expert in space
18 launch, but those would be kind of the questions I
19 would ask.

20 Then there is a legal issue about ceding
21 control. And let's just say -- we're kind of using
22 the title transfer analogy with sales tax.

23 And I guess what I'm -- what I'm -- from a
24 property tax administration and implementation
25 standpoint -- and we share in that responsibility
26 with County assessors -- I just want to be sure we
27 know what we're dealing with here.

28 And I am not expert in space launches, I

1 don't think many assessors are. I don't think they
2 think they would be open to kind of understanding
3 what all happens after leading up to a launch and
4 afterwards.

5 And then the issue about relinquishing
6 control -- I didn't see anywhere from the beginning
7 of this discussion up until now, really how the
8 federal statutes or rules deal with that concept.

9 I think we saw provisions of some
10 fabrication contracts, but in in terms of the
11 analysis of the underlying federal law, I'm just
12 kind of curious about -- and maybe -- this is to
13 Mr. Moon -- how we kind of -- what we actually
14 looked at with respect to the federal --

15 MR. MOON: Part of the -- part of the issue
16 here with this rule, as the speakers have been
17 saying, is this is an incredibly unique industry and
18 part of that is all of the federal laws and
19 authorities that are involved.

20 And, so, when you talk about the federal
21 control and the need to relinquish control to the --
22 to the launch range authority, to the federal
23 authorities, I'd -- it starts with a number of
24 different statutes, the Commercial Space Launch Act
25 and then it goes from there to various government
26 agencies, including Department of Defense, NASA,
27 Department of Transportation and then agency -- or
28 parts of the Department of Transportation and then

1 also to the Air Force as well.

2 And, so, many of these rules -- they're
3 sort of derivative from federal laws that give
4 authority to various branches, other branches of the
5 government.

6 In terms of the range authority -- and one
7 of the reps can correct me if I'm wrong -- but in
8 terms of range authority, that's governed by the
9 Air -- what they call the Air Force Space Command,
10 who issues a manual on range authority and range
11 safety.

12 There's one that's issued to the Air Force
13 Space Wing Command Squadrons, I believe they call
14 them, for -- to guide them in terms of what they're
15 supposed to do.

16 And then there are a series of, I guess
17 it's one manual with many volumes, that applied to
18 the users of the range and what their expectations
19 and requirement are in terms of the control that
20 they need to give up.

21 MR. VINATIERI: Might I interject?

22 I'm informed by my client that literally
23 the Air Force individual who is responsible is
24 sitting right next to the person from, in this case,
25 ULA, and essentially is right there.

26 So, if there's a problem, they take over.
27 And there is a protocol, I believe, as Mr. Moon has
28 indicated as to how it happens.

1 MR. DAKESSIAN: And just to further that
2 point, I am informed by my client that the -- the
3 Air Force sets the -- the range safety sets the date
4 and time for the launches, not the space
5 transportation companies.

6 MR. RUNNER: Member --

7 MS. YEE: I am sorry, Mr. Runner, if I
8 could, just ask one more question?

9 So -- so, does the -- commercial space
10 launcher have any authority over any activities
11 after the launch?

12 MR. MOON: My understanding is that the --
13 that I guess what they would call the mission
14 parameters, the orbital slot as they call it, where
15 they're going to be launching a particular
16 payload -- all of those things are set prior to the
17 actual launch. All of those parameters --
18 everything is set.

19 Once that button is pushed, my
20 understanding is that -- that -- that cannot be
21 changed.

22 If there are changes, those would be
23 minimal and would be in line with the range safety
24 or the launch safety authorities' oversight of that.

25 MS. YEE: Okay. Mr. Stone, just -- yeah.

26 MR. STONE: Yeah, when things are
27 confusing, I think it's important to go to the
28 binding agreements, the contracts between the -- the

1 authorities that have control over this and the --
2 in this case, the -- SpaceX.

3 And let me just recite again, the -- the
4 PMP, which is the document -- it's a written
5 agreement between NASA, SpaceX and the FAA -- and it
6 says,

7 "The contractor or licensee, SpaceX, is
8 responsible for its launch and vehicle
9 operation throughout the mission."

10 Appendix C of the document is even more
11 specific and removes any ambiguity.

12 "The agreement -- the signed agreement
13 between SpaceX, the FAA and NASA says that
14 SpaceX" -- they call it the Orbital Science
15 Corporation -- "always has prime
16 responsibility."

17 That's in a written agreement.

18 And then in talking to the -- the -- the
19 spokes -- the folks at Kennedy Space Center in
20 Florida, that person said yesterday,

21 "The range safety officer only has
22 possession of the safe craft purely for
23 safety reasons, with no change in title or
24 ownership."

25 That's very clear and those are written
26 agreements which SpaceX is a part -- is a party to,
27 as well as the authorities.

28 MR. DAKESSIAN: First of all, not to

1 confuse the issue, but Orbital Sciences is different
2 from SpaceX. SpaceX is Space Exploration
3 Technologies.

4 But, to the point, Mr. Stone is taking
5 excerpts from the contract that pertain to liability
6 and attempting to graft them on to the situation at
7 hand here. That's not appropriate.

8 Again, I don't want to get into a fact by
9 fact, you know, dispute over what SpaceX is doing or
10 is not doing, that -- this is not the appropriate
11 forum for that, okay.

12 I would just redirect and say that there
13 are protocols in place where NASA actually does have
14 control when the capsule is attaching to the
15 international space station. It's called a go/no go
16 protocol.

17 And that's about as much as I want cover
18 here today because now we're getting -- starting to
19 talk about a specific company and not whether the
20 Board has regulatory authority to do this and
21 whether it's doing it in the appropriate fashion.

22 The other point I would like to address is
23 the point of consideration. Go to the contracts and
24 look and you will see that the overwhelming majority
25 of the consideration that is paid for SpaceX is paid
26 for the property.

27 So, to the extent that the County is
28 attempting to paint this as an aberration, I'm going

1 to echo the comments of my colleague, Mr. Vinatieri.

2 The aberration isn't what the County's
3 trying to do. We have here companies that are, for
4 financial accounting purposes --

5 MS. YEE: Mr. Dakessian, I'm going to stop
6 you right there. I just want to get this right.

7 And it's really hard when this Board has to
8 look at a rule right in the middle of a legal
9 challenge. It's really difficult. And I just want
10 to get it right. We share in the administration of
11 the property tax system with the county assessors.
12 We provide oversight. We provide guidance to the
13 extent that it's helpful. And I think there are
14 some factual things that I think -- and, I'm sorry,
15 I wasn't personally a part of the interested parties
16 discussion and I think that the assessors want to
17 get it right. And whether it's this Board that puts
18 this rule forward or whether -- however it gets out
19 there, they have the responsibility of the
20 implementing it correctly. I want to be sure they
21 implement it correctly, give them the proper
22 guidance.

23 And, so, I think there are some factual
24 aspects of what actually takes place that I think
25 all of us can benefit from an understanding --
26 pre-launch, at launch, after launch -- and then
27 really understanding this issue of control because I
28 think contract provisions have been kind of thrown

1 around pretty loosely in terms of what it means.

2 I want -- I want to have all of us
3 understand the context with which we're reading
4 these contract provisions and knowing that as we
5 apply this rule before us that it really is going to
6 achieve the intended outcome.

7 And right now I'm little skeptical because
8 I'm confused as to kind of how you tie it all
9 together to where we're not still going back to the
10 original test of what constitutes business inventory
11 exemptions.

12 MR. RUNNER: Okay. Member Horton.

13 MR. HORTON: Let's see, first let me -- let
14 me commend Assessor Moller and her work. She's a
15 very talented individual. And I don't want to -- I
16 want to acknowledge that, given some of the comments
17 that I've heard -- and thank her for her work.

18 You know, this is -- this is -- is and
19 always has been a very confusing sort of logic in
20 areas of the law because we have an issue with sales
21 tax and the logic on sales tax is quite different
22 can be different from the logic on use tax.

23 And then when you take a look at property
24 tax and you try to overlap the two, they just don't
25 come together. You know, it sort of reminds me of a
26 situation when I served on the City Council when the
27 General Counsel basically said that we own the
28 property from the back to the front, but yet still

1 that little spaceway from the sidewalk to the street
2 is owned by the City. They have complete control
3 over it. But I'm required to cut it every day and
4 rake the leaves off and so forth.

5 And, so, the law has a tendency to sort of
6 separate these different issues. And the basis, as
7 I understand it, is one of -- is two -- first, let
8 me start -- is one of responsibility and liability.
9 And what defines that? And at what point does that
10 kick in?

11 And as an auditor of the federal government
12 for a number of years, I can tell you that it is
13 their historical practice to shift the
14 responsibility and the liability away from them.

15 And then it is their tendency historically
16 to maintain control -- as much control as they
17 possibly can.

18 And, so, it's those two elements that
19 causes somewhat confusion. We're shifting
20 liability. Then we're shifting control.

21 The other sort of confusing aspect about
22 the law is that when you talk about consideration,
23 the presumption is -- is that consideration is
24 between two parties.

25 But the law actually allows consideration
26 to be between three or four parties. So that
27 another party could actually pay the consideration
28 or receive the consideration and so forth. And

1 therein is -- it just makes it so confusing when we
2 began to sort of look at this element.

3 I think, as staff has indicated, the case
4 law is relatively clear. When there is a transfer
5 of control, when you release control on a tangible
6 personal property, then, you know, that particular
7 party, at that point in time, owns the property.
8 They control the property -- have complete control
9 over that particular piece of property.

10 And, so, as you track the property through
11 the process -- okay, it's taxable, it's taxable,
12 it's taxable, it's taxable -- whoop -- you release
13 control, all of a sudden it's not taxable any more
14 because of the control factor.

15 And the federal government and -- you know,
16 from my experience when it comes down to space
17 travel, any complexity of that nature, they are
18 going to maintain control. It is the nature of
19 government.

20 And contractually they have been consistent
21 with that, at least over the last, I don't know, 30
22 years that I've been looking at this.

23 I think -- but I think the beauty of what
24 we do today is that it is a rulemaking process,
25 which means that in the -- without going into that,
26 I'm going to ask staff to kind of expound on the
27 process.

28 What takes place during this time?

1 MR. MOON: During the rulemaking process?

2 MR. HORTON: Yes.

3 MR. MOON: Well, what happens is -- well,
4 we're here today before you to ask for authorization
5 to initiate the official rulemaking process, which
6 means if you were to so authorize, we would publish
7 the proposed rule in the Notice Register. After
8 that time, we would have to have at least one public
9 hearing in 45 days -- at least 45 days, at which
10 point and during which interested parties would be
11 able to provide additional comments, any additional
12 information they felt was relevant at the actual
13 public hearing. Again they could produce any
14 information that they felt was relevant.

15 And then after that hearing, the Board
16 would then decide whether to make changes based on
17 some of that information or whether to go ahead and
18 approve adoption of the the rule, in which case we
19 would send it to OAL.

20 MR. HORTON: Yes, thank you.

21 So, the arguments put forth today are --
22 they -- they sound sort of final, you know. And I
23 just want to say to both parties that it's not final
24 today and that we will have an opportunity to bring
25 some clarity to these areas of the law and the case
26 law and then some factual analysis as well as to
27 what actually happens.

28 You know, I can say, based on my

1 experience, what I've seen dealing with government
2 contracts -- I mean, I have actually done the
3 audits. I've actually been authorized to go and
4 review the contracts, which is not part of the
5 contracts that the assessors see. I mean, this is
6 just something -- if you're not -- I mean, they
7 check to see how you treat your pets and
8 everything -- it was laborious process that an
9 auditor has to go through.

10 But once you pass that you begin to have a
11 pretty good understanding of the government
12 contracts and this whole issue of control. You kind
13 of begin to narrow it down to the basic concept that
14 the government is going to maintain control. They
15 are going to transfer responsibility and liability
16 to whomever they can.

17 And then I want -- I want to just address
18 the distinction, if you will, between AB 777 and
19 this particular rule and our jurisdiction.

20 I'd like for staff to sort of elaborate on
21 what they believe AB 777 seeks to accomplish and
22 what the rulemaking process seeks to accomplish, the
23 distinction, if there is any, and the jurisdiction
24 and authority of this Board as it relates to the
25 rulemaking process.

26 MR. MOON: There is a clear distinction
27 between AB 777 and this proposed rulemaking.

28 AB 777 would -- would exempt all space

1 flight property. This rule is tailored narrowly to
2 apply only to the business inventory exemption.
3 And, so, it would define this type of space flight
4 property as business inventory.

5 That -- that's the big distinction between
6 the two. And I think, as some of the reps have
7 alluded to, we believe the Board does have the
8 authority to -- to implement this proposed rule.

9 MR. HORTON: Given -- if AB 777 is approved
10 and enacted, how would it impact this rule?

11 MR. MOON: Well, AB -- again because AB 777
12 is more broad than this rule, they -- they could
13 rely on that for exemption of their property instead
14 of on Rule 133.

15 MS. MANDEL: Mr. Horton.

16 MR. HORTON: I see Mr. Loper here wants
17 to --

18 MS. MANDEL: Oh.

19 MR. LOPER: Dennis --

20 MR. HORTON: I am going to Mr. Loper.

21 If the assessors want to comment --

22 MR. LOPER: -- Dennis Loper for SpaceX on
23 AB 777.

24 AB 777 has a specific clause that will be
25 amended -- that is amend -- that has been amended
26 that specifically has an indecision clause between
27 Rule 133 and AB 777, which will not impact Rule 133
28 at all.

1 I -- I apologize if the assessors have gone
2 neutral, as of last night that letter had not been
3 delivered, but I'm sure that that's the case.

4 But I apologize for --

5 MR. HORTON: Be thankful for small favors.

6 MR. LOPER: -- yes. But -- but, anyway,
7 the -- they're -- they're distinctly different in
8 that there is -- they address two different areas of
9 law.

10 And there is a distinct amendment to make
11 sure that Rule 130 -- 133 is not impacted by AB 777.

12 MR. STONE: We would concur, other than the
13 final conclusion of Mr. Moon's statement, they are
14 different.

15 So, we would agree with that except for the
16 final conclusion that -- that you have a right to do
17 this.

18 MR. HORTON: Oh, okay.

19 MS. MOLLER: And I would just like to add,
20 yeah, we do see them as two different issues. And,
21 you know, the part that we find -- and continue to
22 find problematic is -- is including it under the
23 business inventory classification.

24 MR. HORTON: Okay. So, hopefully, during
25 the rulemaking process that I would encourage staff
26 to take a look at the -- to isolate, if you will, or
27 delineate the various definitions that are here and
28 sort of segregate, if you will, the areas of the law

1 so that -- so that we have an understanding or so
2 that we are -- we have a level of transparency that
3 is clear as to what area of the law that we're
4 looking at, what's the basis of that and what the
5 determining factors are in each one of those various
6 different categories.

7 And I think going through that process will
8 be very healthy for all of the parties involved.
9 And we will begin to -- hopefully, we'll begin to
10 see a distinction between the issue of sales,
11 control, responsibility, liability.

12 There is -- I -- I believe there is, and I
13 understand the distinction, but I think that process
14 would be very, very helpful to the assessors,
15 certainly encourage you to continue to -- to share
16 your thoughts during the rulemaking process and to
17 make sure that your perspectives are heard by staff
18 before it comes before us.

19 And we'll have another opportunity to take
20 a look at this.

21 Thank you very much, Mr. Chair.

22 MR. RUNNER: Member Mandel, I think you --

23 MS. MANDEL: Well, Mr. Loper jumped up on
24 the bill I had seen last night that it had been
25 amended. So, you have that information.

26 And with respect to business inventories, I
27 strongly believe that this is -- if there is other
28 places, this is certainly one place where I think

1 that the sales tax, whether somebody could buy the
2 property for resale, without paying tax, assuming
3 that there was a sale on the other end, that -- that
4 what's in your inventory for sales tax purposes is
5 the same -- going to be the same as what's in your
6 inventory for property tax purposes.

7 That's the one place of any where they
8 really do overlap. So, you know, there is other
9 areas, like fixtures, where we do see differences in
10 the court cases for property tax and sales tax,
11 historically.

12 But I think that -- that the rules on sales
13 tax of what you have purchased and sell or lease in
14 the ordinary course of business is -- is the same.

15 And I guess I don't just say that 'cause
16 I've had to work in that area before, but I do think
17 it's a area where they do overlap.

18 MR. RUNNER: Mr. Horton.

19 MR. HORTON: I just wanted to ask the
20 assessors, do you support the bill as amended?

21 MS. MOLLER: You mean AB 777?

22 MR. HORTON: Yes.

23 MS. MOLLER: We are neutral.

24 MR. HORTON: Okay.

25 MR. LOPER: I think Santa Clara County
26 still opposes.

27 MR. STONE: Well --

28 MS. MOLLER: I should say -- yeah, the CAA

1 is taking a neutral --

2 MR. STONE: Are you asking me personally
3 or --

4 MR. HORTON: No, no, no, I am not
5 encouraging --

6 MR. STONE: -- I'm a member of the
7 California Assessors' Association and the official
8 position of the Assessors' Association is neutral.

9 MR. RUNNER: Any other -- any other
10 questions, Members?

11 MR. HORTON: Thank you, Mr. Runner.

12 MR. RUNNER: Member Yee.

13 MS. YEE: Just a question about timing.

14 What would be the harm in actually having
15 another interested parties meeting to kind of
16 clarify some of this upfront before we initiated the
17 process?

18 And I'll tell you my concern. Once we
19 initiate the process, this is on a fast track. I
20 would like to have some of the implementation issues
21 addressed a little further. I'm not quite there yet
22 myself.

23 But -- and as I said earlier, it's very,
24 very difficult, I think, to do rulemaking when there
25 are challenges, you know, hovering over.

26 But putting that aside, I think it really
27 heightens the need to try to work through the
28 implementation issues even more before going down

1 the path of initiating the process.

2 But I can be convinced otherwise if you
3 think there's going to be adequate time to deal with
4 that, but that's not been the experience I've had
5 once we --

6 MR. RUNNER: Member Horton.

7 MR. HORTON: During the rulemaking process,
8 we -- there is no requirement, I believe, that this
9 has to be accelerated.

10 I understand the 45-day period and so
11 forth. Why don't -- why don't I suggest, Members,
12 that we might want to do a couple of things.

13 As I sat and listened to the testimony
14 today of all of the parties, after listening to the
15 tax swap and the railroad and so forth and so forth,
16 you know, it all starts to -- to run together. And
17 then, all of a sudden, you got to sort of separate
18 it in your mind.

19 And so, in doing so, because of the
20 complexity of this, initiate the rulemaking process
21 but allow for the rulemaking process to take up
22 those various different issues of concerns
23 separately, so that we can have an interested
24 parties meeting.

25 The implementation may not be an issue of
26 concern once we get past the jurisdictional issue
27 and once we get past case law and so forth -- or it
28 may be.

1 You know, I -- I agree with your concerns,
2 Member Yee. And, so, we would traditionally maybe
3 have one interested parties meeting, possibly two,
4 maybe two or three interested parties meetings,
5 depending on, Mr. Chair, how the Chairman would see
6 the best way to bifurcate these issues.

7 MS. MOLLER: Chairman Horton, can I make a
8 request?

9 I think we -- my County Counsel has
10 reminded me that perhaps we could gain a better
11 understanding, perhaps narrow some of our issues, if
12 we could be privy to information that it appears the
13 BOE had in terms of contracts.

14 We haven't seen any of these contracts. If
15 that could be helpful in terms of this analysis?

16 MR. HORTON: I mean, offhand -- let me just
17 go to the Department instead of --

18 MR. MOON: Yeah, I mean I would say --
19 again because this is not dealing with one
20 particular taxpayer -- I know that there is that
21 SpaceX hearing, but again this is not something that
22 we want to litigate through this process.

23 I'm not sure that one party's particular
24 contracts are going to speak to the contracts of how
25 things are done throughout the industry.

26 I think more relevant would be the federal
27 law involved.

28 MR. HORTON: What -- what might be

1 available to the general public is the -- I forget
2 what the rule is called, but there's a rule -- I
3 thought I heard it earlier -- that basically says
4 that, you know, the government takes over.

5 And that is public information.

6 MR. VINATIERI: That's correct.

7 MR. HORTON: Mr. Vinatieri.

8 MR. VINATIERI: Yeah, I think that what
9 Ms. Yee is talking about is this issue of control.

10 And I think probably what needs to be done
11 is we have a little bit better explanation of what
12 control -- what the control is. I think you've just
13 indicated, Mr. Horton.

14 I think it wouldn't be a bad idea at all to
15 see if we can find somebody from the Air Force or
16 wherever the appropriate is to talk about exactly
17 what happens at the launch center in the control --
18 they have the control computers and we have all seen
19 that before -- and how all that works.

20 Because this issue, as I understand it,
21 we're now talking about is control. Is it direct
22 control? Is it indirect control? Is that a
23 surrogate for ownership, so to speak?

24 S, I mean, that's what this comes down to.

25 MR. HORTON: To the assessor, the only
26 reason -- I sort of query as to whether or not what
27 they can talk about is two-fold.

28 One is I don't know the clearance of our

1 staff and what information they've been able to
2 obtain. There is a certain level of information
3 that deals with the larger security issue for the
4 United States and, so -- but there are -- there is a
5 rule.

6 I don't know what the -- here the young
7 lady's nodding her head, she may be aware of what
8 the generic rules are and maybe they can provide
9 that information.

10 The other thing, I concur with -- with our
11 staff that we don't want to get into situations of
12 litigating or dealing with the litigation on any
13 particular taxpayer or have language or discussions
14 that end up spilling over into that activity.

15 MR. STONE: Chairman Horton, we -- we have
16 had those discussions that you talked about with --
17 with those officials.

18 And, basically, what they have said and
19 what is confirmed in the contracts, is that the
20 range safety officer, Air Force, has control only at
21 launch and only for safety purposes. And after
22 that, control reverts back to the contractor to
23 carry out the -- carry out the mission. That's what
24 happens.

25 I don't know how long that is, but once
26 that -- once that is launched, they're no longer
27 engaged unless it's a safety issue.

28 MR. VINATIERI: And I would indicate --

1 MR. RUNNER: No, I think this is going --

2 MR. VINATIERI: -- we rest our case --

3 MR. RUNNER: -- the discussion going
4 forward --

5 MR. VINATIERI: -- and the ability to
6 destroy --

7 MR. HORTON: Excuse me, excuse me --

8 MR. RUNNER: Yeah, go ahead.

9 MR. HORTON: -- Mr. Vinatieri.

10 MR. RUNNER: Member -- Member Horton.

11 MR. VINATIERI: I'm sorry.

12 MR. HORTON: Mr. Vinatieri --

13 MR. VINATIERI: Sorry.

14 MR. HORTON: -- I -- assessors, I think you
15 hit the nail on the head, you know.

16 I think that's what this process will be
17 about. And, hopefully, they will bring some
18 clarity.

19 To the extent that that information can be
20 provided, I'm sure the various folks who are
21 participating in these government contracts and have
22 a history of dealing with them -- the individuals, I
23 don't know at what level, even within the
24 government, that they have access to these -- to
25 these control rooms.

26 And then the whole discussion about what
27 level of control has to sort of kind of take place.

28 MR. VINATIERI: It's their room.

1 MR. RUNNER: Okay.

2 MR. VINATIERI: I'm sorry.

3 MR. HORTON: Mr. Vinatieri, I --

4 MR. RUNNER: I think we're --

5 MR. HORTON: So, Mr. Runner.

6 MR. RUNNER: Okay. Any other questions?

7 Yes, Member Yee.

8 MS. YEE: Thank you, Mr. Chairman.

9 I'd like to maybe put some definition
10 around what I'd like to see further explored if
11 we're going to initiate the process today.

12 It seems to me there are two things. One
13 is definitely more information that I think would be
14 helpful, both factually on the issue of ceding of
15 control. And then, secondly, legally on the issue
16 of control as it -- we're essentially using control
17 as a substitute for --

18 MR. HORTON: Transfer.

19 MS. YEE: -- transfer.

20 And I'd like see, frankly, a more robust
21 analysis of the federal authority. I think we made
22 a lot of -- and it may not even be available in
23 terms of like just clear statutes, clear rules.

24 We kind of took some federal provisions or
25 contract provisions and -- and drew some
26 conclusions, but just a more robust discussion about
27 federal law.

28 'Cause I do think that is something we're

1 going to have to produce as part of the rulemaking
2 file.

3 And -- and I really do want to look at the
4 underlying statutes. Contracts are one thing, but
5 there's got to be federal statutes or rules that
6 really govern this.

7 MR. HORTON: There is.

8 MS. YEE: And there may be multiple actors
9 in these transactions, but I think we've got to get
10 to the bottom of that so that, as we look at
11 ultimate implementation -- I just want to get this
12 right.

13 I don't want to be back in court about this
14 and there's already a challenge pending. And it
15 would behoove us to take that time and do the
16 diligence on that -- on those two aspects.

17 MR. RUNNER: So, my understanding on that
18 is that -- to create some clarity to staff and the
19 parties in regards to what should be enveloped in
20 the discussions in regards to the -- as this moves
21 forward in the interested parties -- within the
22 rulemaking process, and -- and this certainly then
23 is a unique indication that as this comes back for
24 public hearing, these are going to be the interests
25 the Board has to -- to -- to have -- to have
26 addressed.

27 Any other comments?

28 Is there a motion?

1 MS. YEE: I'll move to initiate the process
2 with those caveats --

3 MR. HORTON: Second.

4 MS. YEE: -- as stated.

5 MR. RUNNER: Okay. There's been a -- a
6 motion by Member Yee to adopt Alternative 1 and
7 seconded by Member Horton.

8 MS. YEE: With the specified caveats.

9 MR. RUNNER: With -- as -- as with -- as
10 discussed. And I think the staff and both parties
11 understand that.

12 Any objections?

13 Okay. With that, the motion is adopted.
14 And this concludes the business -- the business of
15 the Property Tax Committee.

16 MR. VINATIERI: Thank you.

17 MS. MOLLER: Thank you.

18 MR. WARD: Thank you.

19 ---o0o---

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1 REPORTER'S CERTIFICATE.

2
3 State of California)
4) ss
5 County of Sacramento)
6

7 I, JULI PRICE JACKSON, Hearing Reporter for
8 the California State Board of Equalization certify
9 that on FEBRUARY 25, 2014 I recorded verbatim, in
10 shorthand, to the best of my ability, the
11 proceedings in the above-entitled hearing; that I
12 transcribed the shorthand writing into typewriting;
13 and that the preceding pages 1 through 62 constitute
14 a complete and accurate transcription of the
15 shorthand writing.

16
17 Dated: APRIL 16, 2014

18
19 
20
21 JULI PRICE JACKSON
22 Hearing Reporter
23
24
25
26
27
28

**ESTIMATE OF COST OR SAVINGS RESULTING
FROM PROPOSED REGULATORY ACTION**

Proposed Amendment of Property Tax Rule 133, *Business Inventory Exemption*

STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement
Prepared by  Date 4-11-14
Richard Bennion, Regulations Coordinator

Approved by  Date 4/11/14
Randy Ferris, Chief Counsel

If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required

Approved by _____ Date _____
Chief, Financial Management Division

Approved by _____ Date _____
Chief, Board Proceedings Division

NOTE: SAM Section 6615 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

ECONOMIC IMPACT STATEMENT

DEPARTMENT NAME State Board of Equalization	CONTACT PERSON Richard E. Bennion	EMAIL ADDRESS rbennion@boe.ca.gov	TELEPHONE NUMBER 916-445-2130
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400 Title 18, Section 133, Business Inventory Exemption			NOTICE FILE NUMBER Z

A. ESTIMATED PRIVATE SECTOR COST IMPACTS *Include calculations and assumptions in the rulemaking record.*

1. Check the appropriate box(es) below to indicate whether this regulation:

- a. Impacts business and/or employees
- b. Impacts small businesses
- c. Impacts jobs or occupations
- d. Impacts California competitiveness
- e. Imposes reporting requirements
- f. Imposes prescriptive instead of performance
- g. Impacts individuals
- h. None of the above (Explain below):

Please see the attached .

***If any box in Items 1 a through g is checked, complete this Economic Impact Statement.
If box in Item 1.h. is checked, complete the Fiscal Impact Statement as appropriate.***

2. The _____ (Agency/Department) estimates that the economic impact of this regulation (which includes the fiscal impact) is:

- Below \$10 million
- Between \$10 and \$25 million
- Between \$25 and \$50 million
- Over \$50 million *[If the economic impact is over \$50 million, agencies are required to submit a Standardized Regulatory Impact Assessment as specified in Government Code Section 11346.3(c)]*

3. Enter the total number of businesses impacted: _____

Describe the types of businesses (Include nonprofits): _____

Enter the number or percentage of total businesses impacted that are small businesses: _____

4. Enter the number of businesses that will be created: _____ eliminated: _____

Explain: _____

5. Indicate the geographic extent of impacts: Statewide
 Local or regional (List areas): _____

6. Enter the number of jobs created: _____ and eliminated: _____

Describe the types of jobs or occupations impacted: _____

7. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here? YES NO

If YES, explain briefly: _____

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

ECONOMIC IMPACT STATEMENT (CONTINUED)

ESTIMATED COSTS *Include calculations and assumptions in the rulemaking record.*

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? \$ _____

a. Initial costs for a small business: \$ _____ Annual ongoing costs: \$ _____ Years: _____

b. Initial costs for a typical business: \$ _____ Annual ongoing costs: \$ _____ Years: _____

c. Initial costs for an individual: \$ _____ Annual ongoing costs: \$ _____ Years: _____

d. Describe other economic costs that may occur: _____

2. If multiple industries are impacted, enter the share of total costs for each industry: _____

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. *Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.* \$ _____

4. Will this regulation directly impact housing costs? YES NO

If YES, enter the annual dollar cost per housing unit: \$ _____

Number of units: _____

5. Are there comparable Federal regulations? YES NO

Explain the need for State regulation given the existence or absence of Federal regulations: _____

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: \$ _____

C. ESTIMATED BENEFITS *Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.*

1. Briefly summarize the benefits of the regulation, which may include among others, the health and welfare of California residents, worker safety and the State's environment: _____

2. Are the benefits the result of: specific statutory requirements, or goals developed by the agency based on broad statutory authority?

Explain: _____

3. What are the total statewide benefits from this regulation over its lifetime? \$ _____

4. Briefly describe any expansion of businesses currently doing business within the State of California that would result from this regulation: _____

D. ALTERNATIVES TO THE REGULATION *Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.*

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: _____

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

ECONOMIC IMPACT STATEMENT (CONTINUED)

Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation: Benefit: \$ _____ Cost: \$ _____

Alternative 1: Benefit: \$ _____ Cost: \$ _____

Alternative 2: Benefit: \$ _____ Cost: \$ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives:

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? YES NO

Explain: _____

E. MAJOR REGULATIONS *Include calculations and assumptions in the rulemaking record.*

California Environmental Protection Agency (Cal/EPA) boards, offices and departments are required to submit the following (per Health and Safety Code section 57005). Otherwise, skip to E4.

1. Will the estimated costs of this regulation to California business enterprises exceed \$10 million? YES NO

*If YES, complete E2. and E3
If NO, skip to E4*

Briefly describe each alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: _____

Alternative 2: _____

(Attach additional pages for other alternatives)

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation: Total Cost \$ _____ Cost-effectiveness ratio: \$ _____

Alternative 1: Total Cost \$ _____ Cost-effectiveness ratio: \$ _____

Alternative 2: Total Cost \$ _____ Cost-effectiveness ratio: \$ _____

4. Will the regulation subject to OAL review have an estimated economic impact to business enterprises and individuals located in or doing business in California exceeding \$50 million in any 12-month period between the date the major regulation is estimated to be filed with the Secretary of State through 12 months after the major regulation is estimated to be fully implemented?

YES NO

If YES, agencies are required to submit a Standardized Regulatory Impact Assessment (SRIA) as specified in Government Code Section 11346.3(c) and to include the SRIA in the Initial Statement of Reasons.

5. Briefly describe the following:

The increase or decrease of investment in the State: _____

The incentive for innovation in products, materials or processes: _____

The benefits of the regulations, including, but not limited to, benefits to the health, safety, and welfare of California residents, worker safety, and the state's environment and quality of life, among any other benefits identified by the agency: _____

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD 399 (REV 12/2013)

FISCAL IMPACT STATEMENT

A. FISCAL EFFECT ON LOCAL GOVERNMENT *Indicate appropriate boxes 1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.*

- 1. Additional expenditures in the current State Fiscal Year which are reimbursable by the State. (Approximate)
(Pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code).

\$ _____

- a. Funding provided in _____
Budget Act of _____ or Chapter _____, Statutes of _____

- b. Funding will be requested in the Governor's Budget Act of _____
Fiscal Year: _____

- 2. Additional expenditures in the current State Fiscal Year which are NOT reimbursable by the State. (Approximate)
(Pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code).

\$ _____

Check reason(s) this regulation is not reimbursable and provide the appropriate information:

- a. Implements the Federal mandate contained in _____
- b. Implements the court mandate set forth by the _____ Court.

Case of: _____ vs. _____

- c. Implements a mandate of the people of this State expressed in their approval of Proposition No. _____

Date of Election: _____

- d. Issued only in response to a specific request from affected local entity(s).

Local entity(s) affected: _____

- e. Will be fully financed from the fees, revenue, etc. from: _____
Authorized by Section: _____ of the _____ Code;

- f. Provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each;

- g. Creates, eliminates, or changes the penalty for a new crime or infraction contained in _____

- 3. Annual Savings. (approximate)

\$ _____

- 4. No additional costs or savings. This regulation makes only technical, non-substantive or clarifying changes to current law regulations.

- 5. No fiscal impact exists. This regulation does not affect any local entity or program.

- 6. Other. Explain _____

**ECONOMIC AND FISCAL IMPACT STATEMENT
(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2013)

FISCAL IMPACT STATEMENT (CONTINUED)

FISCAL EFFECT ON STATE GOVERNMENT Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.

1. Additional expenditures in the current State Fiscal Year. (Approximate)

\$ _____

It is anticipated that State agencies will:

a. Absorb these additional costs within their existing budgets and resources.

b. Increase the currently authorized budget level for the _____ Fiscal Year

2. Savings in the current State Fiscal Year. (Approximate)

\$ _____

3. No fiscal impact exists. This regulation does not affect any State agency or program.

4. Other. Explain _____

C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.

1. Additional expenditures in the current State Fiscal Year. (Approximate)

\$ _____

2. Savings in the current State Fiscal Year. (Approximate)

\$ _____

3. No fiscal impact exists. This regulation does not affect any federally funded State agency or program.

4. Other. Explain _____

FISCAL OFFICER SIGNATURE

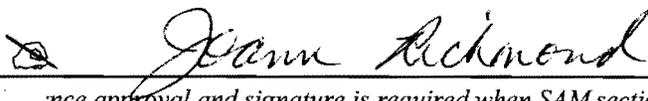


DATE

March 25, 2014

The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6601-6616, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.

AGENCY SECRETARY



DATE

March 25, 2014

Agency approval and signature is required when SAM sections 6601-6616 require completion of Fiscal Impact Statement in the STD. 399.

DEPARTMENT OF FINANCE PROGRAM BUDGET MANAGER

Exempt under SAM section 6615

DATE

**Attachment to Economic and Fiscal Impact
Statement (STD. 399 (Rev. 12/2013)) for the Proposed Amendments to
California Code of Regulations, Title 18,
Section 133, *Business Inventory Exemption***

California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, implements, interprets, and makes specific Revenue and Taxation Code (RTC) sections 129 and 219. By letter dated December 24, 2013, the State Board of Equalization's (Board's) Legal Department opined that the business inventory exemption provided by RTC sections 129 and 219 applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also noted that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

The proposed amendments to Property Tax Rule 133 clarify that, under current law, the business inventory exemption applies to non-reusable space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch. As explained in detail in the initial statement of reasons, the proposed amendments are consistent with the current provisions of RTC sections 129 and 219 and the cases applying those sections, the current provisions of Property Tax Rule 133, and the Sales and Use Tax Law (RTC § 6001 et seq.). And, the Board anticipates that the proposed amendments will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to space flight property, under specified circumstances.

Therefore, based upon the foregoing information and all of the information in the rulemaking file, the Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed regulatory action, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business that is in addition to whatever economic impact the enactment of RTC sections 129 and 219 has had and will have on individuals and businesses, and the Board has determined that the proposed amendments will have no impact on revenue. The Board has also determined that the proposed amendments to Property Tax Rule 133 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period. And, the Board has determined that the proposed amendments to Property Tax Rule 133:

- Will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states;
- Will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California;
- Will not have a significant effect on housing costs;

- Will result in no direct or indirect cost or savings to any state agency, cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California; and
- Will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

Finally, Property Tax Rule 133 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments will not affect the benefits of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state's environment.

NOTICE PUBLICATION/REGULATIONS SUBMISSION(See instructions on
reverse)

For use by Secretary of State only

STD. 400 (REV. 01-2013)

OAL FILE NUMBERS	NOTICE FILE NUMBER Z-2014-0325-02	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
---------------------	---	--------------------------	------------------

For use by Office of Administrative Law (OAL) only

RECEIVED FOR FILING PUBLICATION DATE

MAR 25 '14 APR 04 '14

Office of Administrative Law

NOTICE

REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY
State Board of Equalization

AGENCY FILE NUMBER (if any)

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE Business Inventory Exemption		TITLE(S) 18	FIRST SECTION AFFECTED 133	2. REQUESTED PUBLICATION DATE April 4, 2014	
3. NOTICE TYPE <input checked="" type="checkbox"/> Notice re Proposed Regulatory Action <input type="checkbox"/> Other		4. AGENCY CONTACT PERSON Richard E. Bennion		TELEPHONE NUMBER (916) 445-2130	FAX NUMBER (Optional) (916) 324-3984
OAL USE ONLY <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn		NOTICE REGISTER NUMBER		PUBLICATION DATE	

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)	1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)
------------------------------	--

2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)	ADOPT
	AMEND
	REPEAL
TITLE(S)	

3. TYPE OF FILING

- | | | | |
|---|---|---|---|
| <input type="checkbox"/> Regular Rulemaking (Gov. Code §11346) | <input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute. | <input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h)) | <input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100) |
| <input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4) | <input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1) | <input type="checkbox"/> File & Print | <input type="checkbox"/> Print Only |
| <input type="checkbox"/> Emergency (Gov. Code, §11346.1(b)) | | <input type="checkbox"/> Other (Specify) _____ | |

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

- | | | | |
|---|--|--|--|
| <input type="checkbox"/> Effective January 1, April 1, July 1, or October 1 (Gov. Code §11343.4(a)) | <input type="checkbox"/> Effective on filing with Secretary of State | <input type="checkbox"/> \$100 Changes Without Regulatory Effect | <input type="checkbox"/> Effective other (Specify) _____ |
|---|--|--|--|

6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

- | | | |
|--|--|---|
| <input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660) | <input type="checkbox"/> Fair Political Practices Commission | <input type="checkbox"/> State Fire Marshal |
| <input type="checkbox"/> Other (Specify) _____ | | |

7. CONTACT PERSON

TELEPHONE NUMBER

FAX NUMBER (Optional)

E-MAIL ADDRESS (Optional)

8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

For use by Office of Administrative Law (OAL) only

SIGNATURE OF AGENCY HEAD OR DESIGNEE

DATE

TYPED NAME AND TITLE OF SIGNATORY

Notice of Proposed Regulatory Action

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 133, *Business Inventory Exemption*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Government Code section 15606, proposes to adopt amendments to California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*. The proposed amendments to Property Tax Rule 133 clarify that space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List, and the control of which is relinquished by the owner upon launch, is classified as business inventory within the meaning of Revenue and Taxation Code (RTC) sections 129 and 219.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 22-23, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on May 22 or 23, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Property Tax Rule 133.

AUTHORITY

Government Code section 15606

REFERENCE

RTC sections 129 and 219

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

California Constitution, article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. All property includes tangible personal property. However, RTC section 219 provides that, “For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories.”

Under Government Code section 15606, subdivision (c), the State Board of Equalization (Board) is authorized to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f) authorizes the Board to prescribe “rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures.” The Board adopted California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, pursuant to Government Code section 15606, to implement, interpret, and make specific the provisions, under article XIII of the California Constitution and the RTC, applicable to the exemption of business inventories.

In particular, Property Tax Rule 133 implements, interprets, and makes specific RTC sections 129 and 219. RTC section 129 defines “business inventories” as follows:

“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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

“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.

“Business inventories” shall also include goods held by a licensed contractor and not yet incorporated into real property.

As relevant here, subdivision (a)(1) of Property Tax Rule 133 further defines the term “business inventories” and also defines the phrases “ordinary course of business” and “goods intended for sale or lease,” as used in RTC section 129. The Board added the current provisions of subdivision (a)(2)(A), (C), and (D) to Property Tax Rule 133, in

2000, in order to provide a list of the specific types of property that the Board had previously determined are included within the meaning of the term “business inventories” prior to 2000. And, the Board added subdivision (a)(2)(B) to Property Tax Rule 133, in 2000, to clarify that the Board had recently determined that new and used oak barrels are business inventories, under specific circumstances.

Effects, Objectives, and Benefits of the Proposed Amendments

The transfer of control of space flight property to the federal government is required by Air Force Space Command (AFSPC). Authority over space flight property launch is granted to the Air Force via the Commercial Space Launch Act of 1984, as amended in 1988 (49 U.S.C. §§ 2601-23, October 30, 1984) which grants regulatory authority over space flight property to the Department of Transportation, which through the Federal Aviation Administration Office for Commercial Space Transportation entered into an agreement with the United States Air Force regarding the implementation of procedures for commercial space transportation and range activities. (See Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities, at https://www.faa.gov/about/office_org/headquarters_offices/ast/media/moa.pdf (as of March 18, 2014).)

AFSPC directs safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch. (Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91-711 (February 1, 2007) (AFSPC Manual 91-711) provide mission flight control officers with power to issue flight termination commands.) The federal launch safety authority, in its sole discretion, may terminate the flight. (AFSPC Manual 91-711, § 7.1.1.1.) Termination of the flight would result in destruction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

Prior to December 2013, the Board had provided general guidance regarding the business inventory exemption and specific guidance regarding its application to various types of property; however, the previous Board guidance had not specifically discussed the application of the business inventory exemption to space flight property. By letter dated December 24, 2013, the Board’s Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. In the letter, the Board’s Legal Department also opined that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory “goods intended for sale . . . in the ordinary course of business.” The Property Tax Law (RTC § 50 et seq.)

does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that, “The phrase ‘ordinary course of business’ . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.” Due to the unique nature of the space flight industry, the determination of whether space flight property is a “good intended for sale in the ordinary course of business” must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property. (The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles (22 U.S.C. § 2278, subd. (a)(1)); and the Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List (22 C.F.R. §§ 120-130).) Within that context, the Board’s Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a “sale” and makes space flight property “goods intended for sale in the ordinary course of business” within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board’s Legal Department also based its determination that space flight property is business inventory, under such circumstances, on that fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board’s Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer’s reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement under Cal. Code Regs., tit. 18, § 1700]); See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts – held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer’s gross receipts from each “retail sale,” which is defined as “a sale for any purpose other than resale in the regular course of business.” (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was “sold” in a retail sale and that same property was necessarily, prior to sale, property that was “intended for sale in the ordinary course of business” (i.e., business inventory). Thus, the courts recognize that the definition of “goods intended for sale in the ordinary course of business” must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term “sale” means any transfer of title to or possession of property for a consideration and the term “transfer of possession” includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for the specific exemption for qualified property for use in space flight provided by RTC section 6380, space flight property companies would owe sales tax on such transfers. Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO2 containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller’s control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer’s direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that “[w]hile statutes granting property tax exemptions are generally construed strictly, that approach ‘does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].’” (*Id.* at p. 716.) Therefore, based upon the heavy federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board’s Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219.

In Letter to Assessors (LTA) 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, the Board’s Property and Special Taxes Department advised interested parties that a project had been initiated to proposed revisions to

Property Tax Rule 133 due to “inquiries as to whether the business inventory exemption applies to certain space flight property regulated under the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR)” (footnotes omitted). The LTA also noted the Legal Department’s December 24, 2013, letter regarding space flight property (discussed above), provided a link to a redacted copy of the letter posted on the Board’s website, and gave the interested parties an opportunity to provide comments and suggestions by January 31, 2014.

Board staff conducted an interested parties meeting on February 6, 2014, to discuss the proposed revisions to Property Tax Rule 133. Staff subsequently prepared Formal Issue Paper 14-002, which included as attachments the comments received in support of and in opposition to Board staff’s proposed amendment to Property Tax Rule 133, and submitted it to the Board for consideration during its February 25, 2014, Property Tax Committee meeting.

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)(1):

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase “control over which is relinquished by the owner upon launch” means the transfer of control to a federal launch safety authority for space flight termination purposes.

In addition, in the formal issue paper, Board staff summarized the comments in support of and in opposition to its proposed amendments to Property Tax Rule 133. Board staff responded to the comments in opposition. Board staff also specifically explained that the proposed amendments clarifying the definition of “business inventories” will not apply to “reusable” space flight property. Board staff specifically explained that its proposed amendments are “very narrowly tailored to interpret [RTC] sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch.” Board staff specifically explained that the proposed amendments are more limited than the exemption afforded by Assembly Bill No. (AB) 777 (2013-2014 Reg. Sess.) because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all spaceflight property whether inventory or not. And, Board staff specifically explained that “[because the issue of the qualification of space flight property as exempt business inventory is one that

has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of rulemaking.”

At the conclusion of the Board’s discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is necessary to amend Property Tax Rule 133, as recommended by staff, to have the effect and accomplish the objective of addressing the application of the business inventory exemption to space flight property. Therefore, the Board agreed with staff’s recommendation and the Board Members unanimously voted to propose the amendments to Property Tax Rule 133 recommended by staff, and requested that staff provide additional clarification regarding the “ceding of control” and additional analysis of the federal authority regarding the transfer of control, which is provided above and in the initial statement of reasons.

The Board anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

The Board has performed an evaluation of whether the proposed amendments to Property Tax Rule 133 are inconsistent or incompatible with existing state regulations. The Board has determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Property Tax Rule 133 is the only regulation implementing RTC sections 129 and 219, and the proposed amendments make Property Tax Rule 133 consistent with the statutes as discussed above. In addition, the Board has determined that there are no comparable federal regulations or statutes to Property Tax Rule 133 or the proposed amendments to Property Tax Rule 133.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will result in no direct or indirect cost or savings to any state agency, cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Property Tax Rule 133 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Property Tax Rule 133 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not affect the benefits of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Property Tax Rule 133 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Leslie Ang, Tax Counsel, by telephone at (916) 323-9856, by e-mail at

leslie.ang@boe.ca.gov, or by mail at State Board of Equalization, Attn: Leslie Ang, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on May 22, 2014, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Property Tax Rule 133 during the May 22-23, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Property Tax Rule 133. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underline and strikeout version of the text of Property Tax Rule 133 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Property Tax Rule 133 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be

informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Property Tax Rule 133, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's website at www.boe.ca.gov.

Bennion, Richard

From: State Board of Equalization - Announcement of Regulatory Change
<Legal.Regulations@BOE.CA.GOV>
Sent: Friday, April 04, 2014 11:21 AM
To: BOE_REGULATIONS@LISTSERV.STATE.CA.GOV
Subject: State Board of Equalization - Announcement of Regulatory Change 133

The State Board of Equalization proposes to adopt amendments to Rule 133, *Business Inventory Exemption*. A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 10:00 a.m., or as soon thereafter as the matter may be heard, on May 22-23, 2014.

The proposed amendments to Rule 133, *Business Inventory Exemption*, clarify that the business inventory exemption applies to space flight property, under specific circumstances.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link:
http://www.boe.ca.gov/regs/reg_133_2014.htm.

Questions regarding the substance of the proposed amendments should be directed to Ms. Leslie Ang, Tax Counsel, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email leslie.ang@boe.ca.gov, telephone (916) 323-9856, or FAX (916) 323-3387.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

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Bennion, Richard

From: BOE-Board Meeting Material
Sent: Friday, April 04, 2014 9:31 AM
To: Alonzo, Mary Ann (Legal); Angeja, Jeff (Legal); Angeles, Joel; Appleby, Jaclyn; Armenta, Christopher; Baetge, Michelle; Bartolo, Lynn; Bennion, Richard; Benson, Bill; Bisauta, Christine (Legal); Blake, Sue; BOE-Board Meeting Material; Boyle, Kevin; Bridges, Cynthia; Brown, Michele C; Chung, Sophia (Legal); Cruz, Giovan; Davis, Toya P.; Delgado, Maria; Dixon, Camille; Duran, David; Elliott, Claudia; Epolite, Anthony (Legal); Ferris, Randy (Legal); Ford, Ladeena L; Garcia, Laura; Gau, David; Gilman, Todd; Goehring, Teresa; Hale, Mike; Hamilton, Tabitha; Hanohano, Rebecca; Harvill, Mai; He, Mengjun; Heller, Bradley (Legal); Hellmuth, Leila; Herrera, Cristina; Holmes, Dana; Hughes, Shellie L; Jacobson, Andrew; Kinkle, Sherrie L; Kinst, Lynne; Kruckenberg, Kendra; Kuhl, James; Lambert, Gary; Lambert, Robert (Legal); Lee, Chris; Levine, David H. (Legal); LoFaso, Alan; Madrigal, Claudia; Mandel, Marcy Jo; Matsumoto, Sid; McGuire, Jeff; Miller, Brad; Mandel, Marcy Jo @ SCO; Moon, Richard (Legal); Morquecho, Raymond; Nienow, Trecia (Legal); Oakes, Clifford; Pielsticker, Michele; Ralston, Natasha; Richmond, Joann; Riley, Denise (Legal); Salazar, Ramon; Salgado-Ponce, Sylvia; Schultz, Glenna; Shah, Neil; Silva, Monica (Legal); Singh, Sam; Smith, Kevin (Legal); Smith, Rose; Stowers, Yvette; Torres, Rodrigo; Torres, Rodrigo; Tran, Mai (Legal); Treichelt, Tim; Tucker, Robert (Legal); Vandrick, Tanya; Vasquez, Rosalyn; Vigil, Michael; Wallentine, Sean; Whitaker, Lynn; White, Sharon; Williams, Lee; Zivkovich, Robert
Subject: State Board of Equalization - Announcement of Regulatory Change 133

The State Board of Equalization proposes to adopt amendments to Rule 133, *Business Inventory Exemption*. A public hearing regarding the proposed amendments will be held in Room 121, 450 N Street, Sacramento, at 10:00 a.m., or as soon thereafter as the matter may be heard, on May 22-23, 2014.

The proposed amendments to Rule 133, *Business Inventory Exemption*, clarify that the business inventory exemption applies to space flight property, under specific circumstances.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link:
http://www.boe.ca.gov/regs/reg_133_2014.htm.

Questions regarding the substance of the proposed amendments should be directed to Ms. Leslie Ang, Tax Counsel, at 450 N Street, MIC:82, Sacramento, CA 94279-0082, email leslie.ang@boe.ca.gov, telephone (916) 323-9856, or FAX (916) 323-3387.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Mr. Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail Richard.Bennion@boe.ca.gov or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879-0080, Sacramento, CA 94279-0080.

Please do not reply to this message.

Board Proceedings Division, MIC:80
Rick Bennion
Regulations Coordinator
Phone (916) 445-2130
Fax (916) 324-3984

fax, or by e-mail) to CDCR, Regulation and Policy Management Branch, P.O. Box 942883, Sacramento, CA 94283-0001; by fax at (916) 324-6075; or by e-mail at RPMB@cdcr.ca.gov before the close of the comment period.

AVAILABILITY OF PROPOSED TEXT AND INITIAL STATEMENT OF REASONS

The Department has prepared, and will make available, the text, any documents incorporated by reference, and the Initial Statement of Reasons (ISOR) of the proposed regulations. The rulemaking file for this regulatory action, which contains those items and all information on which the proposal is based (i.e., rulemaking file) is available to the public upon request directed to the Department's contact person. The proposed text, ISOR, documents incorporated by reference, and Notice of Proposed Regulations will also be made available on the Department's website <http://www.cdcr.ca.gov>.

AVAILABILITY OF CHANGES TO PROPOSED TEXT

After considering all timely and relevant comments received, the Department may adopt the proposed regulations substantially as described in this Notice. If the Department makes modifications which are sufficiently related to the originally proposed text, it will make the modified text (with the changes clearly indicated) available to the public for at least 15 days before the Department adopts the regulations as revised. Requests for copies of any modified regulation text should be directed to the contact person indicated in this Notice. The Department will accept written comments on the modified regulations for 15 days after the date on which they are made available.

AVAILABILITY OF THE FINAL STATEMENT OF REASONS

Following its preparation, a copy of the Final Statement of Reasons will be available on the Department's website at <http://www.cdcr.ca.gov>, and may also be obtained from the Department's contact person.

TITLE 18. BOARD OF EQUALIZATION

The State Board of Equalization Proposes to Adopt Amendments to California Code of Regulations, Title 18, Section 133, *Business Inventory Exemption*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Government Code section 15606, proposes to adopt amendments to California Code of Regulations, title 18, section (Property Tax Rule) 133, Business Inventory Exemption. The proposed amendments to Property Tax Rule 133 clarify that space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List, and the control of which is relinquished by the owner upon launch, is classified as business inventory within the meaning of Revenue and Taxation Code (RTC) sections 129 and 219.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 22-23, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on May 22 or 23, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Property Tax Rule 133.

AUTHORITY

Government Code section 15606

REFERENCE

RTC sections 129 and 219

INFORMATIVE DIGEST/POLICY STATEMENT
OVERVIEW

Current Law

California Constitution, article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. All property includes tangible personal property. However, RTC section 219 provides that, “For the 1980–81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories.”

Under Government Code section 15606, subdivision (c), the State Board of Equalization (Board) is authorized to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f) authorizes the Board to prescribe “rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures.” The Board adopted California Code of Regulations, title 18, section (Property Tax Rule) 133, Business Inventory Exemption, pursuant to Government Code section 15606, to implement, interpret, and make specific the provisions, under article XIII of the California Constitution and the RTC, applicable to the exemption of business inventories.

In particular, Property Tax Rule 133 implements, interprets, and makes specific RTC sections 129 and 219. RTC section 129 defines “business inventories” as follows:

“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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

“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.

“Business inventories” shall also include goods held by a licensed contractor and not yet incorporated into real property.

As relevant here, subdivision (a)(1) of Property Tax Rule 133 further defines the term “business inventories” and also defines the phrases “ordinary course of business” and “goods intended for sale or lease,” as used in RTC section 129. The Board added the current provisions of subdivision (a)(2)(A), (C), and (D) to Property Tax Rule 133, in 2000, in order to provide a list of the specific types of property that the Board had previously determined are included within the meaning of the term “business inventories” prior to 2000. And, the Board added subdivision (a)(2)(B) to Property Tax Rule 133, in 2000, to clarify that the Board had recently determined that new and used oak barrels are business inventories, under specific circumstances.

Effects, Objectives, and Benefits of the Proposed Amendments

The transfer of control of space flight property to the federal government is required by Air Force Space Command (AFSPC). Authority over space flight property launch is granted to the Air Force via the Commercial Space Launch Act of 1984, as amended in 1988 (49 U.S.C. §§ 2601–23, October 30, 1984) which grants regulatory authority over space flight property to the Department of Transportation, which through the Federal Aviation Administration Office for Commercial Space Transportation entered into an agreement with the United States Air Force regarding the implementation of procedures for commercial space transportation and range activities. (See Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities, at https://www.faa.gov/about/office_org/headquarters_offices/ast/media/moa.pdf (as of March 18, 2014).)

AFSPC directs safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch. (Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91–711 (February 1, 2007) (AFSPC Manual 91–711) provide mission flight control officers with power to issue flight termination commands.) The federal launch safety authority, in its sole discretion, may terminate the flight. (AFSPC Manual 91–711, § 7.1.1.1.) Termination of the flight would result in de-

struction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

Prior to December 2013, the Board had provided general guidance regarding the business inventory exemption and specific guidance regarding its application to various types of property; however, the previous Board guidance had not specifically discussed the application of the business inventory exemption to space flight property. By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also opined that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory "goods intended for sale . . . in the ordinary course of business." The Property Tax Law (RTC § 50 et seq.) does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that, "The phrase 'ordinary course of business' . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor." Due to the unique nature of the space flight industry, the determination of whether space flight property is a "good intended for sale in the ordinary course of business" must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property. (The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles (22 U.S.C. § 2278, subd. (a)(1)); and the Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List (22 C.F.R. §§ 120–130).) Within that context, the Board's Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a "sale" and makes space flight property "goods intended for sale in the ordinary course of business" within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board's Legal Department also based its determination that space flight property is business inventory, under such

circumstances, on the fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board's Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer's reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement under Cal. Code Regs., tit. 18, § 1700]); See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts — held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer's gross receipts from each "retail sale," which is defined as "a sale for any purpose other than resale in the regular course of business." (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was "sold" in a retail sale and that same property was necessarily, prior to sale, property that was "intended for sale in the ordinary course of business" (i.e., business inventory). Thus, the courts recognize that the definition of "goods intended for sale in the ordinary course of business" must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term "sale" means any transfer of title to or possession of property for a consideration and the term "transfer of possession" includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board's Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for the specific exemption for qualified property for use in space flight provided by RTC section 6380, space flight

property companies would owe sales tax on such transfers. Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO₂ containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller's control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer's direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that "[w]hile statutes granting property tax exemptions are generally construed strictly, that approach 'does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].'" (*Id.* at p. 716.) Therefore, based upon the heavy federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board's Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219.

In Letter to Assessors (LTA) 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, the Board's Property and Special Taxes Department advised interested parties that a project had been initiated to proposed revisions to Property Tax Rule 133 due to "inquiries as to whether the business inventory exemption applies to certain space flight property regulated under the Arms Export Control Act

(AECA) and the International Traffic in Arms Regulations (ITAR)" (footnotes omitted). The LTA also noted the Legal Department's December 24, 2013, letter regarding space flight property (discussed above), provided a link to a redacted copy of the letter posted on the Board's website, and gave the interested parties an opportunity to provide comments and suggestions by January 31, 2014.

Board staff conducted an interested parties meeting on February 6, 2014, to discuss the proposed revisions to Property Tax Rule 133. Staff subsequently prepared Formal Issue Paper 14-002, which included as attachments the comments received in support of and in opposition to Board staff's proposed amendment to Property Tax Rule 133, and submitted it to the Board for consideration during its February 25, 2014, Property Tax Committee meeting.

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)(1):

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase "control over which is relinquished by the owner upon launch" means the transfer of control to a federal launch safety authority for space flight termination purposes.

In addition, in the formal issue paper, Board staff summarized the comments in support of and in opposition to its proposed amendments to Property Tax Rule 133. Board staff responded to the comments in opposition. Board staff also specifically explained that the proposed amendments clarifying the definition of "business inventories" will not apply to "reusable" space flight property. Board staff specifically explained that its proposed amendments are "very narrowly tailored to interpret [RTC] sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch." Board staff specifically explained that the proposed amendments are more limited than the exemption afforded by Assembly Bill No.

(AB) 777 (2013–2014 Reg. Sess.) because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all spaceflight property whether inventory or not. And, Board staff specifically explained that “[because the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of rulemaking.”

At the conclusion of the Board’s discussion of Formal Issue Paper 14–002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is necessary to amend Property Tax Rule 133, as recommended by staff, to have the effect and accomplish the objective of addressing the application of the business inventory exemption to space flight property. Therefore, the Board agreed with staff’s recommendation and the Board Members unanimously voted to propose the amendments to Property Tax Rule 133 recommended by staff, and requested that staff provide additional clarification regarding the “ceding of control” and additional analysis of the federal authority regarding the transfer of control, which is provided above and in the initial statement of reasons.

The Board anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

The Board has performed an evaluation of whether the proposed amendments to Property Tax Rule 133 are inconsistent or incompatible with existing state regulations. The Board has determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Property Tax Rule 133 is the only regulation implementing RTC sections 129 and 219, and the proposed amendments make Property Tax Rule 133 consistent with the statutes as discussed above. In addition, the Board has determined that there are no comparable federal regulations or statutes to Property Tax Rule 133 or the proposed amendments to Property Tax Rule 133.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reim-

bursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will result in no direct or indirect cost or savings to any state agency, cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Property Tax Rule 133 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Property Tax Rule 133 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons.

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not affect the benefits of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state’s environment.

**NO SIGNIFICANT EFFECT ON
HOUSING COSTS**

Adoption of the proposed amendments to Property Tax Rule 133 will not have a significant effect on housing costs.

**DETERMINATION REGARDING
ALTERNATIVES**

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Leslie Ang, Tax Counsel, by telephone at (916) 323-9856, by e-mail at leslie.ang@boe.ca.gov, or by mail at State Board of Equalization, Attn: Leslie Ang, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on May 22, 2014, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Property Tax Rule 133 during the May 22-23, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the

proposed amendments to Property Tax Rule 133. The Board will only consider written comments received by that time.

**AVAILABILITY OF INITIAL STATEMENT OF
REASONS AND TEXT OF
PROPOSED REGULATION**

The Board has prepared an underline and strikeout version of the text of Property Tax Rule 133 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rule-making file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's website at www.boe.ca.gov.

**SUBSTANTIALLY RELATED CHANGES
PURSUANT TO GOVERNMENT CODE
SECTION 11346.8**

The Board may adopt the proposed amendments to Property Tax Rule 133 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

**AVAILABILITY OF FINAL STATEMENT
OF REASONS**

If the Board adopts the proposed amendments to Property Tax Rule 133, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's website at www.boe.ca.gov.



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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Third District, Orange County

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

April 4, 2014

No. 2014/016

TO COUNTY ASSESSORS, COUNTY COUNSELS,
AND OTHER INTERESTED PARTIES:

**Notice of Proposed Regulatory Action
by the
State Board of Equalization**

**Proposed to Adopt
Amendments to California Code of Regulations, Title 18,
Section 133, *Business Inventory Exemption***

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Government Code section 15606, proposes to adopt amendments to California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*. The proposed amendments to Property Tax Rule 133 clarify that space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List, and the control of which is relinquished by the owner upon launch, is classified as business inventory within the meaning of Revenue and Taxation Code (RTC) sections 129 and 219.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 22-23, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on May 22 or 23, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Property Tax Rule 133.

AUTHORITY

Government Code section 15606

REFERENCE

RTC sections 129 and 219

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

California Constitution, article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. All property includes tangible personal property. However, RTC section 219 provides that, "For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories."

Under Government Code section 15606, subdivision (c), the State Board of Equalization (Board) is authorized to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f) authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures." The Board adopted California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, pursuant to Government Code section 15606, to implement, interpret, and make specific the provisions, under article XIII of the California Constitution and the RTC, applicable to the exemption of business inventories.

In particular, Property Tax Rule 133 implements, interprets, and makes specific RTC sections 129 and 219. RTC section 129 defines "business inventories" as follows:

"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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

"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.

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As relevant here, subdivision (a)(1) of Property Tax Rule 133 further defines the term “business inventories” and also defines the phrases “ordinary course of business” and “goods intended for sale or lease,” as used in RTC section 129. The Board added the current provisions of subdivision (a)(2)(A), (C), and (D) to Property Tax Rule 133, in 2000, in order to provide a list of the specific types of property that the Board had previously determined are included within the meaning of the term “business inventories” prior to 2000. And, the Board added subdivision (a)(2)(B) to Property Tax Rule 133, in 2000, to clarify that the Board had recently determined that new and used oak barrels are business inventories, under specific circumstances.

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AFSPC directs safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch. (Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91-711 (February 1, 2007) (AFSPC Manual 91-711) provide mission flight control officers with power to issue flight termination commands.)

The federal launch safety authority, in its sole discretion, may terminate the flight. (AFSPC Manual 91-711, § 7.1.1.1.) Termination of the flight would result in destruction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

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which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also opined that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory "goods intended for sale . . . in the ordinary course of business." The Property Tax Law (RTC § 50 et seq.) does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that, "The phrase 'ordinary course of business' . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor." Due to the unique nature of the space flight industry, the determination of whether space flight property is a "good intended for sale in the ordinary course of business" must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property. (The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles (22 U.S.C. § 2278, subd. (a)(1)); and the Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List (22 C.F.R. §§ 120-130).) Within that context, the Board's Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a "sale" and makes space flight property "goods intended for sale in the ordinary course of business" within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board's Legal Department also based its determination that space flight property is business inventory, under such circumstances, on that fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board's Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer's reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement under Cal. Code Regs., tit. 18, § 1700]; See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts – held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer's gross receipts from each "retail sale," which is defined as "a sale for any purpose other than resale in the regular course of business." (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was "sold" in a retail sale and that same property was necessarily, prior to sale, property that was "intended for sale in the ordinary course of business" (i.e., business inventory). Thus, the courts recognize that the definition of "goods intended for sale in the ordinary course of business" must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other

words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term “sale” means any transfer of title to or possession of property for a consideration and the term “transfer of possession” includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for the specific exemption for qualified property for use in space flight provided by RTC section 6380, space flight property companies would owe sales tax on such transfers. Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO2 containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller’s control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer’s direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that “[w]hile statutes granting property tax exemptions are generally construed strictly, that approach ‘does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].’” (*Id.* at p. 716.) Therefore, based upon the heavy federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board’s Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219.

In Letter to Assessors (LTA) 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, the Board’s Property and Special Taxes Department advised interested parties that a project had been initiated to proposed revisions to Property Tax Rule 133 due to

“inquiries as to whether the business inventory exemption applies to certain space flight property regulated under the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR)” (footnotes omitted). The LTA also noted the Legal Department’s December 24, 2013, letter regarding space flight property (discussed above), provided a link to a redacted copy of the letter posted on the Board’s website, and gave the interested parties an opportunity to provide comments and suggestions by January 31, 2014.

Board staff conducted an interested parties meeting on February 6, 2014, to discuss the proposed revisions to Property Tax Rule 133. Staff subsequently prepared Formal Issue Paper 14-002, which included as attachments the comments received in support of and in opposition to Board staff’s proposed amendment to Property Tax Rule 133, and submitted it to the Board for consideration during its February 25, 2014, Property Tax Committee meeting.

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)(1):

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase “control over which is relinquished by the owner upon launch” means the transfer of control to a federal launch safety authority for space flight termination purposes.

In addition, in the formal issue paper, Board staff summarized the comments in support of and in opposition to its proposed amendments to Property Tax Rule 133. Board staff responded to the comments in opposition. Board staff also specifically explained that the proposed amendments clarifying the definition of “business inventories” will not apply to “reusable” space flight property. Board staff specifically explained that its proposed amendments are “very narrowly tailored to interpret [RTC] sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch.” Board staff specifically explained that the proposed amendments are more limited than the exemption afforded by Assembly Bill No. (AB) 777 (2013-2014 Reg. Sess.) because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all spaceflight property whether inventory or not. And, Board staff specifically explained that “[because the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of rulemaking.”

At the conclusion of the Board's discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is necessary to amend Property Tax Rule 133, as recommended by staff, to have the effect and accomplish the objective of addressing the application of the business inventory exemption to space flight property. Therefore, the Board agreed with staff's recommendation and the Board Members unanimously voted to propose the amendments to Property Tax Rule 133 recommended by staff, and requested that staff provide additional clarification regarding the "ceding of control" and additional analysis of the federal authority regarding the transfer of control, which is provided above and in the initial statement of reasons.

The Board anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

The Board has performed an evaluation of whether the proposed amendments to Property Tax Rule 133 are inconsistent or incompatible with existing state regulations. The Board has determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Property Tax Rule 133 is the only regulation implementing RTC sections 129 and 219, and the proposed amendments make Property Tax Rule 133 consistent with the statutes as discussed above. In addition, the Board has determined that there are no comparable federal regulations or statutes to Property Tax Rule 133 or the proposed amendments to Property Tax Rule 133.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will result in no direct or indirect cost or savings to any state agency, cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Property Tax Rule 133 will not have a significant, statewide adverse economic impact directly

affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Property Tax Rule 133 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not affect the benefits of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Property Tax Rule 133 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Leslie Ang, Tax Counsel, by telephone at (916) 323-9856, by e-mail at leslie.ang@boe.ca.gov, or by mail at State Board of Equalization, Attn: Leslie Ang, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-

2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on May 22, 2014, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Property Tax Rule 133 during the May 22-23, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Property Tax Rule 133. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underline and strikeout version of the text of Property Tax Rule 133 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

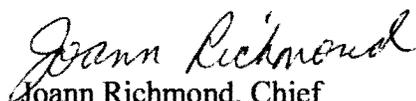
The Board may adopt the proposed amendments to Property Tax Rule 133 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

April 4, 2014

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Property Tax Rule 133, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's website at www.boe.ca.gov.

Sincerely,


Joann Richmond, Chief
Board Proceedings Division

JR:reb

Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 133, *Business Inventory Exemption*

SPECIFIC PURPOSE AND NECESSITY

Current Law

California Constitution, article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. (See also Rev. & Tax. Code, § 201.) All property includes tangible personal property. However, Revenue and Taxation Code (RTC) section 219 provides that, “For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories.”

Under Government Code section 15606, subdivision (c), the State Board of Equalization (Board) is authorized to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f) authorizes the Board to prescribe “rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures.” The Board adopted California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, pursuant to Government Code section 15606, to implement, interpret, and make specific the provisions, under article XIII of the California Constitution and the Revenue and Taxation Code, applicable to the exemption of business inventories.

In particular, Property Tax Rule 133 implements, interprets, and makes specific RTC sections 129 and 219. RTC section 129 defines “business inventories” as follows:

“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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

“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.

“Business inventories” shall also include goods held by a licensed contractor and not yet incorporated into real property.

As relevant here, subdivision (a)(1) of Property Tax Rule 133 further defines the term “business inventories” and also defines the phrases “ordinary course of business” and “goods intended for sale or lease,” as used in RTC section 129. The Board added the current provisions of subdivision (a)(2)(A), (C), and (D) to Property Tax Rule 133, in 2000, in order to provide a list of the specific types of property that the Board had previously determined are included within the meaning of the term “business inventories” prior to 2000. And, the Board added subdivision (a)(2)(B) to Property Tax Rule 133, in 2000, to clarify that the Board had recently determined that new and used oak barrels are business inventories, under specific circumstances.

Proposed Amendments

Need for Clarification

The transfer of control of space flight property to the federal government is required by Air Force Space Command (AFSPC).¹ AFSPC directs safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch.² The federal launch safety authority, in its sole discretion, may terminate the flight.³ Termination of the flight would result in destruction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

Prior to December 2013, the Board had provided general guidance regarding the business inventory exemption and specific guidance regarding its application to various types of property; however, the previous Board guidance had not specifically discussed the

¹ Authority over space flight property launch is granted to the Air Force via the Commercial Space Launch Act of 1984, as amended in 1988 (49 U.S.C. §§ 2601-23, October 30, 1984) which grants regulatory authority over space flight property to the Department of Transportation, which through the Federal Aviation Administration Office for Commercial Space Transportation entered into an agreement with the United States Air Force regarding the implementation of procedures for commercial space transportation and range activities. (See Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities, at https://www.faa.gov/about/office_org/headquarters_offices/ast/media/moa.pdf (as of March 18, 2014).)

² Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91-711 (February 1, 2007) (AFSPC Manual 91-711) provide mission flight control officers with power to issue flight termination commands.

³ AFSPC Manual 91-711, § 7.1.1.1.

application of the business inventory exemption to space flight property. By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also noted that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory "goods intended for sale . . . in the ordinary course of business." The Property Tax Law (RTC § 50 et seq.) does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that, "The phrase 'ordinary course of business' . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor." Due to the unique nature of the space flight industry, the determination of whether space flight property is a "good intended for sale in the ordinary course of business" must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property.⁴ Within that context, the Board's Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a "sale" and makes space flight property "goods intended for sale in the ordinary course of business" within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board's Legal Department also based its determination that space flight property is business inventory, under such circumstances, on that fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board's Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer's reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement⁵]; See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts – held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer's gross receipts from each "retail

⁴ The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles. (22 U.S.C. § 2278, subd. (a)(1).) The Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List. (22 C.F.R. §§ 120-130.)

⁵ Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers as provided in Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*. (Cal. Code Regs., tit. 18, § 1700.)

sale,” which is defined as “a sale for any purpose other than resale in the regular course of business.” (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was “sold” in a retail sale and that same property was necessarily, prior to sale, property that was “intended for sale in the ordinary course of business” (i.e., business inventory). Thus, the courts recognize that the definition of “goods intended for sale in the ordinary course of business” must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term “sale” means any transfer of title to or possession of property for a consideration and the term “transfer of possession” includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for a specific exemption, space flight property companies would owe sales tax on such transfers.⁶ Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO2 containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller’s control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer’s direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that “[w]hile statutes granting property tax exemptions are generally construed strictly, that approach ‘does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].’” (*Id.* at p. 716.) Therefore, based upon the heavy

⁶ RTC section 6380 exempts qualified property for use in space flight from sales and use tax.

federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board's Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219.

Interested Parties Process and Property Tax Committee Meeting

In Letter to Assessors (LTA) 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, the Board's Property and Special Taxes Department advised interested parties that a project had been initiated to propose revisions to Property Tax Rule 133 due to "inquiries as to whether the business inventory exemption applies to certain space flight property regulated under the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR)" (footnotes omitted). The LTA also noted the Legal Department's December 24, 2013, letter regarding space flight property (discussed above), provided a link to a redacted copy of the letter posted on the Board's website, and gave the interested parties an opportunity to provide comments and suggestions by January 31, 2014.

Board staff conducted an interested parties meeting on February 6, 2014, to discuss the proposed revisions to Property Tax Rule 133. Staff subsequently prepared Formal Issue Paper 14-002, which included as attachments the comments received in support of and in opposition to Board staff's proposed amendments to Property Tax Rule 133, and submitted it to the Board for consideration during its February 25, 2014, Property Tax Committee meeting.

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)(1):

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase "control over which is relinquished by the owner upon launch" means the transfer of control to a federal launch safety authority for space flight termination purposes.

In addition, in the formal issue paper, Board staff summarized the comments in support of and in opposition to its proposed amendments to Property Tax Rule 133. Board staff responded to the comments in opposition (and those responses are hereby incorporated by reference). Board staff also specifically explained that the proposed amendments clarifying the definition of “business inventories” will not apply to “reusable” space flight property. Board staff specifically explained that its proposed amendments are “very narrowly tailored to interpret [RTC] sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch.” Board staff specifically explained that the proposed amendments are more limited than the exemption afforded by Assembly Bill No. (AB) 777 (2013-2014 Reg. Sess.) because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all space flight property whether inventory or not. And, Board staff specifically explained that “[b]ecause the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of rulemaking.”

At the conclusion of the Board’s discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that there is an issue (or problem within the meaning of Gov. Code, § 11346.2. subd. (b)(1)) because Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is reasonably necessary to amend Property Tax Rule 133, as recommended by staff, for the specific purpose of addressing that issue. Therefore, the Board agreed with staff’s recommendation and the Board Members unanimously voted to propose the amendments to Property Tax Rule 133 recommended by staff, and requested staff to provide additional clarification regarding the “ceding of control” and additional analysis of the federal authority requiring the transfer of control, which is provided above.

The Board anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

The proposed amendments to Property Tax Rule 133 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Property Tax Rule 133.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-002, the attachments to the issue paper, and the comments made during the Board’s discussion of the issue paper during its February 25, 2014, Property Tax Committee meeting in deciding to propose the amendments to Property Tax Rule 133 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Property Tax Rule 133 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Property Tax Rule 133 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The proposed amendments to Property Tax Rule 133 clarify that, under current law, the business inventory exemption applies to space flight property, under specified circumstances. The proposed amendments are consistent with the current provisions of RTC sections 129 and 219 and the cases applying those sections, the current provisions of Property Tax Rule 133, and the Sales and Use Tax Law. And, the Board anticipates that the proposed amendments will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

As a result, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business that is in addition to whatever economic impact the enactment of RTC sections 129 and 219 has had and will have on individuals and businesses. And, the Board has determined that the proposed amendments to Property Tax Rule 133 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period. Also, based on the above information and all the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

In addition, Property Tax Rule 133 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Property Tax Rule 133 will not affect the benefit of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Property Tax Rule 133 will not have a significant adverse economic impact on business.

The proposed amendments may affect small businesses.

**Text of Proposed Amendments to
California Code of Regulations, Title 18, Section 133**

133. Business Inventory Exemption.

(a) Scope of Exemption.

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase “control over which is relinquished by the owner upon launch” means the transfer of control to a federal launch safety authority for space flight termination purposes.

(b) Exclusions. Property eligible for the “business inventories” exemption does not include:

(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased. Examples of property excluded from business inventories are office supplies, furniture, machines and equipment and manufacturing machinery, equipment and supplies such as dies, patterns, jigs, tooling or chemicals used to produce a chemical or physical reaction, and contractors’ supplies, tools, concrete forms, and other items that will not be incorporated into and become a part of the property. Also ineligible are materials that a contractor is holding to incorporate into real property that will be retained for his own use.

(2) Property being used by its owner for any purpose not directly associated with the prospective sale or lease of that property.

(3) Property actually leased or rented on the lien date.

(4) Property which has been used by the holder prior to the lien date, even though held for lease on the lien date.

(5) Property intended to be used by the lessor after being leased or during intervals between leases even though held for lease on the lien date.

(6) Property in the hands of a lessor who, with intent to enjoy the benefits of the inventory exemption, had leased the property for a period that expired shortly before the lien date but who renewed, extended or renegotiated the lease shortly thereafter.

(c) Service Enterprises. Property held by a person in connection with a profession which is primarily a service activity such as medicine, law, architecture or accountancy is not “business inventories” held for sale or lease even though such property may be transferred to a patient or client incidental to the rendition of the professional service. Property held by enterprises rendering services of a nonprofessional type such as dry cleaners, beauty shop operators and swimming pool service companies is to be regarded as “business inventories” held for sale if such property is delivered as an item regularly included in the service.

(d) Repairers and Reconditioners. Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and materials shall be regarded as holding said parts and materials as “business inventories.”

(e) Agricultural Enterprises. Animals, crops and feed held primarily for sale or lease in the ordinary course of business are included in the term “business inventories,” as are animals used in the production of food or fiber and feed for such animals.

(1) “Animals used in the production of food and fiber” includes all animals customarily employed in the raising of crops or for the feeding, breeding and management of livestock, or for dairying, or any other confined animals whose products are normally used as food for human consumption or for the production of fiber useful to man. Excluded are animals held by an owner or lessee principally for sport, recreation or pleasure such as show animals, horses held for racing or horses and other animals kept as pets.

(2) The term “crops” means all products grown, harvested, and held primarily for sale, including seeds held for sale or seeds to be used in the production of a crop which is to be held primarily for sale. It does not include growing crops exempted pursuant to Article XIII, section 3(h), of the California Constitution or fruit trees, nut trees, and grapevines exempted by section 223 of the Revenue and Taxation Code.

(3) The term “food” means property normally considered as food for human consumption.

(4) Feed for animals held primarily for sale or lease or for animals used in the production of food or fiber constitutes “business inventories” subject to exemption. It includes every type of natural-grown or commercial product fed to animals except medicinal commodities intended to prevent or cure disease unless the medicinal commodities are purchased as a component part of feed for such animals.

Note: Authority cited: Section 15606, Government Code. Reference: Sections 129 and 219, Revenue and Taxation Code.

Regulation History

Type of Regulation: Property Tax

Rule: 133

Title: *Business Inventory Exemption*

Preparation: Leslie Ang

Legal Contact: Leslie Ang

The proposed amendments clarify that the business inventory exemption applies to space flight property, under specific circumstances.

History of Proposed Regulation:

May 22, 2014	Public Hearing
April 4, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
March 25, 2014	Notice to OAL
February 25, 2014	Property Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor: NA

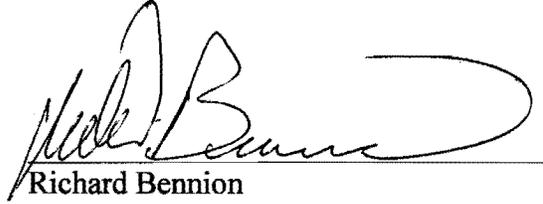
Support: Capitol Strategies Group, Commercial Spaceflight Federation, Los Angeles County Economic Development Corporation, Reliance Machine Products, Inc., United Launch Alliance, Westco Aircraft Hardware Corp.

Oppose: California Assessors' Association, Los Angeles County Assessor, Santa Clara County Assessor

Statement of Compliance

The State Board of Equalization, in process of adopting Property Tax Rule 133, *Business Inventory Exemption*, did comply with the provision of Government Code section 11346.4(a)(1) through (4). A notice to interested parties was mailed on April 4, 2014, 47 days prior to the public hearing.

May 21, 2014

A handwritten signature in black ink, appearing to read "Richard Bennion", written over a horizontal line.

Richard Bennion
Regulations Coordinator
State Board of Equalization

Office of the Assessor

County of Santa Clara

County Government Center, East Wing
70 West Hedding Street, 5th Floor
San Jose, CA 95110-1771
(408) 299-5500 www.sccassessor.org



Lawrence E. Stone, Assessor

April 9, 2014

Hon. Jerome Horton
Chair, State Board of Equalization
450 N Street, MIC 72
Sacramento, CA 95814

Re: Property Tax Rule 133

Dear Jerome,

I write to reinforce my formal comments at the Board meeting on February 25 in Culver City, when I expressed my strong disappointment with the Board's decision to fast-track a rule making process when clearly there were insufficient facts to support the proposed change to Rule 133 and there was no crisis demanding the unusually aggressive schedule.

The crux of the dispute, which has been appealed in just one jurisdiction and does not yet even have a hearing date, concerns a contention by the space transport industry that a special exemption is needed because they are forced to "relinquish ultimate control at launch under federal law, to a Range Safety Officer." The conclusion, upon which your legal counsel rests his opinion and reiterated in the April 4 Notice of Proposed Regulatory Action, states "contracts are drafted, as required by federal law, such that a company cedes ultimate control of the equipment at launch to a federal Range Safety Officer." This is simply not true. Consequently, the basic premise of Counsel's opinion, the basis for the rule, is factually invalid.

Before proceeding, I would urge your staff to do what I have done, meet with representatives from NASA and contact a Range Safety Officer. Our research indicates that companies like SpaceX no more turn over control of their vehicles to a Range Safety Officer, than United Airlines turns over control of its aircraft to the FAA. The job of Range Safety Officers—and it is their only job—is safety. Just as the FAA has the authority to ground any and all aircraft, as it did on "9-11", so too does the Range Safety Officer have the authority to destroy SpaceX cargo vehicles based only on safety considerations.

Hon. Jerome Horton
April 9, 2014
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We came to this conclusion by examining the 2013 "Range Safety Manual for Goddard Space Flight Center (WFF)." This 66-page document states the RSO is an authority only for "range safety policy, processes, and requirements." The RSO has no more control than an air traffic control officer.

In addition, we reviewed the 2011 NASA and Federal Aviation Administration Joint Program Management Plan (PMP) published by NASA's International Space Station Program. That 50-page document explicitly details the partnership between NASA, SpaceX and the FAA. The Management Plan states: "The contractor or licensee (SpaceX) is responsible for its launch and vehicle operation throughout the mission." Appendix C of the document states: "SpaceX or Orbital Sciences Corporation (OSC) always has prime responsibility." The third piece of evidence we received came directly from the Associate Center Director at the Kennedy Space Center in Florida, who stated through his spokesperson, "The RSO only has possession of a space craft purely for safety reasons."

Thankfully, Board Member Yee did recognize these contradictions and requested, as part of initiating the rule making process, the following:

1. More information must be obtained regarding the factual control of the equipment before, during, and after a launch.
2. More information must be obtained regarding the legal control of the equipment, with emphasis and discussion about the federal statutes and authorities involved in a launch.

Despite issuing the Notice of Proposed Regulatory Action, the hearing scheduled for May 22-23 does not contain any response to Member Yee's requests.

SpaceX claims that the vehicles it launches into space cannot be reused for space exploration, yet in a segment on "60 Minutes" on Sunday, March 30, SpaceX made clear, through a mock demonstration, that it plans for their rockets to return to earth with a soft landing that would not damage the rocket. This Rule would likely preclude assessing this property.

The California Assessors' Association is adamantly opposed to proposed Rule 133 for the reasons stated above. I am confident that if the rule is adopted, the CAA will file legal action against the BOE, something that the CAA rarely considers. County counsels from several major counties, including Los Angeles, are equally confident that, because the action of the BOE would be so devoid of facts, the CAA would prevail in such litigations. In the interim, you will have wasted substantial resources of both the BOE and the CAA and possibly even unfairly tainted the pending assessment appeal.

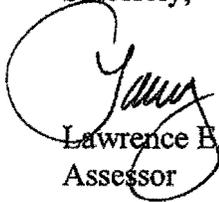
Hon. Jerome Horton
April 9, 2014
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It is disturbing that in the last 12 months the Board has taken the unprecedented action of requesting its Board Counsel opine on issues confronting assessors, bypassing their normal process of receiving input from BOE property tax experts and the California Assessors' Association. Further, on three separate issues (PILOTS, PTR 133, and Possessory Interests) the Board has sought to contradict its own prior direction.

I am hopeful that this significant erosion of our historic collaborative relationship is temporary and that, going forward, Board members will once again work with assessors—the administrators of the local property tax system—in a more collaborative manner to identify policies that benefit all taxpayers.

As always, I would be happy to discuss the content of this letter with you or any other member of your staff.

Sincerely,



Lawrence B. Stone
Assessor

Cc: Cynthia Bridges, Executive Director, State Board of Equalization
Larry Ward, President, California Assessors' Association
Chuck Leonhardt, Chair, California Assessors' Association Standards Committee
Sharon Moller, Los Angeles County Assessor
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Lawrence E. Stone, Assessor

April 9, 2014

Hon. Betty T. Yee
Member, State Board of Equalization
450 N Street, MIC 71
Sacramento, CA 95814

Re: Property Tax Rule 133

Dear Betty,

I write to reinforce my formal comments at the Board meeting on February 25 in Culver City, when I expressed my strong disappointment with the Board's decision to fast-track a rule making process when clearly there were insufficient facts to support the proposed change to Rule 133 and there was no crisis demanding the unusually aggressive schedule.

The crux of the dispute, which has been appealed in just one jurisdiction and does not yet even have a hearing date, concerns a contention by the space transport industry that a special exemption is needed because they are forced to "relinquish ultimate control at launch under federal law, to a Range Safety Officer." The conclusion, upon which your legal counsel rests his opinion and reiterated in the April 4 Notice of Proposed Regulatory Action, states "contracts are drafted, as required by federal law, such that a company cedes ultimate control of the equipment at launch to a federal Range Safety Officer." This is simply not true. Consequently, the basic premise of Counsel's opinion, the basis for the rule, is factually invalid.

Before proceeding, I would urge your staff to do what I have done, meet with representatives from NASA and contact a Range Safety Officer. Our research indicates that companies like SpaceX no more turn over control of their vehicles to a Range Safety Officer, than United Airlines turns over control of its aircraft to the FAA. The job of Range Safety Officers—and it is their only job—is safety. Just as the FAA has the authority to ground any and all aircraft, as it did on "9-11", so too does the Range Safety Officer have the authority to destroy SpaceX cargo vehicles based only on safety considerations.

Hon. Betty Yee
April 9, 2014
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Thankfully, Board Member Yee did recognize these contradictions and requested, as part of initiating the rule making process, the following:

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Hon. Betty Yee
April 9, 2014
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Lawrence E. Stone, Assessor

April 9, 2014

Hon. George Runner
Member, Board of Equalization
500 Capitol Mall, Ste. 1750
Sacramento, CA 95814

Re: Property Tax Rule 133

Dear George,

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Hon. George Runner
April 9, 2014
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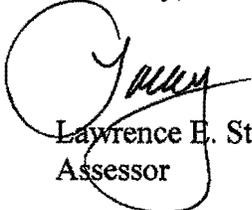
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Lawrence E. Stone, Assessor

April 9, 2014

Hon. Michelle Steel
Member, Board of Equalization
450 N St., MIC 77
Sacramento, CA 95814

Re: Property Tax Rule 133

Dear Michelle,

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Hon. Michelle Steel
April 9, 2014
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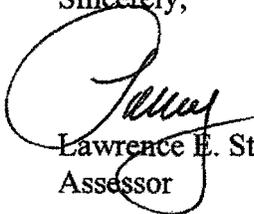
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Assessor

Cc: Cynthia Bridges, Executive Director, State Board of Equalization
Larry Ward, President, California Assessors' Association
Chuck Leonhardt, Chair, California Assessors' Association Standards Committee
Sharon Moller, Los Angeles County Assessor
Brian Donnelly, Los Angeles County Assessor's Office
Dean Kinnee, Property Tax Division, Board of Equalization
David Gau, Deputy Director, Board of Equalization

LES:dhl

Office of the Assessor

County of Santa Clara

County Government Center, East Wing
70 West Hedding Street, 5th Floor
San Jose, CA 95110-1771
(408) 299-5500 www.sccassessor.org



Lawrence E. Stone, Assessor

April 9, 2014

Hon. John Chiang
State Controller, Ex-Officio Member, State Board of Equalization
300 Capitol Mall, 18th Floor
Sacramento, CA 95814

Re: Property Tax Rule 133

Dear John,

I write to reinforce my formal comments at the Board meeting on February 25 in Culver City, when I expressed my strong disappointment with the Board's decision to fast-track a rule making process when clearly there were insufficient facts to support the proposed change to Rule 133 and there was no crisis demanding the unusually aggressive schedule.

The crux of the dispute, which has been appealed in just one jurisdiction and does not yet even have a hearing date, concerns a contention by the space transport industry that a special exemption is needed because they are forced to "relinquish ultimate control at launch under federal law, to a Range Safety Officer." The conclusion, upon which your legal counsel rests his opinion and reiterated in the April 4 Notice of Proposed Regulatory Action, states "contracts are drafted, as required by federal law, such that a company cedes ultimate control of the equipment at launch to a federal Range Safety Officer." This is simply not true. Consequently, the basic premise of Counsel's opinion, the basis for the rule, is factually invalid.

Before proceeding, I would urge your staff to do what I have done, meet with representatives from NASA and contact a Range Safety Officer. Our research indicates that companies like SpaceX no more turn over control of their vehicles to a Range Safety Officer, than United Airlines turns over control of its aircraft to the FAA. The job of Range Safety Officers—and it is their only job—is safety. Just as the FAA has the authority to ground any and all aircraft, as it did on "9-11", so too does the Range Safety Officer have the authority to destroy SpaceX cargo vehicles based only on safety considerations.

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We came to this conclusion by examining the 2013 “Range Safety Manual for Goddard Space Flight Center (WFF).” This 66-page document states the RSO is an authority only for “range safety policy, processes, and requirements.” The RSO has no more control than an air traffic control officer.

In addition, we reviewed the 2011 NASA and Federal Aviation Administration Joint Program Management Plan (PMP) published by NASA’s International Space Station Program. That 50-page document explicitly details the partnership between NASA, SpaceX and the FAA. The Management Plan states: “The contractor or licensee (SpaceX) is responsible for its launch and vehicle operation throughout the mission.” Appendix C of the document states: “SpaceX or Orbital Sciences Corporation (OSC) always has prime responsibility.” The third piece of evidence we received came directly from the Associate Center Director at the Kennedy Space Center in Florida, who stated through his spokesperson, “The RSO only has possession of a space craft purely for safety reasons.”

Thankfully, Board Member Yee did recognize these contradictions and requested, as part of initiating the rule making process, the following:

1. More information must be obtained regarding the factual control of the equipment before, during, and after a launch.
2. More information must be obtained regarding the legal control of the equipment, with emphasis and discussion about the federal statutes and authorities involved in a launch.

Despite issuing the Notice of Proposed Regulatory Action, the hearing scheduled for May 22-23 does not contain any response to Member Yee’s requests.

SpaceX claims that the vehicles it launches into space cannot be reused for space exploration, yet in a segment on “60 Minutes” on Sunday, March 30, SpaceX made clear, through a mock demonstration, that it plans for their rockets to return to earth with a soft landing that would not damage the rocket. This Rule would likely preclude assessing this property.

The California Assessors’ Association is adamantly opposed to proposed Rule 133 for the reasons stated above. I am confident that if the rule is adopted, the CAA will file legal action against the BOE, something that the CAA rarely considers. County counsels from several major counties, including Los Angeles, are equally confident that, because the action of the BOE would be so devoid of facts, the CAA would prevail in such litigations. In the interim, you will have wasted substantial resources of both the BOE and the CAA and possibly even unfairly tainted the pending assessment appeal.

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It is disturbing that in the last 12 months the Board has taken the unprecedented action of requesting its Board Counsel opine on issues confronting assessors, bypassing their normal process of receiving input from BOE property tax experts and the California Assessors' Association. Further, on three separate issues (PILOTS, PTR 133, and Possessory Interests) the Board has sought to contradict its own prior direction.

I am hopeful that this significant erosion of our historic collaborative relationship is temporary and that, going forward, Board members will once again work with assessors—the administrators of the local property tax system—in a more collaborative manner to identify policies that benefit all taxpayers.

As always, I would be happy to discuss the content of this letter with you or any other member of your staff.

Sincerely,



Lawrence E. Stone
Assessor

Cc: Cynthia Bridges, Executive Director, State Board of Equalization
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May 19, 2014

By Electronic Mail

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

Re: Property Tax Rule 133, Business Inventory Exemption

Dear Ms. Kinkle:

On behalf of our client, Space Exploration Technologies Corp (“SpaceX”), we write to express our full support of Chief Counsel Randy Ferris’ memorandum to the Board dated May 8, 2014 (“Board Analysis”). We also write to respond to the misleading and inaccurate comments submitted by Santa Clara County Assessor Larry Stone. We reserve the right to provide further comments at the Board’s May 22, 2014 hearing in Sacramento.

First, Mr. Stone states that the “crux of the dispute ... concerns a contention by the space transport industry that a special exemption is needed....” This statement is wrong. We agree with the Board Analysis that the proposed revisions to Rule 133 simply clarify existing law, which is consistent with the Legal Division’s ruling on the subject. In short, this is not a “special exemption,” but a necessary clarification of existing law.

Second, Mr. Stone states that his “research indicates that companies like SpaceX no more turn over control of their vehicles to a Range Safety Officer, than United Airlines turns over control of its aircraft to the FAA,” and then, draws the analogy that “[j]ust as the FAA has the authority to ground any and all aircraft, as it did on ‘9-11’, so too does the Range Safety Officer have the authority to destroy SpaceX cargo vehicles based only on safety considerations.... The RSO has no more control than an air traffic control officer.” Not only is Mr. Stone’s analogy misplaced, but his conclusion is wrong. We agree with the Board Analysis with respect to the responsibilities and authority of the Air Force (Range Safety) and the Mission Flight Control Officer’s role as the sole decision-making authority and initiator of the flight termination system. Mr. Stone’s analogy makes no sense — an air traffic controller does not have the authority or the ability to destroy an aircraft. The analogy also implies that SpaceX personnel operate the vehicle in the same manner as a United Airlines pilot operates an aircraft, but the

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Board Analysis confirms that the vehicle is preprogrammed and autonomous and the Range User (such as SpaceX) has no ability to control the vehicle from launch to reaching orbital space.

Third, Mr. Stone states that “[t]he contractor or licensee (SpaceX) is responsible for its launch and vehicle operation throughout the mission.” Again, Mr. Stone’s facts are incorrect. We agree with the Board Analysis regarding the responsibility and authority of the Air Force (Range Safety) and the fact that the Range User has no ability to control the vehicle after launch and from launch to when the vehicle reaches orbital space. Ceding control of the launch vehicle to the Air Force is the hallmark of the federal regulatory system to ensure safe conduct.

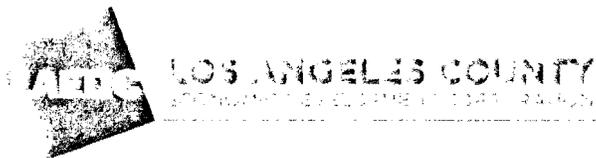
Fourth, Mr. Stone states that “[t]he RSO only [sic] has possession of a space craft purely for safety reasons.” We observe that Mr. Stone’s statement, in contrast to his other statements, correctly concedes that the Air Force actually takes possession of the vehicle and payload. Mr. Stone, however, wrongly seeks to downplay the importance of safety control by implying that: (1) there are other types of control at play during the flight mission; and, (2) such other control is more important than safety control. Mr. Stone is wrong on both points. First, as the Board Analysis correctly concludes, the Range User has no ability to control the vehicle from launch to reaching orbital space. Thus, Range Safety control for safety purposes is in fact the **only** control that exists during the mission. Second—and at the risk of stating the obvious—range safety is of paramount importance to any launch. Ceding control to federal authorities is required by the federal system to ensure public safety and cannot be minimized. The Board Analysis regarding the responsibility and authority of the Air Force (Range Safety) is correct.

Should you have any questions or concerns, please contact me at (213) 457-8310. Thank you for your time and consideration.

Very truly yours,

Mardiros H. Dakessian

MHD:ih



May 19, 2014

The Honorable Jerome Horton
Chair, Board of Equalization
621 Capitol Mall, Ste. 975
Sacramento, CA 95814

Re: Revisions to Board of Equalization Rule 133 – SUPPORT

Dear Chairman Horton:

On behalf of the Los Angeles County Economic Development Corporation, an organization dedicated to promoting job growth, economic expansion, and preserving the overall global competitiveness of California and Los Angeles County, I am pleased to offer our support for the proposed Board of Equalization (BOE) amendments to Rule 133. We believe the revised BOE Rule 133, which classifies equipment used in space travel as a “business inventory” thus providing a property tax exemption, is not only the normatively “equitable” thing to do, but it is also critically important to retaining, expanding and attracting new entrants into California’s fast growing space commercialization industry – a “homegrown” California industry that is not only carrying on the state’s aerospace dominance, but continuing to push the creative limits by changing the contours of the aerospace industry and expanding the creative bounds of what is possible in privately-supported space travel.

The public policy rationale for the revisions to BOE Rule 133 is simple: it’s about fairness and equitable treatment of businesses across all industries and sectors. Although California does not have a so-called “inventory tax,” which levies a tax on inventories without regard to profitability, the current property tax on equipment used in space travel is for “all intents and purposes” tantamount to an inventory tax, making California significantly less appealing for these space commercialization firms and creating a strong disincentive for these companies to locate their inventories in-state, where they’d be subject to the tax.

Making this inequitable treatment of California’s space sector even more troubling is that the state can – and must – do even more to support its fast-emerging, innovation sectors – as the future job generators. Moreover, we know that the state’s space sector is taking off in California through privately-supported space commercialization. However, we must not take it for granted and, in doing so, work hard to ensure it stays here. The space industry’s decision – meaning, it’s a choice – to be in our state is a great distinction and of great value, not only for our economy but also for our communities that benefit from the thousands of well-paying, high-skilled jobs, as well as the induced and indirect jobs, output, tax and investment impacts that flow to our regions.

Yet, the “newness” of this industry comes with its own set of challenges. For example, SpaceX, a Southern California stalwart in this emerging private space commercialization industry, employing more than 3,000 workers, received an unexpected and sizeable multi-million dollar tax bill for back property taxes on its propulsion systems (rockets)—chattel that was previously untaxed when space exploration and travel was a government-dominated field. At its core, the revisions to BOE Rule 133 exempt from property taxes this and other types of equipment for use in space flight.



However, the revisions to Rule 133 mean much more than that.

The revised BOE Rule 133 is a friendly reminder that in today's global economy, location is not permanent, but companies – especially those at the forefront of innovation and the technology revolution – have many opportunities to locate outside of California. We have already seen California's aerospace employment decrease by more than two-thirds from over 321,000 in 1990 due to combination of factors. And here in Los Angeles County, we've witnessed first-hand the destructive effects that the industry's decline from 189,000 workers in 1990 to fewer than 60,000 in 2011 has wreaked on our local communities. Not to mention the ancillary – but enormous - repercussions that the loss of aerospace programs has had on our nation-leading manufacturing base, as well as the state and local tax dollars lost due to these severe job declines – tax dollars that help fund critical community services and social programs.

Still, make no mistake; aerospace remains an incredibly vital industry to the economies and communities of California, Southern California, and Los Angeles County. So while the industry has suffered staggering job losses during the past 20+ years, the aerospace industry has also brought forth some incredible advances with companies like Northrop, Boeing, AeroVironment and SpaceX, which is not only revolutionizing space travel and leading – dare I say: “winning” – this generation's space race, but designing and building over 70 percent of its vehicles in-house, making their Hawthorne, California headquarters one of the few places in the world where you can view an entire rocket or spacecraft being manufactured. And again, this is all being done right here, in California's very own backyard. This should not be a business we slam with a very costly, past-due notice on a previously never taxed piece of equipment.

For all of the above reasons, the LAEDC commends your leadership on this and other important tax issues that help make California a better place to do business and offers its strong support for the revisions to BOE Rule 133—a much-needed business inventory classification that is not only rooted in notions of rational public policy, objective fairness and equitable treatment of businesses across sectors, but it will help secure our state's position as the home to the burgeoning space commercialization sector while simultaneously sending a message to all current and future space companies that “California is open for business.”

Sincerely,

A handwritten signature in black ink, appearing to read "D. Flaks", is written over a horizontal line.

David Flaks, Chief Operating Officer
Los Angeles County Economic Development Corporation



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OFFICE OF THE COUNTY COUNSEL

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JOHN F. KRATTLI
County Counsel

May 20, 2014

Chairman Jerome E. Horton
State Board of Equalization
450 N Street
P.O. Box 942879
Sacramento, CA 94279

Re: Opposition to Amendment to Property Tax Rule 133

Dear Chairman Horton:

This is to provide comments by the Los Angeles County Assessor's Office ("LACAO") opposing the proposed amendment to Property Tax Rule 133, calendared to be considered by the California State Board of Equalization ("Board") on May 22, 2014.

I. Introduction

Newly enacted Revenue and Taxation Code section 242 exempts from property taxation tangible personal property that has space flight capacity. Space Exploration Technologies Corporation ("SpaceX"), headquartered in Hawthorne, California, is a private company that constructs rockets that deliver satellites into space as well as spacecraft that carry cargo to the International Space Station. A description by SpaceX of its business is attached as exhibit A. The main competition of SpaceX for launch services is United Launch Alliance ("ULA"). An overview of ULA's business is attached as exhibit B.

SpaceX and its competitor United Launch Alliance, urge an amendment of Rule 133 to define "space flight property" as exempt from property taxation. The intent of the proposed amendment to Rule 133 is to provide industry a basis for arguing for a retroactive exemption of space flight property for all open assessment years. Section 242 takes effect for the 2014 and later assessment years, and the open assessment years are for years prior to 2014.

II. The Proposed Amendment Fails the Necessity Standard of Gov. Code § 11346.2(b)(1)

California law recognizes a business inventory exemption to the property tax. (Rev. & Tax. code 129 and 219.) Section 129 states that "business inventories" shall include goods intended for sale or lease in the ordinary course of business.

California law provides that all property is subject property taxation unless otherwise exempt pursuant to constitutional authority. (Cal.Const., art. XIII, section 1.) The California Constitution authorizes the Legislature to exempt personal property from taxation upon two-thirds membership of each house concurring. (Cal.Const., art. XIII, section 2.)

The Legislature in section 242 determined that space flight property is prospectively exempt, but did not enact the exemption retroactively. It is within the Legislature's prerogative to determine whether a category of personal property should be exempt from property taxation, and when that exemption first applies.

In the pending rulemaking process, Board staff writes ". . . By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. . . ." (Initial Statement of Reasons for the proposed amendment ["Initial Statement"], page 3.)

An initial statement in support of proposed rulemaking shall provide "A statement of the specific purpose of each adoption, amendment, or repeal, the problem the agency intends to address, and the rationale for the determination by the agency that each adoption, amendment, or repeal is reasonably necessary to carry out the purpose and address the problem for which it is proposed. . . ." (Cal. Gov. 11346.2(b)(1).)

The purported necessity for the proposed amendment is stated at page 6 of the Initial Statement: "At the conclusion of the Board's discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that there is an issue (or problem within the meaning of Gov. Code, § 11346.2(b)(1)) because Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is reasonably necessary to amend Property Tax Rule 133, as recommended by staff, for the specific purpose of addressing that issue."

The prerogative to declare property exempt from taxation is a legislative prerogative. The Board relies on its legal counsel's opinion as the statement of necessity for why an amendment to Rule 133 is required, and as a description of the amendment's specific purpose. The Board states that it agrees with the staff's recommendation to initiate rulemaking "[b]ecause the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existent statutes, [. . .]."

The Board's stated purpose for the proposed action is to declare space flight property as business inventory that is exempt from property tax assessment, and to amend Rule 133 to set forth that interpretation. The Rule, however, did not previously address space flight property, and newly enacted Rev. & Tax. code section 242 makes that change prospectively only. **Amending Rule 133 so as to provide an argument for the retroactive exemption of space flight property from assessment exceeds the authority of the Board.** As previously cited, Board staff acknowledges that Rule 133 did not previously address space flight property. The purpose of broaching the subject now, a mere month after the Legislature has addressed the issue, is to enact an unauthorized retroactive exemption.

It is for the Legislature to decide whether to exempt personal property from assessment. The Board's proposed action to interpret section 129 to arguably provide a retroactive exemption where the Legislature itself declined to do so, fails the "necessity" standard that is required of rulemaking.

The proposed amendment is also substantively wrong. Federal policy is to "acquire space transportation services from United States commercial providers whenever such services are required in the course of its activities. To the maximum extent practicable, the Federal Government shall plan missions to accommodate the space transportation services capabilities of United States commercial providers." (51 USC § 50131(a).)

The term "space transportation services" is defined in federal statute 51 USC § 50131(4):

(4) Space transportation services. The term "space transportation services" means the preparation of a space transportation vehicle and its payloads for transportation to, from, or within outer space, or in suborbital trajectory, **and the conduct of transporting a payload** to, from, or within outer

space, or in suborbital trajectory. (Emphasis added.)

A commercial provider of space transportation services does not deliver space flight property to the government as a proxy for the provider's customer, for the government to then transport the property to space. The provider instead merely **contracts** with a federal launch range for the use of the range and for flight safety system property and services. (14 CFR 417.13; 417.301(d)(2)(i).) If anything, the government in this context is an agent of the commercial provider!! A commercial provider of space transportation services is required to reimburse the government for the use of space-related facilities and is presumably also subject to a possessory interest assessment on that use. (51 USC §50504.)

A federal license is required to launch cargo into space. (51 USC §50904(a).) Customers contract with launch service providers for the delivery of their space-bound asset. As a condition of a launch services contract, the launch provider and the customer are required to enter into a reciprocal waiver of liability with regard to personal injury and damage to the payload. (51 USC §50914(b)(1).) The launch service provider is in addition required to carry up to \$500 million in insurance to protect third parties. (51 USC § 50914.)

The notion that a launch service provider is a retailer of tangible personal property to its customer, and that its space flight property is non-assessable business inventory is unsupported by substantial evidence, particularly when the Board's proposed regulatory action is viewed in the context of the relevant federal legal authorities.

III. The Proposed Amendment is Inconsistent with Section 129.

SpaceX and ULA are in the transportation business, the transporting of cargo into space. They are not retailers of personal property, instead they provide space launch services. California law does not impose sales tax on the performance of services. (*Navistar Internat. Transportation Corp. v. State Bd. of Equalization* (1994) 8 Cal.4th 868, 874; 18 Cal.Code of Regs. § 1500 [". . . The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the **true objects of the contract**; that is, is the real object sought by the buyer the service per se or the property produced by the service." . . .].)

The Board's reliance on sales tax doctrine as the rationale for granting industry a retroactive property tax exemption is sophistry. The true object of a launch contract is for the conduct of the transportation of a payload into space.

The customers of the launch industry, such as the government in obtaining resupply of the International Space Station, or the National Reconnaissance Office in placing satellites in orbit, have no interest in taking possession or title to the launch equipment that is employed in performing the professional service of delivering cargo to space.

The Board's argument that SpaceX or ULA are retailers of tangible personal property for consideration mischaracterizes the taxpayers' business. A launch service provider is responsible for the service that is provided. (*Martin Marietta Corp. v. International Telecommunications Satellite Organization* (4th Cir. 1993) 991 F.2d 94.) And though it is true that the federal government oversees launch operations on a federal launch range, the launch licensee is ultimately responsible for the success of the engagement.

The Board's reliance on *Transworld Systems, Inc. v. County of Sonoma* (2000) 78 Cal.App.4th 713 does not support its analysis. The issue in *Transworld* was whether business forms mailed out by a third party service to debtors on behalf of a collection agency were eligible for the business inventory exemption. The court found that it did not matter that the collection agency did not take possession of the forms, holding that "the critical consideration is whether the goods are transferred away from the business **pursuant to sale**. . . ." (*Id.*, p. 717; emphasis.) Here, the commercial provider contracts with the government for the use of a federal facility and public safety related operations and support. This does not, however, limit in anyway the commercial provider's ultimate responsibility for the success or failure of its launch operations.

Here, the Board opines that the yielding of control of a launch vehicle to the federal safety officer is in effect a constructive sale of the vehicle to the launch customer. The analysis fails. The customer never takes delivery of the vehicle. The launch service company is responsible for the mission well beyond the time that the mission is complete. (14 CFR 417.25; 417.129.) Moreover, the Board's own rules provide that "[p]roperty held by a person in connection with a **profession** which is primarily a **service activity** such as medicine, law, architecture or accountancy is **not 'business inventories'** held for sale or lease" Launch engineering is a profession, and true object of the arrangement is for the customer to obtain professional delivery of its asset.

The *Transworld* court expressly states "Regulations must be construed in a manner consistent with the legislative purpose, and may not conflict with the statute." (*Id.*, p. 717.) The Board's proposed amendment of Rule 133 conflicts with a reasonable definition of "business inventory." It is inconsistent with the Legislature's plain intent to only exempt space flight property prospectively. In addition, the proposed amendment does not satisfy the required elements for

Chairman Horton
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rulemaking of necessity and consistency. In light of this we respectfully urge that the proposed amendment not be adopted.

Thank you for your consideration of our comments.

Respectfully submitted,

JOHN F. KRATTLI
County Counsel

By

ALBERT RAMSEYER
Principal Deputy County Counsel
Government Services Division

Attorneys for the Los Angeles
County Assessor's Office



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May 20, 2014

Chairman Jerome E. Horton
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Mr. Rick Bennion
May 20, 2014
Page 2

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The Legislature in section 242 determined that space flight property is prospectively exempt, but did not enact the exemption retroactively. It is within the Legislature's prerogative to determine whether a category of personal property should be exempt from property taxation, and when that exemption first applies.

In the pending rulemaking process, Board staff writes ". . . By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. . . ." (Initial Statement of Reasons for the proposed amendment ["Initial Statement"], page 3.)

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Mr. Rick Bennion
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Page 3

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The Board's stated purpose for the proposed action is to declare space flight property as business inventory that is exempt from property tax assessment, and to amend Rule 133 to set forth that interpretation. The Rule, however, did not previously address space flight property, and newly enacted Rev. & Tax. code section 242 makes that change prospectively only. **Amending Rule 133 so as to provide an argument for the retroactive exemption of space flight property from assessment exceeds the authority of the Board.** As previously cited, Board staff acknowledges that Rule 133 did not previously address space flight property. The purpose of broaching the subject now, a mere month after the Legislature has addressed the issue, is to enact an unauthorized retroactive exemption.

It is for the Legislature to decide whether to exempt personal property from assessment. The Board's proposed action to interpret section 129 to arguably provide a retroactive exemption where the Legislature itself declined to do so, fails the "necessity" standard that is required of rulemaking.

The proposed amendment is also substantively wrong. Federal policy is to "acquire space transportation services from United States commercial providers whenever such services are required in the course of its activities. To the maximum extent practicable, the Federal Government shall plan missions to accommodate the space transportation services capabilities of United States commercial providers." (51 USC § 50131(a).)

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space, or in suborbital trajectory. (Emphasis added.)

A commercial provider of space transportation services does not deliver space flight property to the government as a proxy for the provider's customer, for the government to then transport the property to space. The provider instead merely *contracts* with a federal launch range for the use of the range and for flight safety system property and services. (14 CFR 417.103; 417.302(d)(2)(i).) If anything, the government in this context is an agent of the commercial provider!! A commercial provider of space transportation services is required to reimburse the government for the use of space-related facilities and is presumably also subject to a possessory interest assessment on that use. (51 USC §50504.)

A federal license is required to launch cargo into space. (51 USC §50904(a).) Customers contract with launch service providers for the delivery of their space-bound asset. As a condition of a launch services contract, the launch provider and the customer are required to enter into a reciprocal waiver of liability with regard to personal injury and damage to the payload. (51 USC §50914(b)(1).) The launch service provider is in addition required to carry up to \$500 million in insurance to protect third parties. (51 USC § 50914.)

The notion that a launch service provider is a retailer of tangible personal property to its customer, and that its space flight property is non-assessable business inventory is unsupported by substantial evidence, particularly when the Board's proposed regulatory action is viewed in the context of the relevant federal legal authorities.

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The Board's reliance on sales tax doctrine as the rationale for granting industry a retroactive property tax exemption is sophistry. The true object of a launch contract is for the conduct of the transportation of a payload into space.

Mr. Rick Bennion
May 20, 2014
Page 5

The customers of the launch industry, such as the government in obtaining resupply of the International Space Station, or the National Reconnaissance Office in placing satellites in orbit, have no interest in taking possession or title to the launch equipment that is employed in performing the professional service of delivering cargo to space.

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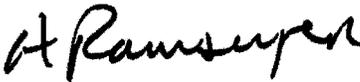
Mr. Rick Bennion
May 20, 2014
Page 6

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Respectfully submitted,

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County Counsel

By 

ALBERT RAMSEYER
Principal Deputy County Counsel
Government Services Division

Attorneys for the Los Angeles
County Assessor's Office

COMPANY

LEADERSHIP ((ABOUT/LEADERSHIP))

CAPABILITIES & SERVICES

SpaceX designs, manufactures and launches advanced rockets and spacecraft. The company was founded in 2002 to revolutionize space technology, with the ultimate goal of enabling people to live on other planets.

QUICK FACTS ABOUT SPACEX:

FOUNDED
2002

VEHICLES
3

MANIFEST
40+

EMPLOYEES
3,000+

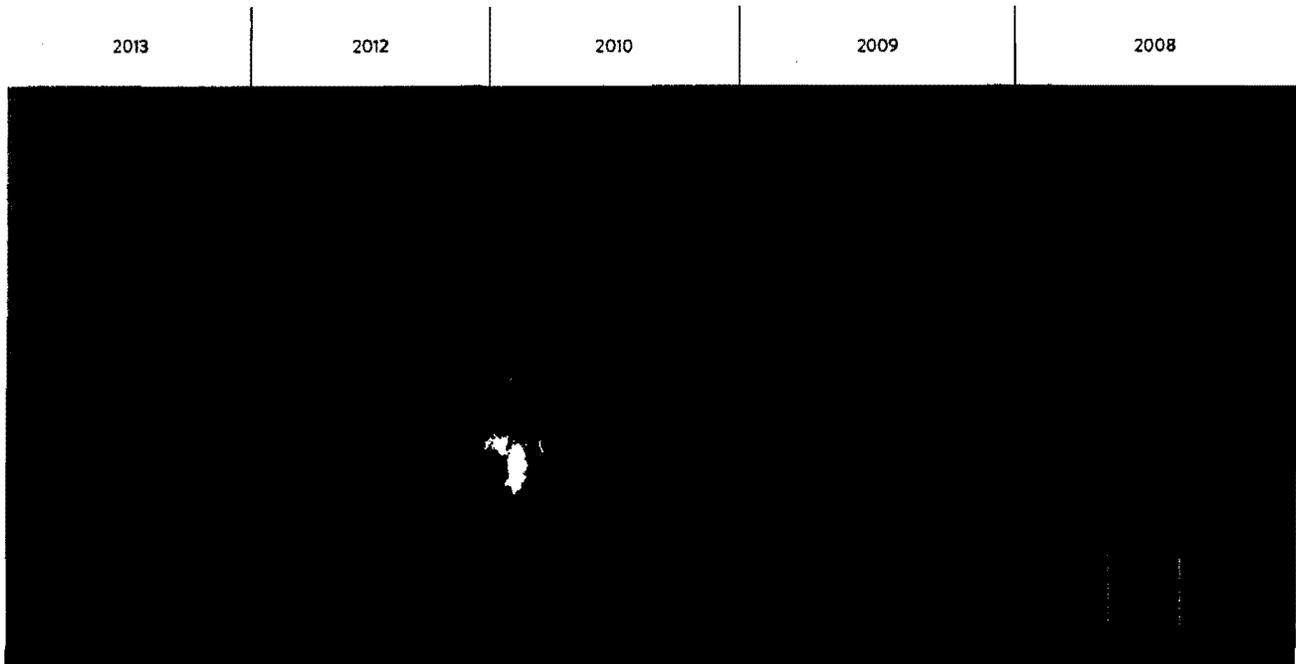


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MAKING HISTORY

Ex. A-1

SpaceX has gained worldwide attention for a series of historic milestones. It is the only private company ever to return a spacecraft from low-Earth orbit, which it first accomplished in December 2010. The company made history again in May 2012 when its Dragon spacecraft attached to the International Space Station, exchanged cargo payloads, and returned safely to Earth — a technically challenging feat previously accomplished only by governments. Since then Dragon has delivered cargo to and from the space station multiple times, providing regular cargo resupply missions for NASA.



2013

2012

2010

2009

2008

'13

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GRASSHOPPER
COMPLETES HIGHEST
LEAP TO DATE**

Grasshopper achieves 325m leap—higher than the Chrysler building.

'12

**SEPTEMBER 2012
GRASSHOPPER'S FIRST
HOP**

First in a series of successful tests of SpaceX's reusability technology.

**MAY 2012
DRAGON V**

Dragon becomes the first private spacecraft in history to visit the space station.

ADVANCING THE FUTURE

Under a \$1.6 billion contract with NASA, SpaceX will fly numerous cargo resupply missions to the ISS, for a total of at least 12—and in the near future, SpaceX will carry crew as well. Dragon was designed from the outset to carry astronauts and now, under a \$440 million agreement with NASA, SpaceX is making modifications to make Dragon crew-ready. SpaceX is the world's fastest-growing provider of launch services. Profitable and cash-flow positive, the company has nearly 50 launches on its manifest, representing close to \$5 billion in contracts. These include commercial satellite launches as well as NASA missions.

Currently under development is the Falcon Heavy, which will be the world's most powerful rocket. All the while, SpaceX continues to work toward one of its key goals—developing reusable rockets, a feat that will transform space exploration by delivering highly reliable vehicles at radically reduced costs.

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SALES INQUIRIES
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SpaceX is a private company owned by management and employees, with minority investments from Founders Fund, Draper Fisher Jurvetson, and Valor Equity Partners. The company has more than 3,000 employees at its headquarters in Hawthorne, California; launch facilities at Cape Canaveral Air Force Station, Florida, and Vandenberg Air Force Base, California; a rocket-development facility in McGregor, Texas; and offices in Houston, Texas; Chantilly, Virginia; and Washington, DC. See our SpaceX Supplier/Contractor Policy [here](#) ([/news/2013/07/29/spacex-suppliercontractor-policy](#)).

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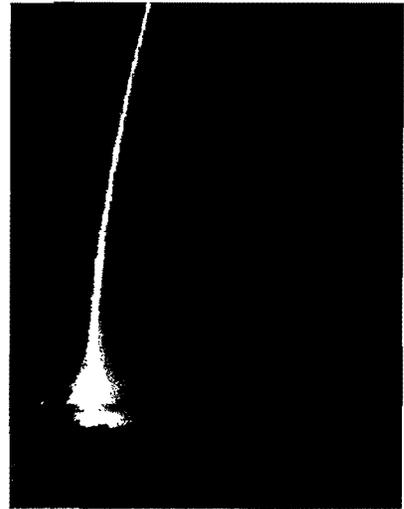
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(/)<https://twitter.com/#!/ulalaunch> (<https://www.facebook.com/ulalaunch>)<http://www.youtube.com/user/UnitedLaunchAlliance> (<news-press-rss.aspx?Category=0>)Search: ([javascript: doPostBack\('ctl00](#)[\\$EntireBody\\$uxSearch\\$uxSearchBox\\$bc\\$uxSearchButton',"\)](#))

Quick Facts

- ULA is a 50-50 joint venture between Lockheed Martin and The Boeing Company formed in 2006 to provide reliable, cost-efficient access to space for U.S. government missions.
- United Launch Alliance brings together two of the launch industry's most experienced and successful teams—Atlas and Delta—that have supported America's presence in space for more than 50 years.
- ULA program management, engineering, test, and mission support functions are headquartered in Denver, Colo. Manufacturing, assembly and integration operations are located at Decatur, Ala., and Harlingen, Texas. Launch operations are located at Cape Canaveral Air Force Station, Fla., and Vandenberg Air Force Base, Calif.
- The United Launch Alliance team consists of approximately 3,600 employees working at sites across the country. Job category functions include program management, engineering, test, manufacturing, launch site operations, mission and business support.
- Atlas and Delta expendable launch vehicles carry payloads to space ranging from weather, telecommunications and national security satellites that protect and improve life on Earth, to deep space and interplanetary exploration missions that further our knowledge of the universe.
- Launch customers include the Department of Defense, NASA, the National Reconnaissance Office, the U.S. Air Force and other organizations.
- Atlas and Delta represent more than 100 years of combined launch experience.
- Over more than 50 years, Atlas and Delta have launched approximately 1,300 missions.
- ULA employs more rocket scientists than any other company in the world.
- **[About ULA\(/about-ula.aspx\)](#)**
 - **[Quick Facts\(/about_quickfacts.aspx\)](#)**
 - **[Leadership\(/about_Bios.aspx\)](#)**
 - **[History\(/history.aspx\)](#)**
 - **[ULA in the Community\(/about_Citizen.aspx\)](#)**
 - **[Ethics\(/about_ethics.aspx\)](#)**
 - **[Published Papers\(/Education_PublishedPapers.aspx\)](#)**

[\(/about_Citizen.aspx\)](#)

Ex. B

5/20/2014



COUNTY OF LOS ANGELES
OFFICE OF THE COUNTY COUNSEL

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500 WEST TEMPLE STREET
LOS ANGELES, CALIFORNIA 90012-2713

TELEPHONE
(213) 974-0809
FACSIMILE
(213) 617-7182
TDD
(213) 633-0901

JOHN F. KRATTLI
County Counsel

May 20, 2014

Mr. Rick Bennion
State Board of Equalization
450 N Street, MIC:80
P.O. Box 942879
Sacramento, CA 94279-0080



Re: Opposition to Amendment to Property Tax Rule 133

Dear Mr. Bennion:

This is to provide comments by the Los Angeles County Assessor's Office ("LACAO") opposing the proposed amendment to Property Tax Rule 133, calendared to be considered by the California State Board of Equalization ("Board") on May 22, 2014.

I. Introduction

Newly enacted Revenue and Taxation Code section 242 exempts from property taxation tangible personal property that has space flight capacity. Space Exploration Technologies Corporation ("SpaceX"), headquartered in Hawthorne, California, is a private company that constructs rockets that deliver satellites into space as well as spacecraft that carry cargo to the International Space Station. A description by SpaceX of its business is attached as exhibit A. The main competition of SpaceX for launch services is United Launch Alliance ("ULA"). An overview of ULA's business is attached as exhibit B.

SpaceX and its competitor United Launch Alliance, urge an amendment of Rule 133 to define "space flight property" as exempt from property taxation. The intent of the proposed amendment to Rule 133 is to provide industry a basis for arguing for a retroactive exemption of space flight property for all open assessment years. Section 242 takes effect for the 2014 and later assessment years, and the open assessment years are for years prior to 2014.

II. The Proposed Amendment Fails the Necessity Standard of Gov. Code § 11346.2(b)(1)

California law recognizes a business inventory exemption to the property tax. (Rev. & Tax. code 129 and 219.) Section 129 states that "business inventories" shall include goods intended for sale or lease in the ordinary course of business.

California law provides that all property is subject property taxation unless otherwise exempt pursuant to constitutional authority. (Cal.Const., art. XIII, section 1.) The California Constitution authorizes the Legislature to exempt personal property from taxation upon two-thirds membership of each house concurring. (Cal.Const., art. XIII, section 2.)

The Legislature in section 242 determined that space flight property is prospectively exempt, but did not enact the exemption retroactively. It is within the Legislature's prerogative to determine whether a category of personal property should be exempt from property taxation, and when that exemption first applies.

In the pending rulemaking process, Board staff writes ". . . By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. . . ." (Initial Statement of Reasons for the proposed amendment ["Initial Statement"], page 3.)

An initial statement in support of proposed rulemaking shall provide "A statement of the specific purpose of each adoption, amendment, or repeal, the problem the agency intends to address, and the rationale for the determination by the agency that each adoption, amendment, or repeal is reasonably necessary to carry out the purpose and address the problem for which it is proposed. . . ." (Cal. Gov. 11346.2(b)(1).)

The purported necessity for the proposed amendment is stated at page 6 of the Initial Statement: "At the conclusion of the Board's discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that there is an issue (or problem within the meaning of Gov. Code, § 11346.2(b)(1)) because Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is reasonably necessary to amend Property Tax Rule 133, as recommended by staff, for the specific purpose of addressing that issue."

The prerogative to declare property exempt from taxation is a legislative prerogative. The Board relies on its legal counsel's opinion as the statement of necessity for why an amendment to Rule 133 is required, and as a description of the amendment's specific purpose. The Board states that it agrees with the staff's recommendation to initiate rulemaking "[b]ecause the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existent statutes, [. . .]."

The Board's stated purpose for the proposed action is to declare space flight property as business inventory that is exempt from property tax assessment, and to amend Rule 133 to set forth that interpretation. The Rule, however, did not previously address space flight property, and newly enacted Rev. & Tax. code section 242 makes that change prospectively only. **Amending Rule 133 so as to provide an argument for the retroactive exemption of space flight property from assessment exceeds the authority of the Board.** As previously cited, Board staff acknowledges that Rule 133 did not previously address space flight property. The purpose of broaching the subject now, a mere month after the Legislature has addressed the issue, is to enact an unauthorized retroactive exemption.

It is for the Legislature to decide whether to exempt personal property from assessment. The Board's proposed action to interpret section 129 to arguably provide a retroactive exemption where the Legislature itself declined to do so, fails the "necessity" standard that is required of rulemaking.

The proposed amendment is also substantively wrong. Federal policy is to "acquire space transportation services from United States commercial providers whenever such services are required in the course of its activities. To the maximum extent practicable, the Federal Government shall plan missions to accommodate the space transportation services capabilities of United States commercial providers." (51 USC § 50131(a).)

The term "space transportation services" is defined in federal statute 51 USC § 50131(4):

(4) Space transportation services. The term "space transportation services" means the preparation of a space transportation vehicle and its payloads for transportation to, from, or within outer space, or in suborbital trajectory, **and the conduct of transporting a payload to, from, or within outer**

space, or in suborbital trajectory. (Emphasis added.)

A commercial provider of space transportation services does not deliver space flight property to the government as a proxy for the provider's customer, for the government to then transport the property to space. The provider instead merely *contracts* with a federal launch range for the use of the range and for flight safety system property and services. (14 CFR 417.103; 417.302(d)(2)(i).) If anything, the government in this context is an agent of the commercial provider!! A commercial provider of space transportation services is required to reimburse the government for the use of space-related facilities and is presumably also subject to a possessory interest assessment on that use. (51 USC §50504.)

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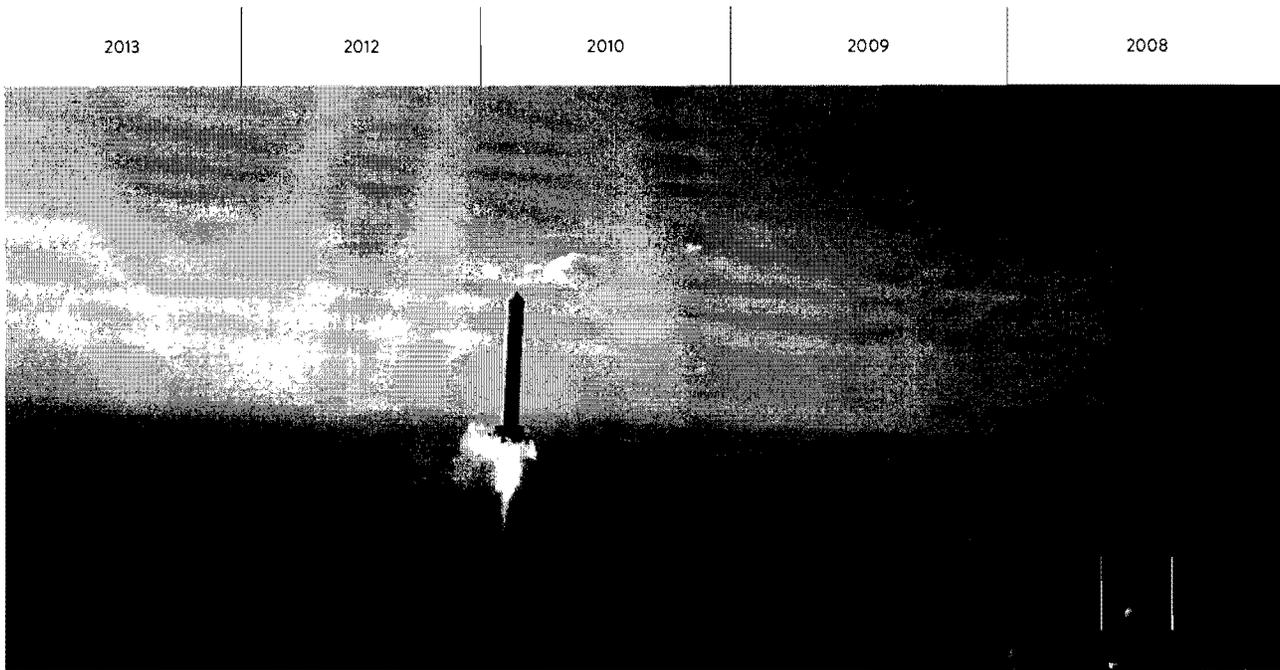
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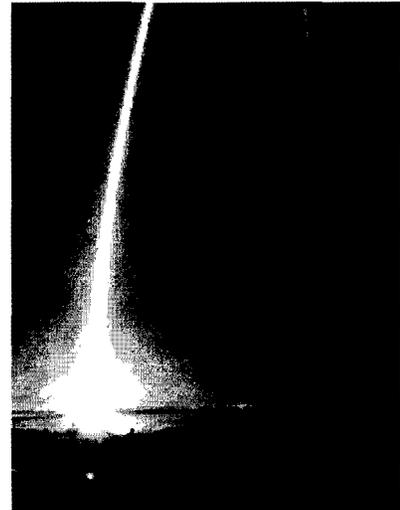
(<http://www.youtube.com/user/UnitedLaunchAlliance>) (<news-press-rss.aspx?Category=0>)

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Ex. B

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET
SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

MAY 22, 2014

F PUBLIC HEARINGS
F3 PROPOSED ADOPTION OF
AMENDMENTS TO RULE 133
BUSINESS INVENTORY EXEMPTION

Reported by: Juli Price Jackson

No. CSR 5214

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For the Board
of Equalization:

Jerome E. Horton
Chairman

Michelle Steel
Vice-Chairwoman

Betty T. Yee
Member

George Runner
Member

Marcy Jo Mandel
Appearing for John
Chiang, State
Controller (per
Government Code
Section 7.9)

Joann Richmond
Chief, Board
Proceedings Division

For Board Staff:

Richard Moon
Tax Counsel IV
Legal Department

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	SpaceX										
	MARTY DAKESSIAN				21						
	Attorney, Reed Smith										
	SpaceX										

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1 450 N STREET
2 SACRAMENTO, CALIFORNIA

3
4 MAY 22, 2014

5 ---oOo---

6 MR. HORTON: Ms. Richmond, our next matter.

7 MS. RICHMOND: Our next item is F3,
8 proposed adoption of amendments to Rule 133,
9 Business Inventory Exemption.

10 And we do have several speakers.

11 MR. HORTON: Okay. I guess they're
12 forthcoming.

13 Give me a second to get sort of organized
14 here.

15 In the essence of time, I'm going to ask
16 that -- we have one, two, three, four chairs -- ask
17 four of the speakers to come forward.

18 The Santa Clara County Assessor, Mr. Larry
19 Stone, would you please come forward?

20 The Principal Deputy County Counsel,
21 counsel for LA County Assessor, Albert Ramseyer,
22 please come forward.

23 United Launch Alliance, Vanberg (verbatim)
24 Range Coordinator, Mr. Phil Anderson, please come
25 forward.

26 And Senior Tax Manager, United Launch
27 Alliance -- I don't know if both of you want to come
28 forward, but you are certainly welcome, certainly

1 would encourage you to you try to avoid any
2 redundancy, it's your desire to sit on the opposite
3 side of these gentlemen?

4 MS. REYNOLDS CLARK: I don't know where you
5 want us to sit.

6 MR. HORTON: You know, you never know. I'm
7 just calling names here, so, you're all smiling,
8 that's a good thing.

9 Please come forward.

10 Welcome, Mr. Moon. Would you please -- I
11 thought I heard you introduce yourself for the
12 record .

13 MR. MOON: No, not yet.

14 MR. HORTON: Please proceed.

15 MR. MOON: Good afternoon, Mr. Chairman and
16 Members of the Board.

17 Richard Moon with the Legal Department.
18 We're here to ask the Board to vote to adopt the
19 proposed amendments to Rule 133, which clarify that
20 the business inventory exemption applies to
21 non-reusable space flight property, over which
22 control is relinquished at launch to a federal
23 launch safety authority.

24 And I'd also note that if the Board
25 approves, we had made a typo in some of the
26 documents that were issued to OAL and we would, of
27 course, correct those.

28 And I'd be happy to provide any detail or

1 answer any questions either now or at the conclusion
2 of the -- of the comments.

3 MR. HORTON: Yes. Members, out of
4 deference to the assessor, I'm going to ask that he
5 start us off, if that be his desire.

6 ---o0o---

7 LARRY STONE

8 ASSESSOR, SANTA CLARA COUNTY

9 ---o0o---

10 MR. STONE: Thank you, Mr. Chairman and
11 Members of the Board. I'm Larry Stone, the County
12 Assessor of Santa Clara County.

13 In February you directed your staff to
14 provide, quote,

15 "More information regarding the
16 factual control of the equipment before,
17 during and after launch."

18 Nearly three months later your staff still
19 has not addressed the fundamental question of who
20 owns the space vehicles when they return to Earth?

21 Instead, your staff focused exclusively on
22 what occurs at launch. They described in some
23 detail the federal government's control at the
24 moment of launch and their authority, if necessary,
25 to destroy a spacecraft.

26 That authority is no different than the
27 authority exercised by the FAA over commercial
28 airlines -- as we saw when they ordered all aircraft

1 down during 9-11.

2 And let's be clear, the federal government
3 never -- the federal government never obtains legal
4 ownership to any property in direct conflict with
5 your staff's assertion.

6 One need no -- look no further than SpaceX,
7 which proudly displays a returned spacecraft in
8 their lobby.

9 Is the BOE really saying that this
10 spacecraft is owned by NASA? In news articles
11 over -- over a year ago, SpaceX extensively
12 described how hours into a rendezvous with the
13 international space station, one of their spaceships
14 ran into problems. SpaceX provided great detail
15 about how their staff, not NASA, fixed the problem.

16 The evidence refuting your staff's
17 conclusion is overwhelming and irrefutable. Your
18 staff relied mostly entirely on one of the prime
19 beneficiaries of this rule, United Launch Space
20 Alliance, to arrive at their conclusion. They
21 relied on, quote,

22 "Informational discussion, informal
23 discussions with Vandenberg Air Force
24 base personnel."

25 In contrast, I contacted the Associate
26 Center Director for the Kennedy Space Center in
27 Florida. And through his spokesperson, he said
28 and -- I quote,

1 "The range safety officer only
2 has possession of the spacecraft
3 purely for safety reasons." End quote.

4 SpaceX financial model is predicated on the
5 reuse of its space vehicles. SpaceX makes one claim
6 to assessors, that the vehicles it launches into
7 space cannot be reused for space exploration and,
8 therefore, are not taxable.

9 Yet they tell the public and their
10 investors an entirely different story. In a segment
11 on "60 Minutes," just this last March 30th, SpaceX
12 made clear that it plans for its rockets to return
13 to Earth with a, quote, "soft landing," that will
14 not damage the rocket.

15 Since then they have successfully returned
16 a spacecraft to Earth. This rule would likely
17 preclude assessing that property.

18 In a recent article, and I quote,
19 "Elon Musk announced a major
20 breakthrough in spacecraft and space
21 flight on Friday. The successful soft
22 landing of Falcon's 9s reusable,"
23 underscore reusable, "rocket booster
24 stage in the Atlantic Ocean." End quote.

25 It is clear you are being misled by your
26 staff with glaring factual errors.

27 The FAA Joint Program Management Plan, a
28 written document published by NASA -- by the NASA

1 International Space Station Program and to which
2 SpaceX is a signator, states, and I quote,

3 "SpaceX always -- always has
4 prime responsibility."

5 This rule should be rejected because of the
6 BOE staff faulty reasoning that this equipment
7 should be considered inventory. That defies common
8 sense and reflects a complete disregard for the
9 overwhelming evidence.

10 To suggest that spacecraft is inventory of
11 a company is a reach that is far beyond what we
12 should be doing.

13 SpaceX is not in the business of selling or
14 leasing property. Rather, they are in the same
15 business as UPS or FedEx or, eventually, I guess,
16 United Airlines and Southwest Air.

17 SpaceX provides a service, transportation
18 service, which is delivered -- which is to deliver
19 cargo to and from the international space station.

20 The BOE analysis that the subject space
21 property somehow qualifies as business inventory has
22 no merit.

23 More importantly, we are concerned with the
24 dangerous precedent that this would set. If the BOE
25 decides with this rule that you can expect -- you
26 can expect other companies will argue their
27 equipment is also inventory.

28 I urge the BOE to reject this rule. Thank

1 you.

2 MR. HORTON: Thank you very much, Assessor
3 Stone.

4 I believe Mr. Ramseyer would share that.

5 MR. RAMSEYER: Good afternoon.

6 No, I'd like to --

7 MR. HORTON: Yes.

8 MR. RAMSEYER: -- say a few, say a few
9 words, Chairman Horton and Members --

10 MR. HORTON: Yes.

11 Just for my own clarification, you --

12 ---o0o---

13 ALBERT RAMSEYER

14 PRINCIPAL DEPUTY COUNTY COUNSEL

15 ---o0o---

16 MR. RAMSEYER: Albert Ramseyer, Principal
17 Deputy County Counsel appearing for the assessor.

18 MR. HORTON: Thank you, sir.

19 MR. RAMSEYER: I've been representing the
20 LA County Assessor for about 25 years.

21 MR. HORTON: Excellent.

22 MR. RAMSEYER: And first of all, I'd like
23 to tie in with Mr. Moon's request to correct some
24 typos.

25 There was a typo on the letter submitted by
26 my office dated May 20th on page 4. And if I could
27 have consent, Mr. Chairman, to provide a corrected
28 electronic version, say by tomorrow?

1 MR. HORTON: Uhmm --

2 MR. RAMSEYER: Update -- to correct the
3 file?

4 MR. HORTON: Certainly, you can certainly
5 provide the -- the version and if it's possible, can
6 you give it to us today?

7 MR. RAMSEYER: And I only have handwritten
8 corrections, Mr. Chairman.

9 MR. HORTON: That will work.

10 MR. RAMSEYER: Okay.

11 MR. HORTON: And we will take those
12 corrections. I would ask that you submit them to
13 Ms. Richmond.

14 And then we will submit them to Mr. Moon
15 and ask Mr. Moon to testify on the necessity to
16 incorporate that in their presentation.

17 MR. RAMSEYER: May I show it to him right
18 now?

19 MR. HORTON: No, continue with your
20 representation.

21 MR. RAMSEYER: Okay.

22 MR. HORTON: And when I go on to the next
23 speaker, then you can --

24 MR. RAMSEYER: Okay.

25 MR. HORTON: Okay.

26 MR. RAMSEYER: That's fine.

27 You know, I'd also like to tie in with
28 Assessor Stone's point regarding the proposed rule

1 amendment not being supported by substantial
2 evidence and not being consistent with the law.

3 In 1984 Congress enacted an act called the
4 Commercial Space Launch Act of 1984 that privatized
5 space transportation business and allowed for
6 commercial activity.

7 And what this -- the problem with staff's
8 analysis here is it -- it's based upon a false
9 premise. And that false premise is that ULA and
10 SpaceX are in the rocket manufacturing business.

11 They're not in the manufacturing business,
12 they're in the launch business. Their business, as
13 I understand it -- and they're here today -- their
14 business is to transport cargo into outer space.
15 And Congress privatized that business and,
16 naturally, when you -- when you ignite a rocket,
17 there's going to be safety concerns.

18 But they -- pursuant to Code of Federal
19 Regulations, they contract with federal government
20 for the use of the federal launch facilities and for
21 safety systems. But those services are provided by
22 contract to SpaceX, a private corporation.

23 So, what is it? What business is it that
24 they're in? Who is the end user of those rockets?

25 Is the end user of those rockets the
26 federal government? Or is the end user of those
27 rockets actually SpaceX?

28 And -- and -- and the answer there is

1 clear, it's SpaceX. We've seen this before where
2 you have this kind of a public-private type of
3 relations. And we've seen it before where the
4 private company takes the benefits and then when
5 there is burdens involved, they want to put the
6 burdens on government.

7 Well, that's -- that's not how it should go
8 here. If you're in private -- if you are in private
9 business, you should incur the same tax obligation
10 that every other private business incurs that's in
11 commercial enterprise.

12 And, so, they're in the launch business.
13 They are the end user of those rockets. They are
14 the owner of that -- of those assets. They're
15 subject to California property tax on those assets.

16 It's the legislature's prerogative whether
17 to exempt that property or not, it's not this
18 Board's prerogative. This Board has rulemaking
19 authority, but that rulemaking authority has to be
20 consistent with law.

21 The law that applies here is Revenue and
22 Taxation Code Section 129, which defines business
23 inventory as property held for sale in the ordinary
24 course of business. Those rockets are not built to
25 be held for sale. Those rockets are used for the
26 launch business. They're up -- they're a launch
27 company. They provide launch services. Those
28 rockets are subject to assessment.

1 If they are to be exempt, they should be
2 exempted by the legislature, not by this Board.

3 The other -- the other rationale that's
4 provided is that somehow this property is now
5 federal -- this property is -- this property, when
6 it goes on the entry, somehow becomes in the custody
7 of the United States government.

8 Whatever role the government has in that
9 launch operation is for safety purposes. And we
10 see govern -- government has -- of course, we know
11 this, being Californians, everything is potentially
12 subject to regulation -- food, drug manufacturers,
13 construction -- everything is subject to a potential
14 government official coming in and saying, "Halt your
15 operation."

16 But that does not make it a government
17 asset and that does not make that property exempt
18 from property tax. And to say -- to say that is
19 simply inconsistent with the law.

20 And that's my two words. Thank you very
21 much.

22 MR. HORTON: Thank you very much.

23 You can now, if you so desire, provide us a
24 copy --

25 MR. RAMSEYER: Thank you.

26 MR. HORTON: -- of that as we move through
27 the --

28 MR. RAMSEYER: I would still like to follow

1 up with an electronic copy just because it's
2 cleaner.

3 MR. HORTON: Yes, please.

4 Do you need your original? Is that your
5 original?

6 MR. RAMSEYER: Yes, but I know where the
7 corrections are, Mr. Chairman.

8 MR. HORTON: Well, let's -- let's do this:
9 Mr. Moon, can you provide that to Ms. Richmond and
10 we will ask that they make a copy of it and give
11 you -- return your original to you, just to make
12 sure -- so, you know, make it as simple as we can to
13 get your thoughts.

14 MR. RAMSEYER: Thank you very much.

15 MR. HORTON: Members, we'll now, in the
16 essence, go to the other witnesses that are here to
17 hear their testimony.

18 And I would remind the Members that we have
19 two additional witnesses that we will try to
20 accommodate.

21 And I guess we can -- in the essence of
22 time, let's ask them to come on and come forward.

23 Mr. Dennis Loper, representing SpaceX;
24 Marty Dakessian, attorney at Reed Smith,
25 representing SpaceX.

26 Okay, Mr. Reynolds -- Ms. Reynolds Clark,
27 State Tax Manager with United Launch Alliance.

28 MS. REYNOLDS CLARK: Yes.

1 MR. HORTON: Welcome to the Board of
2 Equalization.

3 ---o0o---

4 DEBRA REYNOLDS CLARK
5 SENIOR TAX MANAGER
6 UNITED LAUNCH ALLIANCE

7 ---o0o---

8 MS. REYNOLDS CLARK: Well, thank you. And
9 I want to thank the Board and their staff for
10 spearheading this rule.

11 And I thought that their policy statement
12 overview was an excellent analysis of the actual
13 facts. And I think they have done a tremendous job.
14 This is a very difficult subject and complex.

15 There is a couple of things -- facts that
16 I'd like to set straight. I've made these comments
17 to you before, but they seem to be recurring themes
18 from the assessors that oppose this rule.

19 First of all, this isn't a single company
20 rule, this is an industry rule. United Launch
21 Alliance has been launching our polar orbits
22 missions from three different space complex in
23 Vandenberg since 2007. And prior to that, our
24 member companies, Lockheed and Boeing, were
25 launching.

26 Over, I would say at least the last 15
27 years, ULA, Lockheed, Boeing, have all been subject
28 to personal property tax audits. The government

1 contracts have not changed at all in the last 15
2 years. And the county assessors have always treated
3 the rockets as inventory for 15 plus years.

4 Now, to me, that's similar to an easement.
5 An easement is established in seven years. After 15
6 years of treating this as inventory, I find it very
7 unfair to the taxpayer to all of a sudden change the
8 rules without any notification.

9 Now to the reusable question, our vehicles
10 are 100 percent EELV, that stands for evolved,
11 expendable launch vehicles. The expendable means
12 that they are expended in the delivery of the
13 satellite. They do not come back. They are not
14 reusable. They're gone. And it's 100 percent EELV
15 contracts. That's all we have. All right, there's
16 nothing coming back to Earth.

17 Now as far as the control issue and this
18 whole business about whether the facts are right or
19 not, I brought Phil Anderson. He is our Vandenberg
20 Range Coordinator. He actually works with the --
21 the Air Force in the range safety. So, if there's
22 any technical questions you have, he'll be able to
23 handle them -- like I said, 'cause he understands
24 this probably even better than I do.

25 One thing that -- just kind of give you a
26 little overview, the Range Safety Officer of the
27 federal government actually takes control of the
28 rocket before take-off. So, before it's even

1 launched, so, somewhere under T minus 4 they'll take
2 control. They can blow that rocket up right on the
3 pad if there's a problem, if there's going to be a
4 threat to public safety.

5 Now being able to destroy a rocket is the
6 ultimate sign of ownership. It's the ultimate sign
7 of control. You can destroy it.

8 And I know that this issue about maybe
9 merging with -- back with the space station, we
10 don't do that. But to me, within 18 seconds that
11 rocket is so far out of California, even if the
12 company did take possession again, it's out of
13 California at the time it would transfer back -- and
14 I'm not saying it does.

15 And for some reason it seems to me that I
16 believe the assessors think that we've got somebody
17 sitting with a joystick steering that rocket. And
18 if that was true, every 13 year-old boy in the world
19 would be lined up for this job, right?

20 But, unfortunately, what happens is that
21 the everything that is needed to -- to steer and
22 deliver that satellite has been programmed into the
23 software of the rocket. Once the rocket takes off,
24 that's it. It's done. There is -- you know, we
25 have no more -- no more ability to control it.

26 I also wanted to state that as far as an
27 economic issue, you know, ULA employs hundreds of
28 people in Vandenberg and these aren't minimum wage

1 jobs, these are good jobs.

2 And we think that just for the space
3 industry there should be some exemptions that are
4 similar to what Florida is giving.

5 So, we launch rockets also from Florida.
6 Florida has spaceport exemption. There's no
7 personal property tax on anything. There is no real
8 property tax. There's no possessory property tax.
9 And this makes it much more attractive to do
10 business in Florida.

11 And I believe that California should really
12 reconsider being able to attract the space vehicle
13 business back to California, because it used to be
14 the aerospace mecca.

15 And I think that's -- I'd just recommend
16 that the Board adopt this rule. I think it will be
17 helpful in -- in generating some economic
18 development here. And also it will memorialize what
19 the assessors have been doing in practice over the
20 last 15 years.

21 MR. HORTON: And Mr. Anderson, I'm
22 presuming is here as an expert witness?

23 MS. REYNOLDS CLARK: Yes, yes.

24 MR. HORTON: Okay.

25 MS. REYNOLDS CLARK: So, if there's
26 questions, we wanted to allow him to be here to
27 answer.

28 MR. HORTON: Thank you very much.

1 We will now go on to Mr. Dennis Loper with
2 SpaceX.

3 ---o0o---

4 DENNIS LOPER

5 SPACEX

6 ---o0o---

7 MR. LOPER: Thank you, Mr. Chairman and
8 Members.

9 MR. HORTON: Please identify yourself.

10 MR. LOPER: Dennis Loper representing
11 SpaceX.

12 First of all, we strongly agree with the
13 legal analysis of Ms. -- of the general counsel --
14 chief counsel.

15 We believe and have always believed that
16 our inventory is business inventory. We believe
17 that -- that the -- we secede control to the federal
18 safety launch officer. And we're a little
19 different, we're at T-5, I'm told.

20 And as a launch operator we're required to
21 work with the FAA and the Range Safety Officer
22 prior to -- prior to launch to prepare them to make
23 the launch work.

24 The Range Safety Officer has sole control
25 of the rocket. And I will leave it with that to
26 Marty Dakessian, but with just two asides because --
27 because it seems that people want to attack the
28 company that I represent.

1 And both Mr. Stone and Mr. Ramseyer seem to
2 have you focused on something about us that --
3 that -- they're not not correct. There is a capsule
4 in our Hawthorne facility, but it'll never been used
5 again. It did return, but it's unusable.

6 We have a whole set of those out in Texas,
7 if they want to go look at them, but they're not
8 reusable.

9 Now, does -- does our company wish it some
10 day to be reusable? We do. But at this point
11 neither the federal government or range safety would
12 allow that.

13 So, with that I'll turn it over to
14 Mr. Dakessian.

15 MR. HORTON: Welcome, Mr. Dakessian.
16 Introduce yourself.

17 MR. LOPER: And one other aside. I'm
18 wondering if this is the same advice given on the
19 DirectTV case 12 years ago?

20 MR. HORTON: Welcome, Mr. Dakessian.

21 Please introduce yourself for the record.
22 You have three minutes.

23 ---o0o---

24 MARTY DAKESSIAN

25 SPACEEX

26 ---o0o---

27 MR. DAKESSIAN: Good afternoon,
28 Mr. Chairman and Members of the Board.

1 My name is Marty Dakessian and I represent
2 SpaceX. I work for the law firm Reed Smith.

3 And I have to commend staff, they've done
4 an outstanding job throughout this regulatory
5 process.

6 I agree with our colleagues from United
7 Launch, it was a very difficult subject to tackle.
8 It's a novel issue, which is why we're here and
9 we're glad that the Board has exercised its legal
10 authority to -- to engage in the rulemaking process.
11 And we're very glad that the staff put forth the
12 effort that it did.

13 It's very difficult for me to sit here now
14 through the second hearing, as Mr. Loper has, and
15 hear the potshots that are being taken against
16 SpaceX. It's very difficult for me to do that as an
17 advocate, but I'm going to do my my best to be
18 dispassionate and address the points that were --
19 that were mentioned by -- by our colleagues on the
20 other side of the table.

21 The first point, again, is aspirational,
22 the return of the spacecraft to the Earth is purely
23 aspirational at this point. And why not? We want
24 to move in that direction. It's just not the case
25 today.

26 The analogy with respect to the FAA is
27 completely inappropriate. The FAA does not have the
28 ability to destroy aircraft on a runway. That

1 analogy is -- is so bizarre it doesn't even make any
2 sense.

3 The other point that I think people keep
4 getting hung up on is you do not actually need a
5 transfer of legal title in order to qualify as
6 business inventory. That has not been required
7 since the inception of the regulation.

8 There are -- there are portions of the
9 regulation that address property to be regarded
10 as -- as business inventory in a service context, we
11 know that for a fact.

12 This notion -- I am sorry for the speed of
13 my comments but I have limited time, but this notion
14 that safety is the --

15 MR. HORTON: If it helps you to relax, sir,
16 we'll add another minute.

17 MR. DAKESSIAN: -- thank you, thank you.

18 So, this notion of minimizing and
19 downplaying the control of the federal range
20 authority is inappropriate. Safety is not only
21 paramount to any launch, it's the only control that
22 is exercised after T minus 5. There is no other
23 control to be exercised.

24 We agree with United Launch's view here
25 that there's nobody sitting down in mission control
26 with a joystick. Once T minus 5 hits, federal range
27 safety takes over and there is no more control to be
28 had with respect to these -- with these vehicles.

1 This point -- again another non sequitur --
2 this point with respect to SpaceX's responsibility
3 for the launch -- responsibility for the launch does
4 not preclude business inventory treatment.

5 Another non sequitur, this time raised by
6 LA County, which is that the fact that SpaceX may be
7 in the space transportation industry -- which it is,
8 it does provide space transportation services --
9 does not disqualify it for business inventory
10 treatment, does not disqualify these vehicles for
11 business inventory treatment. That is just false.
12 That is -- that is completely untrue.

13 It is as untrue in the property tax context
14 as it is in the sales tax context, where we know
15 that the characterization of the -- of the services
16 of the contract doesn't matter, it's what actually
17 happens.

18 And if possession is transferred and
19 control is transferred, there are plenty of
20 annotations and plenty of pieces of guidance by this
21 Board that should -- suggest that -- that is an
22 appropriate treatment for a service industry.

23 And with respect to this point of SpaceX is
24 not a manufacturer, I think LA County has actually
25 gone down and visited the facility -- if that's not
26 a manufacturer of the space vehicles, then I don't
27 know what it is.

28 They build their equipment in-house,

1 90 percent of the parts that they use they build
2 themselves right here in Hawthorne, so, there is
3 manufacturing going on.

4 With respect to the -- the treatment of
5 business inventory, this is a theme that's been
6 consistent. For financial accounting purposes, this
7 is business inventory. For sales tax purposes, this
8 is business inventory. For income tax purposes,
9 this is business inventory.

10 The County is trying to -- to impose a
11 different treatment on this than every other area of
12 tax.

13 MR. RAMSEYER: May I ask -- may I inquire?

14 MR. HORTON: Sir, I'm going to allow him to
15 finish his testimony and then, at that point, I
16 would believe that we're not going to get into a
17 question and answer, but the Members may very well
18 engage.

19 And through that process, you may have an
20 opportunity.

21 MR. DAKESSIAN: In conclusion,
22 Mr. Chairman, this property has never before been
23 taxed, so, this whole notion of a retroactive
24 exemption is false on its face.

25 I don't have really anything more to add at
26 this point, but we're here to answer questions.

27 Thank you very much.

28 MR. HORTON: Okay. A lot has been said.

1 And, Members, with your indulgence, I would go to
2 Mr. Richard Moon to address some of the issues here
3 and then open it up for discussion to the Members.

4 MR. MOON: I guess I would begin by saying
5 that the Government Code clearly gives the Board the
6 authority to do this type of rulemaking.

7 The Government Code is explicit in giving
8 the Board the power to do classifications of
9 property, which this is, and, especially in an area
10 and an industry that's not entirely -- that doesn't
11 entirely fit things that we've seen in the past, I
12 would think that it's the exact type of transactions
13 and the exact type of industry that's proper for the
14 Board to do rulemaking.

15 In this process of -- of thinking about
16 whether this property qualifies as business
17 inventory under -- under Rule 133, we looked at a
18 number of things.

19 And starting with, of course, the
20 definition, which is the sale of goods in the
21 ordi -- goods intended for sale in the ordinary
22 course of business.

23 In looking at the industry, the regulation
24 and then especially looking at what happens at the
25 end, towards launch, when complete control is
26 essentially given over to the Range Safety Office,
27 it appears to us that that meets the definition of a
28 sale, which is very broad.

1 And it says, "by any manner or by any means
2 whatsoever." And when you have that kind of broad
3 language, we believe that it -- that it meets that
4 test.

5 For the sales tax purposes, this would be a
6 transfer, upon which sales tax would be owed, except
7 for the specific exemption.

8 And to be consistent, if it's being treated
9 as a sale, then if prior to the sale you're holding
10 it, then it has to be intended for sale. And, so,
11 it makes sense that for property tax purposes, as
12 well it would be treated as -- as a -- as business
13 inventory.

14 And then I guess lastly what I would add is
15 that it is true that the federal authorities take
16 control for safety purposes. That is absolutely
17 true. But that does not change the fact that they
18 take control.

19 From a certain point prior to launch, they
20 have -- the launch operators have absolutely -- they
21 can do nothing -- they are 100 percent hands off.

22 The only human that can do anything to
23 the -- to the vehicle at that point is the federal
24 authority.

25 MR. HORTON: Thank you very much, Mr. Moon.

26 Members, we'll now go to discussion.

27 Member Yee.

28 MS. YEE: Thank you, Mr. Chairman.

1 Question for Mr. Moon, I know there was --
2 and maybe representatives for SpaceX can also
3 comment -- there was bill that was recently
4 enacted --

5 MR. MOON: Yes.

6 MS. YEE: -- that looked at this issue more
7 broadly with respect to all space flight property.

8 I mean, are we kind of headed there any way
9 under that bill?

10 MR. MOON: Yeah, that's correct.

11 So, from lien date 2014, space flight
12 property would be exempt under AB 777.

13 And I would add that there was an
14 uncodified provision in that bill -- in that law
15 that explicitly stated that -- that no inference is
16 to be drawn on whether this property is business
17 inventory with regard to our rule.

18 So, that has no effect on -- on this rule.

19 MS. YEE: Okay. And the limitation with
20 respect to this rule is it does not apply to
21 reusable spacecraft?

22 MR. MOON: Correct.

23 MS. YEE: Okay. I, Mr. Chairman, was the
24 one who initiated more analysis about the existing
25 authorities with respect to the issue of control.
26 And I think one of the issues that we have here is,
27 perhaps -- I didn't really understand the use of use
28 this equipment or -- 'til I read the authorities and

1 began to understand a little bit better what this
2 all means.

3 But in some ways the issue of control is --
4 I don't think it's typically how we look at it with
5 respect to --

6 MR. MOON: No, it's not typically how we
7 look at it, that's correct.

8 MS. YEE: -- so -- and Mr. Moon, the case
9 law that you cite, we believe provides sufficient
10 authority for us to --

11 MR. MOON: I do. I think those cases, the
12 reason why they were cited is because those are two
13 cases at least that talk about the element of
14 control --

15 MS. YEE: Yeah.

16 MR. MOON: -- as to whether it's a sale or
17 not. So, ordinarily you would have just a straight
18 sale of goods. Like you could walk into a car
19 dealer and buy a car.

20 MS. YEE: Right.

21 MR. MOON: That would be a sale.

22 But those were at least two cases where --
23 where -- where the transfer of the property didn't
24 follow sort of those straight facts.

25 MS. YEE: Right, okay.

26 Let me pass for now.

27 MR. HORTON: Okay, further discussion

28 Members?

1 Hearing none, Member Yee?

2 MS. YEE: This is -- I mean, what I found
3 interesting about this -- and my goal, as far as why
4 I wanted this put over, more analysis about the
5 authorities, I want there to be some clear -- I want
6 there to be clarity for the assessors.

7 And I think there is. And I think part of
8 the difficulty is that the concept of control is not
9 how we typically look at it. And I'm also then --
10 even though the -- the bill that was enacted has no
11 effect with respect to the rule before us, the
12 direction that the bill is moving would suggest to
13 me that this was what was contemplated.

14 MR. HORTON: Thank you, Member Yee.

15 Further discussion, Members?

16 MR. RUNNER: Move adoption.

17 MR. HORTON: Moved adoption by
18 Member Runner, second by Member Steel.

19 Without objection, Members, such will be
20 the order.

21 Thank you very much for appearing before us
22 today. The Board truly appreciates your
23 presentation and testimony.

24 We will now go to Member Yee.

25 MS. YEE: May I ask a question on this?

26 MR. HORTON: Mr. Moon, everyone -- please
27 return.

28 MS. YEE: What kind of guidance are we

1 going to be giving to assessors about this?

2 MR. HORTON: Member Yee has asked what type
3 of guidance.

4 And I believe this is a question of Mr.
5 Moon, but, gentlemen, please have a seat.

6 Did you notice both of you are wearing gray
7 suits and blue ties, is that like a uniform or
8 something?

9 MR. DAKESSIAN: I just do what he tells
10 me.

11 MR. HORTON: Okay, all right.

12 Mr. Moon.

13 MR. MOON: Once the -- once the final rule
14 documents are submitted to OAL, the rule, of course,
15 would get published.

16 There is a legal opinion that we are
17 planning to annotate that would give guidance.

18 As well we could certainly have discussions
19 with CAPD to issue an LTA on this issue as well.

20 MS. YEE: I ask only because I don't think
21 this is the last time we're going to see an issue
22 like this where sole concept of control is, you
23 know, just --

24 MR. HORTON: Yeah, even -- even this issue,
25 continuing in the minds of the assessors would be
26 helpful, I think, to engage as the assessors -- and
27 continue to have those types of discussions.

28 I think it's just helpful as we go forward.

1 So, I certainly encourage that as well.

2 Action has been taken already, this is just
3 discussion.

4 MR. DAKESSIAN: Thank you.

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REPORTER'S CERTIFICATE.

State of California)
) ss
County of Sacramento)

I, JULI PRICE JACKSON, Hearing Reporter for the California State Board of Equalization certify that on MAY 22, 2014 I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding pages 1 through 32 constitute a complete and accurate transcription of the shorthand writing.

Dated: JUNE 4, 2014



Juli Price Jackson

JULI PRICE JACKSON

Hearing Reporter

Thursday, May 22, 2014

The Board recessed at 2:46 p.m. and reconvened immediately in open session with Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel present.

Mr. Horton announced the appointments of David Gau to the position of Chief Deputy Director, and Edna Murphy to Deputy Director, Administration Department.

PUBLIC HEARINGS

Business Taxpayers' Bill of Rights Hearings

Todd Gilman, Chief, Taxpayers' Rights and Equal Employment Opportunity Division, made introductory remarks regarding the Business Taxpayers' Bill of Rights hearings. Individuals have the opportunity to present ideas, concerns, and recommendations regarding legislation, the quality of agency services, and other issues related to the Board's administration of its tax programs, including sales and use taxes, environmental fees, fuel taxes, and excise taxes, and any problems identified in the Taxpayers' Rights Advocate's Annual Report (Exhibit 5.1).

Speaker: Jesse McClellan, Attorney, McClellan Davis, LLC

Mr. Gilman entered into the record written comments from Gary P. Salamone, Editor-in-Chief Continental Features, Continental News Service and William Davenport Lewis of Lewis & Associates Law Firm (Exhibit 5.2).

Exhibits to these minutes are incorporated by reference.

Property Taxpayers' Bill of Rights Hearings

Todd Gilman, Chief, Taxpayers' Rights and Equal Employment Opportunity Division, made introductory remarks regarding the Property Taxpayers' Bill of Rights hearings. Individuals have the opportunity to present their ideas, concerns, and recommendations regarding legislation, the quality of agency services, and other issues related to the Board's administration of its tax programs, including state and county property tax programs, and any problems identified in the Taxpayers' Rights Advocate's Annual Report (Exhibit 5.3).

Speakers: Carol Daum, Resident, Alpine County
Larry Ward, Assessor, Riverside County
Dave Peets, Assessor, Alpine County

Mr. Gilman entered into the record written comments from Fred Bottino, Taxpayer, Mariposa County (Exhibit 5.4).

Proposed Adoption of Amendments to Rule 133, *Business Inventory Exemption*

Richard Moon, Tax Counsel, Tax and Fee Programs Division, Legal Department, made introductory remarks regarding the proposed amendments, which clarify that the business inventory exemption applies to space flight property, under specific circumstances (Exhibit 5.5).

Thursday, May 22, 2014

Speakers: Larry Stone, Assessor, Santa Clara County
 Albert Ramseyer, Principle Deputy County Counsel, representing the
 Los Angeles County Assessor's Office (Exhibit 5.6)
 Debra Reynolds-Clark, Senior Tax Manager, United Launch Alliance
 Dennis Loper, Representative, Space X
 Marty Dakessian, Attorney, Reed Smith, Representing Space X (Exhibit 5.7)

Action: Upon motion of Mr. Runner, seconded by Ms. Steel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board adopted amendments to Rule 133 as published.

The Board recessed at 3:56 p.m. and reconvened at 4:32 p.m. with Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel present.

SALES AND USE TAX APPEALS HEARINGS

James J. Barbera, Jr., 526563, 526564, 526565 (BH)
 07/01/04 to 12/31/06, \$3,356.00 Tax, \$335.00 Failure-to-file Penalty, \$335.60 Finality Penalty
 01/01/07 to 08/31/07, \$891.00 Tax, \$89.10 Failure-to-file Penalty, \$89.10 Finality Penalty
 07/01/01 to 08/31/07, \$32,916.84 Tax, \$2,196.90 Failure-to-file Penalty, \$1,094.78 Negligence
 Penalty, \$1,094.78 Amnesty Double Negligence Penalty, \$3,291.68 Finality Penalty, \$1,094.78
 Amnesty Double Finality Penalty

For Taxpayer: James Barbera, Taxpayer
 For Sales and Use Tax Department: Scott Lambert, Hearing Representative
 Contribution Disclosures pursuant to Government Code section 15626: None were disclosed.
 Issues: Whether adjustments are warranted to the audited amounts of unreported taxable
 sales.

Whether taxpayer was negligent.

Action: Upon motion of Mr. Runner, seconded by Ms. Yee and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board ordered that the petition be submitted for decision.

GEO G2 Solutions, Inc., 563641 (UT)

05/09/08, \$84,975.00 Tax
 For Petitioner: Kevin E. Spry, Representative
 For Sales and Use Tax Department: Andrew Kwee, Tax Counsel
 Contribution Disclosures pursuant to Government Code section 15626: None were disclosed.
 Issue: Whether petitioner owes use tax on its storage, use, or other consumption
 of the aircraft in California.

Action: Upon motion of Ms. Yee, seconded by Ms. Mandel and unanimously carried, Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel voting yes, the Board ordered that the petition be submitted for decision.

The Board recessed at 5:10 p.m. and reconvened at 5:16 p.m. with Mr. Horton, Ms. Steel, Ms. Yee, Mr. Runner and Ms. Mandel present.



STATE BOARD OF EQUALIZATION
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BETTY T. YEE
First District, San Francisco
SEN. GEORGE RUNNER (RET.)
Second District, Lancaster
MICHELLE STEEL
Third District, Orange County
JEROME E. HORTON
Fourth District, Los Angeles
JOHN CHIANG
State Controller
CYNTHIA BRIDGES
Executive Director

STATE BOARD OF EQUALIZATION MEETING
450 N Street, Room 121, Sacramento
NOTICE AND AGENDA
Meeting Agenda

Thursday, May 22, 2014

10:00 a.m. Board Committee Meetings Convene*

Board Meeting convenes upon Adjournment of the Board Committee Meetings**

Agenda items occur in the order in which they appear on the agenda. When circumstances warrant, the Board's Chair may modify the order of the items on the agenda.

Board Committee Meetings*

Legislative CommitteeMr. Horton, Committee Chairman

I. 2014 Legislative Proposal

Set forth below is a suggestion for legislation to be sponsored by the BOE in the second year of the 2013/14 Legislative Session.

2014 Legislative Proposal: Business Taxes: Sales and Use Taxes

3-5 Amend Revenue and Taxation Code Section 6377.1 of the Sales and Use Tax Law to include within the partial sales and use tax exemption those qualified persons that conduct agricultural business activities that are currently excluded from the partial exemption.

II. 2014 Legislative Bill

- Recommendation for Board Position:
AB 2234 Property Tax: Assessment Practice Surveys (Ting)

Customer Service and Administrative
Efficiency Committee.....Ms. Yee, Committee Chairwoman

1. Proactive Outreach Manager (POM)

Staff will present a report on the current and proposed uses of POM and present a timeline for the proposed expansion.

Business Taxes Committee..... Ms. Steel, Committee Chairwoman

1. Regulation 1603, Taxable Sales of Food Products

Request approval and authorization to publish proposed amendments to clarify the application of tax to tips, gratuities, and service charges.

Property Tax CommitteeMr. Runner, Committee Chairman

1. Adoption of Assessors' Handbook Section 410, *Assessment of Newly Constructed Property*

Adoption of Assessors' Handbook to provide guidance on the assessment of newly constructed property under the provisions of Proposition 13.

2. Addendum to the *Report on Bundled Nontaxable Software – Embedded Software*

Staff to present an addendum to the report and discussion on assessment issues for embedded software.

Board Meeting**

State-Assessed Properties Value Setting

Property Tax Matter - 'CF' ++ Mr. Thompson

Board sets unitary values of state-assessed properties annually, on or before May 31, pursuant to constitutional and statutory law.

Special Presentations

2012-2013 Employee Recognition Award Program..... Ms. Herrera

The Board will announce and congratulate Northern California recipients of the Employee Recognition Awards.

Board Member Annual Photograph

A. Homeowner and Renter Property Tax Assistance Appeals Hearings
There are no items for this matter.

B. Corporate Franchise and Personal Income Tax Appeals Hearings
(Contribution Disclosure forms required pursuant to Gov. Code, § 15626.)

~~B1. Joseph W. Valva and Marilyn K. Valva, 719017 +
For Appellants: Sophia Lumbang, Representative
For Franchise Tax Board: Maria Brosterhous, Tax Counsel
Diane Ewing, Tax Counsel~~

~~B2. Graeme Kling and Lora Kling, 612775 +
 For Appellants: Sophia Lumbang, Representative
 For Franchise Tax Board: Kristen Kane, Tax Counsel
 Maria Brosterhaus, Tax Counsel~~

C. Sales and Use Tax Appeals Hearings

(Contribution Disclosure forms required pursuant to Gov. Code, § 15626.)

C1. James J. Barbera, Jr., 526563, 526564, 526565 (BH) +
 For Taxpayer: James Barbera, Taxpayer
 For Department: Scott Lambert, Hearing Representative

~~C2. Hukilau San Francisco, LLC, 533841 (BH) +
 For Petitioner: Eric Tao, Representative
 For Department: Scott Lambert, Hearing Representative~~

C3. GEO G2 Solutions, Inc., 563641 (UT) +
 For Petitioner: Kevin E. Spry, Representative
 For Department: Andrew Kwee, Tax Counsel

There are no items for the following matters:

- D. Special Taxes Appeals Hearings
- E. Property Tax Appeals Hearings

F. Public Hearings

F1. Business Taxpayers' Bill of Rights Hearings.....Mr. Gilman

Individuals have the opportunity to present their ideas, concerns, and recommendations regarding legislation, the quality of agency services, and other issues related to the Board's administration of its tax programs, including sales and use taxes, environmental fees, fuel taxes, and excise taxes, and any problems identified in the Taxpayers' Rights Advocate's Annual Report +.

F2. Property Taxpayers' Bill of Rights Hearings.....Mr. Gilman

Individuals have the opportunity to present their ideas, concerns, and recommendations regarding legislation, the quality of agency services, and other issues related to the Board's administration of its tax programs, including state and county property tax programs, and any problems identified in the Taxpayers' Rights Advocate's Annual Report +.

F3. Proposed Adoption of Amendments to Rule 133, *Business Inventory Exemption* + Mr. Moon

The proposed amendments clarify that the business inventory exemption applies to space flight property, under specific circumstances.

G. Tax Program Nonappearance Matters – Consent(Contribution Disclosure forms not required pursuant to Gov. Code, § 15626.)

- G1. Legal Appeals Matters Mr. Angeja
- Hearing Notices Sent – No Response
 1. Alvin Wireless, Inc., 527727 (GH)
 2. Bernie Chong, 564370 (GH)
 3. McKinney Griff., Inc., 607201 (CH)
 - Petitions for Release of Seized Property
 4. Dhama JS Corporation, Inc., 781906 (STF)
 5. Roy's Liquor & Market, Inc., 781908 (STF)
 6. Silverhawk, Inc., 781525 (STF)
 7. Patricia Anne E. Bailey and Louis Edward Snider, 781528 (STF)
 - Petitions for Rehearing
 8. Monarch Consulting, Inc., 525103 (STF)
- G2. Franchise and Income Tax Matters..... Mr. Epolite
- Hearing Notices Sent – No Response
 1. April Mottahedeh, 599752
 - Decisions
 2. Tony Aguilar, 738702
 3. Scott Ambrose and Wendy Ambrose, 676541
 4. Christine Asnaran, 660078
 5. William C. Burns and Linda Converse-Burns, 742213
 6. California Creative Foods, Inc., 595861
 7. Manuel De La Torre, 739089
 8. Jonie B. Dodgens, 716520
 9. Joseph D. Funkey and Susan L. Funkey, 577563
 10. David Hauber, 711188
 11. Sheng-Yu Ko, 603614
 12. Thomas A. Lee III, 610609
 13. Billie Jo Ann Llenas, 717025
 14. Albert H. MacKenzie and Hideko MacKenzie, 606115
 15. Carole L. McKee-Livingston (Schnugg) and Mark T. Livingston, 427529
 16. Gordon C. Merrick and Julie Nikcevich, 573097
 17. Christopher J. Nelson and Nancy L. Nelson, 613625
 18. Nestor Nieves and Lucy Nieves, 740002
 19. Palm Springs Industrial Development, L.P., 673144
 20. Rachel Raasch, 738585
 21. Michael Ramsey, 606120
 22. Brandon W. Ricks, 625450
 23. Lincoln L. Saul and Maureen E. Saul, 720758
 24. Joleen Soo, 713619
 25. Randy Stanley and Stephanie Stanley, 609454
 26. The Soft Forge, Inc., 717054
 27. Alvin Tjong, 643681
 28. Top Vision Development, LLC, 704842
 29. Didier Tran, 722786
 30. Bayani B. Villena and Thelma F. Villena, 611230

- Petitions for Rehearing
 - 31. ~~Todd Bentley and Kate Bentley, 593582~~
 - 32. Greg Karraker, 620604
 - 33. Roslyn Kirk and Willis Kirk, 588344
 - 34. Craig Norton, 693097

- G3. Homeowner and Renter Property Tax Assistance Matters
There are no items for this matter.

- G4. Sales and Use Taxes MattersMr. McGuire
 - Redeterminations
 - 1. Lithographix, Inc., 594527 (AS)
 - 2. D'Anna Yacht Center, Inc., 627009 (CH)
 - 3. TCK United Furniture, Inc., 592711 (KH)
 - 4. Cabwest, LLC, 719315 (OH)
 - 5. Resonetics, Inc., 460706 (OH)
 - Relief of Penalty/Interest
 - 6. Gelson's Markets, 796920 (AA)
 - 7. Cemex Construction Materials Pacific, LLC, 796175 (OH)
 - Denials of Claims for Refund
 - 8. KCI USA, Inc., 624009 (OH)
 - 9. Union Pacific Railroad Company, 734429 (OH)
 - 10. Cardinal Health 200, Inc., 554616 (OH)
 - Grant One-Day Interest Relief
 - 11. Lloyd Curtis Chittock, 796907 (KH)
 - 12. Lloyd Curtis Chittock, 796906 (KH)

- G5. Sales and Use Taxes Matters – Credits, Cancellations,
and RefundsMr. McGuire
 - Credits and Cancellations
 - 1. Circuit City Stores West Coast, Inc., 809827 (OH)
 - Refunds
 - 2. Woodward Hrt, Inc., 484298 (AR)
 - 3. Henkels & Mc-Coy, Inc., 797521 (OH)
 - 4. KCI USA, Inc., 624009 (OH)
 - 5. Rush Truck Leasing, Inc., LSR, 611190 (UT)
 - 6. Coso Junction Store, Inc., 771277 (DF)
 - 7. Irvine Eurocars, LLC, 614406 (EA)
 - 8. Buena Park Eurocars, LLC, 614403 (EA)
 - 9. Long Beach Eurocars, LLC, 614408 (AA)
 - 10. DFS SPV, LLC, 745211 (OH)
 - 11. Union Pacific Railroad Company, 734429 (OH)
 - 12. Cardinal Health 200, Inc., 554616 (OH)
 - 13. Borrego Solar Systems, Inc., 703784 (FH)
 - 14. S & R Architectural Metals, Inc., 786837 (EA)
 - 15. Kern Schools Federal Credit Union, 744162 (DF)
 - 16. TA Operating, LLC, 760078 (OH)
 - 17. Alcatel-Lucent USA, Inc., 735462 (OH)
 - 18. Buena Vista International, Inc., 790242 (OH)

- G6. Special Taxes Matters Mr. Gau
 ➤ Denials of Claims for Refund
 1. ConocoPhillips Company (STF), 720766
- G7. Special Taxes Matters – Credits, Cancellations,
 and Refunds Mr. Gau
 ➤ Credits and Cancellations
 1. Eagle Energy, Inc., 528233 (STF)
 ➤ Refunds
 2. ConocoPhillips Company, 710824 (STF)
 3. Massachusetts Mutual Life Insurance, Co., 790106 (STF) 'CF'
 4. Protective Life Insurance, Co., 790151 (STF) 'CF'

There are no items for the following matters:

- G8. Property Tax Matters
 G9. Cigarette License Fee Matters
 G10. Legal Appeals Property Tax Matters

H. Tax Program Nonappearance Matters – Adjudicatory

(Contribution Disclosure forms required pursuant to Gov. Code, § 15626.)

- H1. Legal Appeals Matters Mr. Angeja
 ➤ Cases Heard Not Decided
 1. General Industrial Tool & Supply, 281207 (AC) +
- H2. Franchise and Income Tax Matters..... Mr. Epolite
 ➤ Decisions
 1. Affina Soft, LLC, 609944
 2. Tonja M. Jarrell, 571357
 3. Gaddam Reddy and Preetha Reddy, 623814
 ➤ Cases Heard Not Decided
 4. SC Brokers, Inc., 600519

There are no items for the following matters:

- H3. Homeowner and Renter Property Tax Assistance Matters
 H4. Sales and Use Taxes Matters
 H5. Sales and Use Taxes Matters – Credits, Cancellations, and Refunds
 H6. Special Taxes Matters
 H7. Special Taxes Matters – Credits, Cancellations, and Refunds
 H8. Property Tax Matters
 H9. Cigarette License Fee Matters
 H10. Legal Appeals Property Tax Matters

I. Tax Program Nonappearance Matters

(Contribution Disclosure forms not required pursuant to Gov. Code, § 15626.)

I1. Property Taxes Matters

➤ Audits

1. Kerman Telephone Co. (246) 'CF'
2. Nationwide Telecom, Inc. (8026) 'CF'
3. Callcatchers, Inc. (8113) 'CF'
4. IntelePeer, Inc. (8118) 'CF'

➤ Land Escaped Assessments

5. AT&T Mobility, LLC (2606) 'CF'

➤ Board Roll Changes

6. 2010, 2011, 2012 and 2013 Board Rolls of State-Assessed Property 'CF'

I2. Offer in Compromise RecommendationsMr. Anderson

1. Ali Altafi
2. Mary Teresa Autera
- 3a. Amarjit Kaur Badesha
- 3b. Jasvir Badesha
4. Luis Galo Biondi
5. Jesus Casillas, Jr.
- 6a. Steven Michael Chack
- 6b. Cynthia Diane Kiddoo
7. Soo Lei Choi
8. Barbara E. Conklin
9. Juanito Dakis
- 10a. Alfredo DiNunzio
- 10b. CMR Day Spa, LLC
- 10c. Alfredo, LLC
- 10d. Di Roma, LLC
11. Malek Karch
12. Boris Khodzhoyan
13. Camie Lynn Peachy
14. Robert Brooks Peterson
- 15a. Victor Castillo Ruiz
- 15b. Maria Adela Ruiz
16. Randal Torres
17. Westcoast Powercats, Inc.

I3. Local Tax Reallocation Matters

There are no items for this matter.

Chief Counsel Matters

Items that appear under these matters provide information to the Members and may require Board action or direction.

J. Rulemaking

Section 100 Changes

- J1. Sales and Use Tax Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes* + Mr. Heller

Staff request for authorization to complete Rule 100 changes to update cross-references in Regulation 1802 to make the regulation consistent with 2012 amendments to Regulation 1684.

There are no items for the following matters:

- K. Business Taxes
- L. Property Taxes
- M. Other Chief Counsel Matters

Administrative Session

Items that appear under these matters provide information to the Members and may require Board action or direction.

- N. Consent Agenda** Ms. Richmond
(Contribution Disclosure forms not required pursuant to Gov. Code, § 15626.)

- N1. Retirement Resolutions +
 - John Huk
 - Nancy Pin-Pin Li
- N2. Approval of Board Meeting Minutes
 - April 22, 2014 +
- N3. Proposed Revisions to the Compliance Policy and Procedures Manual Chapter 5, *Returns* +
- N4. Adoption of Property Tax Forms +
 - BOE-58-AH *Claim for Reassessment Exclusion for Transfer Between Parent and Child*
Revised instructions to add information regarding taxpayers ability to file "place-holder" claims when all information is not available by the filing deadline. Clarified that the value requested is the factored base year value.
 - BOE-58-G *Claim for Reassessment Exclusion for Transfer From Grandparent to Grandchild*
Revised instructions to add information regarding taxpayers ability to file "place-holder" claims when all information is not available by the filing deadline. Clarified that the value requested is the factored base year value.

- BOE-268-B *Free Public Library or Free Museum Claim*
Revised to add a box for assessor's parcel number.
- BOE-502-D *Change in Ownership Statement—Death of Real Property Owner*
Revised to add a box for assessor's parcel number and instructions regarding filing requirements when multiple parcels are involved.
- ~~BOE 571-W~~ ~~2015 Wind Generation Property Statement~~
~~This is a new property statement that was developed to gather data from this emerging industry after consultation with assessors and industry.~~
- BOE-577 *Aircraft Property Statement*
Revised to make bold the notation on the top of page 1 regarding filing the claim; made various revisions on page 2 to capture relevant data necessary to make value determinations.

O. Adoption of Board Committee Reports and Approval of Committee Actions

- O1. Legislative Committee – May 22, 2014
- ~~O2. Customer Service and Administrative Efficiency Committee – May 22, 2014~~
- O3. Business Taxes Committee – April 22, 2014
- O4. Business Taxes Committee – May 22, 2014
- O5. Property Tax Committee – May 22, 2014

P. Other Administrative Matters

- P1. Executive Director’s Report Ms. Bridges
 - 1. Report on time extensions to Del Norte, El Dorado, Lake, Mariposa, Modoc, Tehama, Trinity, and Yuba Counties to complete and submit 2014/15 Local Assessment Roll, pursuant to Revenue and Taxation Code section 155. +
 - 2. CROS Project UpdateMr. Steen
Progress on the CROS project to replace BOE’s two current tax legacy technology systems.
- P2. Chief Counsel Report
There are no items for this matter.
- P3. Sales and Use Tax Deputy Director’s ReportMr. McGuire
 - 1. Security Deposit Update +
An update regarding the Sales and Use Tax Department’s security deposit release process.

- P4. Property and Special Taxes Deputy Director's Report..... Mr. Gau
1. Adoption of 4-R Act Equalization Ratio for 2014/15 + Mr. Fitz
Ensures that rail transportation property is assessed at the same percentage of market value as all other commercial/ industrial property.
- P5. Administration Deputy Director's Report..... Ms. Houser
- ~~1. Expanding Government Services..... Ms. Demes
A report will be provided on the number of new offices opened and to be opened and a report on the number of new positions created since 2009.~~

There are no items for the following matters:

- P6. Technology Deputy Director's Report
P7. External Affairs Deputy Director's Report

Announcement of Closed Session Ms. Richmond

Q. Closed Session

- Q1. Discussion and approval of staff recommendations regarding settlement cases (Rev. & Tax. Code, §§ 6901, 7093.5, 30459.1, 50156.11).
- Q2. Pending litigation: *Lucent Technologies, Inc., and AT&T Corp. v. State Bd. of Equalization*, Superior Court of Los Angeles (Case No. BC402036) (Lucent I), consolidated with *Lucent Technologies, Inc., v. State Bd. of Equalization*, Superior Court of Los Angeles (Case No. BC448715) (Lucent II) (Gov. Code, § 11126(e)).
- Q3. Discussion and action on personnel matters (Gov. Code, § 11126(a)).

Announcement of Open Session..... Ms. Richmond

Adjourn

General information regarding Board and Committee Meetings can be found at www.boe.ca.gov/meetings/boardcomm.htm. If you would like specific information regarding items on this Notice and Agenda, please telephone (916) 322-2270 or email: MeetingInfo@boe.ca.gov. Please be advised that material containing confidential taxpayer information cannot be publicly disclosed.

If you wish to receive this Notice and Agenda electronically, you can subscribe at www.boe.ca.gov/agenda.

If you wish to listen to and/or view a live broadcast of the Board meeting, please go to www.boe.ca.gov and click on Webcast.

The hearing location is accessible to people with disabilities. Please contact Rose Smith at (916) 323-9656, or email Rose.Smith@boe.ca.gov if you require special assistance.

Joann Richmond, Chief
Board Proceedings Division

- * Public comment on any committee agenda item will be accepted at the beginning of the committee meeting. Subsequent to committee meetings, committee agenda items may be taken up separately during the Board meeting.
- ** Public comment on any agenda item, other than a Closed Session item or an item which has already been considered by a Board Committee, will be accepted at that meeting.
- + Material is available for this item.
- ++ Material will be available at a later date.
- 'CF' Constitutional Function – The Deputy State Controller may not participate in this matter under Government Code section 7.9.

Memorandum

To: Honorable Jerome E. Horton, Chairman
Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, First District
Senator George Runner, Second District
Honorable John Chiang, State Controller

Date: May 8, 2014

From: Randy Ferris 
Chief Counsel

Subject: Proposed Adoption of Amendments to Property Tax Rule 133,
Business Inventory Exemption
May 22-23, 2014 Board Meeting – Item F – Public Hearing

This memorandum provides background information and legal analysis regarding the amendments to Property Tax Rule¹ 133, *Business Inventory Exemption* (Rule 133), published in the California Regulatory Notice Register on April 4, 2014, as a result of the Board's approval, at the February 25, 2014, Board meeting, to initiate the formal rulemaking process. The amendments clarify that the business inventory exemption applies to non-reusable space transportation equipment (space flight property) fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch to a federal launch safety authority.

At the February 25, 2014, Board meeting, staff was asked to provide additional clarification regarding the ceding of control and additional analysis of the federal authority regarding the transfer of control.

I. Factual and Federal Authorities Background

The Commercial Space Launch Act of 1984, as codified and amended at 51 U.S.C. § 50901 et seq., authorizes the Secretary of the Department of Transportation (Secretary) to regulate commercial launch activities as carried out within the United States. (51 U.S.C. §§ 50903, 50905.) The Secretary exercises this authority through delegations to the Federal Aviation Administration (FAA). (See 64 Fed.Reg. 19586 (Apr. 21, 1999).) The FAA assesses launch operators through the licensing process and also assesses the safety of federal launch ranges. (71 Fed.Reg. 50510 (Aug. 25, 2006).) Prior to launch, a commercial launch operator is required to obtain a launch license from the FAA. (51 U.S.C. § 50904(a), 14 C.F.R. § 415.9.)

¹ All references to Property Tax Rules or Rules are to sections of title 18 of the California Code of Regulations.

The Department of the Air Force (Air Force) is the owner and operator of the two primary federal space launch base ranges (Ranges or, individually, Range) – Cape Canaveral Air Force Station, Florida and Vandenberg Air Force Base, California.² (Air Force Space Command Instruction (AFSPCI) 91-701, *Launch Safety Program Policy*, (June 1, 2005) (AFSPCI 91-701), ¶ 1.) It operates these bases through its Air Force Space Command. (*Ibid.*)

Pursuant to a Memorandum of Agreement between the Air Force and the FAA, both agencies work together to achieve common safety requirements for launches. (*Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities* (MOA), January 16, 2001, as modified by MOA dated September 13, 2007.) Safety requirements are codified at 14 C.F.R. § 417 through FAA rulemaking. These rules were “necessary to codify current launch practices at Federal launch ranges . . .” (71 Fed.Reg. 50508, 50510 (Aug. 25, 2006).) The Air Force implements the common safety requirements as they apply to launches from its Ranges. At the time of promulgation of 14 C.F.R. § 417, Air Force Space Command Manual 91-710, *Range Safety User Requirements*³ (July 1, 2004) (AFSPCMAN 91-710), volumes 1-7, represented current safety practice at the federal launch Ranges.⁴ Air Force safety requirements are also reflected in AFSPCI 91-701, and Air Force Space Command Manual 91-711, *Launch Safety Requirements for Air Force Space Command Organizations* (Feb. 1, 2007) (AFSPCMAN 91-711).

A launch operator must work together with the FAA and the Air Force to ensure public safety. (14 C.F.R. § 417.101.) The FAA has detailed specific rules that launch operators must follow to comply with its safety requirements for the issuance of a license. These rules require a launch operator planning to launch from a federal launch Range to enter into an agreement with the Range that gives it access to and use of government property and services and to comply with any requirements of the agreement. (See 14 C.F.R. § 417.13.) Therefore, a launch operator launching from a Range (Range User) must comply with Air Force safety requirements detailed in AFSPCMAN 91-710. (AFSPCMAN 91-710, vol. 1, ¶ 1.2.1.)

AFSPCMAN 91-710 makes clear that safety is a joint responsibility of the Air Force and the Range User. (AFSPCMAN 91-710, vol. 1, ¶ 2.1.) It also makes clear that Range Users are solely responsible for complying with Air Force safety requirements. (AFSPCMAN 91-701, ¶ 1.3.7.) The Air Force Space Command Commander is responsible for setting safety policy (AFSPCMAN 91-710, vol. 1, ¶ 2.2), while the Range Commander has overall authority and responsibility for public safety at Air Force Ranges (AFSPCMAN 91-710, vol. 1, ¶ 2.3.1.1). Thus, at a Range, a Range User must comply with strict federal rules relating to its launch with oversight by federal authorities. While a launch operator supplies much of the information needed by a federal launch Range for safety analysis and verification, the federal launch Range clearly staffs and controls the launch. (71 Fed.Reg. 50509 (Aug. 25, 2006).)

² A third federal launch range, the Wallops Flight Facility (WFF) located in Wallops Island, Virginia, is owned and operated by the National Aeronautics and Space Administration (NASA). All operations at WFF are conducted under NASA control. (*Wallops Range User's Handbook* (WFF RUH), ¶ 2.2.)

³ WFF safety is governed by the *Range Safety Manual for Goddard Space Flight Center (GSFC) Wallops Flight Facility (WFF)* (WFF RSM), the WFF RUH, and *NASA Procedural Requirements* (NPR). We note that the *NASA and Federal Aviation Administration Joint Program Management Plan (PMP) for the Commercial Resupply Services (CRS) Contracts-International Space Station Program* is an agreement between NASA and the FAA and is not a description of range safety and flight termination requirements.

⁴ AFSPCMAN 91-710 is dated July 1, 2004. FAA rulemaking related to launch safety (14 C.F.R. § 417) became effective September 25, 2006. For one example of conformity to AFSPCMAN 91-710, see 71 C.F.R. § 50517 (explaining the FAA's requirements for a “separation distance” that matches the federal launch range terminology used in AFSPCMAN 91-710).

AFSPCMAN 91-711 defines and implements launch safety policies for all Air Force Ranges. As part of launch safety requirements, it sets forth all mission rules and flight control policies. (AFSPCMAN 91-711, ¶ 1.6.3.) The flight control mission is executed by the Mission Flight Control Officer (MFCO). (AFSPCMAN 91-711, ¶ 7.1.1.1.) Flight control of a mission begins when the system or procedures used to exercise positive control of launch vehicle flight is initiated during the launch countdown and is completed when positive control is no longer required or the capability of positive control is lost (also referred to as Flight Control End of Mission). (AFSPCMAN 91-711, ¶ 7.1.1.1 & Attachment 1.) Positive control is the continuous capability to ensure acceptable risk to the public is not exceeded throughout each stage of flight. (AFSPCMAN 91-711, Attachment 1.) The MFCO is the individual responsible for maintaining positive control of launched vehicles and initiating Range “command destruct” functions for an errant vehicle during the flight control mission. (*Ibid.*) “Command destruct” is the process in which a sequence of commands is issued that causes a launch vehicle to be destroyed. (*Ibid.*)

During the flight control mission, the MFCO’s launch safety responsibilities include:

a safety assessment of the readiness of the operation to proceed; final Launch Safety Go/No-Go recommendation; monitoring launch vehicle performance in flight; and ***servicing as the sole decision-making authority and initiator of the flight termination system*** [FTS] (if required).

(AFSPCMAN 91-711, ¶ 7.1.1, emphasis added.) This requirement is repeated in AFSPCMAN 91-710, vol. 1, ¶ 2.3.5.11, which states that Range Safety⁵ acts as “*the sole authority for the real-time determination and execution of flight termination.*”⁶ (Italics added.) The FTS includes all components that provide the ability to terminate a launch vehicle’s flight in a controlled manner, including all command termination systems, inadvertent separation destruct systems, and other systems or components used to terminate flight. (AFSPCMAN 91-711, ¶ 7.1.1 & Attachment 1.)

Range personnel must ensure that Range-managed instrumentation provides uninterrupted command capability for all flight termination systems. (AFSPCMAN 91-711, ¶ 7.1.3.) As well, a command receiver decoder (CRD)⁷ must be synchronized with the designated termination command frequency from the time of FTS turn-on through Flight Control End of Mission. (*Ibid.*) Typically, the CRD is activated (or “captured”) approximately one-to-two hours prior to launch.⁸ At approximately five minutes to 90 seconds prior to launch, the destruct system is armed. At approximately 60 seconds to launch, Range personnel verify that the destruct system is on and give the “Go” command if the launch is ready to proceed. The MFCO is responsible for the launch commit decision from a launch safety perspective and must perform checks of instrumentation prior to accepting the system for operational launch commit. (AFSPCMAN 91-711, ¶ 7.2.1.) Until approximately five seconds prior to launch, the Range User may abort the launch. After this time, the Range User has no ability to stop the launch, terminate the flight, or

⁵ Range Safety is now referred to as Launch Safety. (AFSPCMAN 91-711, Intro.)

⁶ A similar requirement exists for WFF. Both the WFF RSM and the WFF RUH require adherence to the safety policies and criteria defined in NPR 8715.5, *Range Flight Safety Program (updated with Change 2)*. (WFF RSM, p. 3 & WFF RUH, ¶ 2.3.1.) NPR 8715.5, ¶ 1.3.7.4 states that, for any vehicle that has an FTS, “the RSO [Range Safety Officer] or equivalent shall . . . make a flight termination decision when any aspect of the flight (including, but not limited to, vehicle or support system performance) violates preplanned termination criteria (Requirement).” Further WFF RUH, ¶ 2.2.3 provides that the “RSO has authority to stop work, hold a launch, or terminate a mission in flight if necessary.”

⁷ A CRD detects and translates destruct commands sent by the Range to the launch vehicle FTS.

⁸ Factual information regarding rocket flight and the ceding of control to the MFCO was obtained in a phone conversation between Board Legal Staff and Phil Anderson, United Launch Alliance Vandenberg Air Force Base Range Coordinator, and in informal discussions with Vandenberg Air Force Base personnel.

control the launch vehicle. Therefore, from approximately five seconds before launch, the Range User is completely “hands off,” and whether the space flight succeeds or fails, the space flight property is either spent or destroyed.⁹

Once launched, the vehicle flies according to coordinates, orbital slots, and other guidance information pre-programmed into the navigational computer system pursuant to the customer’s direction. The computer systems are also pre-programmed to automatically make any necessary adjustments to reach the pre-programmed coordinates. The Range User has no ability to control the vehicle after launch, and from launch to approximately when the vehicle reaches orbital space (which is the Flight Control End of Mission if the flight is not terminated earlier), the MFCO has exclusive control over the vehicle to terminate flight and destroy the vehicle. The MFCO is responsible for making decisions concerning continued flight or flight termination, and bases that decision on interpreting real-time events, mission rules, all available data sources, and sound judgment. (AFSPCMAN 91-711, ¶ 7.1.2.)

Range personnel control also extends to aborted launches. If a launch is aborted and the status of the launch vehicle is unknown, Range personnel must assume that the vehicle may liftoff without warning and shall not release instrumentation until all launch safety requirements have been met and are no longer necessary. (AFSPCMAN 91-711, ¶ 7.3.1.) In fact, the flight safety system must remain configured in a manner that will enable the MFCO to take destruct action if necessary until he or she has received verification that the vehicle is no longer in launch configuration. (AFSPCMAN 91-711, ¶ 7.3.1.1.2.) Finally, in cases where the mission and/or launch countdown is terminated under normal circumstances, Range personnel shall not release instrumentation until all launch safety requirements have been met. (AFSPCMAN 91-711, ¶ 7.3.2.)

II. Legal Analysis

California Constitution, article XIII, section 1 provides that all property is taxable unless otherwise provided by the California Constitution or by the laws of the United States. (See also Rev. & Tax. Code, § 201.) All property includes tangible personal property. Revenue and Taxation Code¹⁰ section 219 provides a property tax exemption for business inventories and states: “For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories.” “Business inventories” are defined at section 129 as including “goods intended for sale or lease in the ordinary course of business” The Property Tax Law (Rev. & Tax. Code, § 50 et seq.) does not specifically define this phrase. Rule 133, subdivision (a)(1)(A) provides that “[t]he phrase ‘ordinary course of business’ . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.”

In interpreting the business inventory exemption, a court has stated:

While statutes granting property tax exemptions are generally construed strictly, that approach “does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must

⁹ While we are aware that Range Users may be engaged in research and development with a goal of manufacturing reusable space flight property, to date, no Range User has received federal approval to put such space flight property to operational reuse.

¹⁰ All further statutory references are to the Revenue and Taxation Code unless otherwise indicated.

be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].”

(*Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 716 (hereafter *Transworld*)).

In determining whether property meets the definition of business inventory, courts have looked to whether sales tax is owed on transfers of property as an important factor. This is because sales tax is generally imposed on transfers of property that were held as business inventory prior to sale. Since sales tax is imposed on each retail sale (Rev. & Tax. Code, § 6051) and a retail sale is defined as “a sale for any purpose other than resale in the regular course of business” (Rev. & Tax. Code, § 6007), it necessarily follows that *prior* to a retail sale, the property is held and “intended for sale in the ordinary course of business.” If that property is “intended for sale in the ordinary course of business,” that property meets the section 129 definition of business inventory. In *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter *Westinghouse*), at issue was whether a soft drink manufacturer’s reusable containers supplied to wholesale customers were business inventory. The court, in determining that the containers were not business inventory, cited as one factor that the manufacturer did not collect sales tax reimbursement.¹¹ This is because if the containers were held as business inventory (i.e., “goods intended for sale in the ordinary course of business”), sales tax would have been due upon their transfer. Since sales tax was not due, the containers could not have been “goods intended for sale in the ordinary course of business” and, thus, did not meet the definition of business inventory. (See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [rotatable spare parts held not to be business inventory under facts where sales tax reimbursement was not collected].)

Thus, the courts have implicitly recognized that “goods intended for sale in the ordinary course of business” must have the same meaning for the same transaction. There is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes. Therefore, it follows that if sales tax is owed on a transfer of specified property in the ordinary course of business, then that property was “sold” in a retail sale and that same property was, prior to sale, property that was “intended for sale in the ordinary course of business” (i.e., business inventory).

“Sale” is defined broadly in the Sales and Use Tax Law to mean and include “[a]ny transfer of title or possession, exchange, or barter, conditional or otherwise, ***in any manner or by any means whatsoever***, of tangible personal property for a consideration.” (RTC § 6006, subd. (a), emphasis added.) Thus, if possession is transferred for a consideration, a sale has transpired and sales tax is imposed on that transfer. In the case of space flight property, consideration is paid by the customer that requires transfer of control of the property to a federal launch safety authority. As explained above, possession of that property is transferred upon launch when the MFCO (i.e., the federal launch safety authority) takes control over the property for safety purposes. Because the federal launch safety authority has the sole discretion to destroy the property, all meaningful control is in the safety authority’s hands. Such transfer at launch is a retail sale for sales tax purposes pursuant to sections 6006 and 6007. Therefore, but for a specific exemption, space flight property companies would owe sales tax on such transfers.¹²

¹¹ Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers as provided in Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*. (Cal. Code Regs., tit. 18, § 1700.)

¹² Section 6380 exempts qualified property for use in space flight from sales and use tax.

Since the transfer of control to the federal launch safety authority of such property upon launch for consideration is a "sale," prior to transfer, such properties are "goods intended for sale in the ordinary course of business." Since such properties are "goods intended for sale in the ordinary course of business," they are business inventory within the meaning of sections 129 and 219 and Property Tax Rule 133. We note that this analysis also considers the heavy federal regulation under which the space flight industry must operate that restricts the transfer of title to such property.¹³ This satisfies the Rule 133 requirement to construe the phrase "ordinary course of business" in accordance with "the regular and usual practice and method of the business of the vendor or lessor." (Rule 133, subd. (a)(1)(A).)

Finally, the classification of space flight property meeting the requirements of proposed Rule 133, subdivision (a)(2)(E) as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. In *Transworld, supra*, 78 Cal.App.4th 713, the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer's direction. Implicit in the court's reasoning was that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. (See also *Westinghouse, supra*, 203 Cal.App.3d 1442 [reusable containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers].) As noted above, in the case of space flight property, all delivery coordinates are pre-programmed pursuant to the customer's direction, and all meaningful control of space flight property is transferred to the federal launch safety authority upon launch since that authority has the sole discretion to destroy the property.

Therefore, based upon the above discussion of sales and use tax and property tax law, and the heavy federal regulation which constrains the transfer of title to space flight property, space flight property for which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as business inventory. As business inventory, such property qualifies for the business inventory exemption under sections 129 and 219.

If you need more information or have any questions, please contact Robert Tucker, Assistant Chief Counsel, at (916) 322-0437 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

Approved:

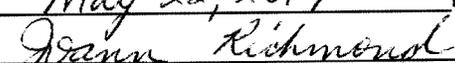

 Cynthia Bridges
 Executive Director

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STATE BOARD OF EQUALIZATION



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- Mr. Todd Gilman MIC: 70
- Mr. Dean Kinnee MIC: 64
- Mr. Robert Tucker MIC: 82
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BOARD APPROVED *as amended*
 At the May 22, 2014 Board Meeting

 Joann Richmond, Chief
 Board Proceedings Division

¹³ See, for example, the Arms Export Control Act (22 U.S.C. § 2778) and the International Traffic in Arms Regulations (22 C.F.R. §§ 120-130).



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State Controller

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April 4, 2014

No. 2014/016

TO COUNTY ASSESSORS, COUNTY COUNSELS,
AND OTHER INTERESTED PARTIES:

**Notice of Proposed Regulatory Action
by the
State Board of Equalization**

**Proposed to Adopt
Amendments to California Code of Regulations, Title 18,
Section 133, *Business Inventory Exemption***

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Government Code section 15606, proposes to adopt amendments to California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*. The proposed amendments to Property Tax Rule 133 clarify that space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List, and the control of which is relinquished by the owner upon launch, is classified as business inventory within the meaning of Revenue and Taxation Code (RTC) sections 129 and 219.

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on May 22-23, 2014. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on May 22 or 23, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Property Tax Rule 133.

AUTHORITY

Government Code section 15606

REFERENCE

RTC sections 129 and 219

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

California Constitution, article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. All property includes tangible personal property. However, RTC section 219 provides that, "For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories."

Under Government Code section 15606, subdivision (c), the State Board of Equalization (Board) is authorized to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f) authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures." The Board adopted California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, pursuant to Government Code section 15606, to implement, interpret, and make specific the provisions, under article XIII of the California Constitution and the RTC, applicable to the exemption of business inventories.

In particular, Property Tax Rule 133 implements, interprets, and makes specific RTC sections 129 and 219. RTC section 129 defines "business inventories" as follows:

"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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

"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.

“Business inventories” shall also include goods held by a licensed contractor and not yet incorporated into real property.

As relevant here, subdivision (a)(1) of Property Tax Rule 133 further defines the term “business inventories” and also defines the phrases “ordinary course of business” and “goods intended for sale or lease,” as used in RTC section 129. The Board added the current provisions of subdivision (a)(2)(A), (C), and (D) to Property Tax Rule 133, in 2000, in order to provide a list of the specific types of property that the Board had previously determined are included within the meaning of the term “business inventories” prior to 2000. And, the Board added subdivision (a)(2)(B) to Property Tax Rule 133, in 2000, to clarify that the Board had recently determined that new and used oak barrels are business inventories, under specific circumstances.

Effects, Objectives, and Benefits of the Proposed Amendments

The transfer of control of space flight property to the federal government is required by Air Force Space Command (AFSPC). Authority over space flight property launch is granted to the Air Force via the Commercial Space Launch Act of 1984, as amended in 1988 (49 U.S.C. §§ 2601-23, October 30, 1984) which grants regulatory authority over space flight property to the Department of Transportation, which through the Federal Aviation Administration Office for Commercial Space Transportation entered into an agreement with the United States Air Force regarding the implementation of procedures for commercial space transportation and range activities. (See Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities, at https://www.faa.gov/about/office_org/headquarters_offices/ast/media/moa.pdf (as of March 18, 2014).)

AFSPC directs safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch. (Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91-711 (February 1, 2007) (AFSPC Manual 91-711) provide mission flight control officers with power to issue flight termination commands.)

The federal launch safety authority, in its sole discretion, may terminate the flight. (AFSPC Manual 91-711, § 7.1.1.1.) Termination of the flight would result in destruction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

Prior to December 2013, the Board had provided general guidance regarding the business inventory exemption and specific guidance regarding its application to various types of property; however, the previous Board guidance had not specifically discussed the application of the business inventory exemption to space flight property. By letter dated December 24, 2013, the Board’s Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over

which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also opined that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory "goods intended for sale . . . in the ordinary course of business." The Property Tax Law (RTC § 50 et seq.) does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that, "The phrase 'ordinary course of business' . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor." Due to the unique nature of the space flight industry, the determination of whether space flight property is a "good intended for sale in the ordinary course of business" must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property. (The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles (22 U.S.C. § 2278, subd. (a)(1)); and the Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List (22 C.F.R. §§ 120-130).) Within that context, the Board's Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a "sale" and makes space flight property "goods intended for sale in the ordinary course of business" within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board's Legal Department also based its determination that space flight property is business inventory, under such circumstances, on that fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board's Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer's reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement under Cal. Code Regs., tit. 18, § 1700]); See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts – held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer's gross receipts from each "retail sale," which is defined as "a sale for any purpose other than resale in the regular course of business." (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was "sold" in a retail sale and that same property was necessarily, prior to sale, property that was "intended for sale in the ordinary course of business" (i.e., business inventory). Thus, the courts recognize that the definition of "goods intended for sale in the ordinary course of business" must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other

words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term “sale” means any transfer of title to or possession of property for a consideration and the term “transfer of possession” includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for the specific exemption for qualified property for use in space flight provided by RTC section 6380, space flight property companies would owe sales tax on such transfers. Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO2 containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller’s control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer’s direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that “[w]hile statutes granting property tax exemptions are generally construed strictly, that approach ‘does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].’” (*Id.* at p. 716.) Therefore, based upon the heavy federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board’s Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219.

In Letter to Assessors (LTA) 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, the Board’s Property and Special Taxes Department advised interested parties that a project had been initiated to proposed revisions to Property Tax Rule 133 due to

“inquiries as to whether the business inventory exemption applies to certain space flight property regulated under the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR)” (footnotes omitted). The LTA also noted the Legal Department’s December 24, 2013, letter regarding space flight property (discussed above), provided a link to a redacted copy of the letter posted on the Board’s website, and gave the interested parties an opportunity to provide comments and suggestions by January 31, 2014.

Board staff conducted an interested parties meeting on February 6, 2014, to discuss the proposed revisions to Property Tax Rule 133. Staff subsequently prepared Formal Issue Paper 14-002, which included as attachments the comments received in support of and in opposition to Board staff’s proposed amendment to Property Tax Rule 133, and submitted it to the Board for consideration during its February 25, 2014, Property Tax Committee meeting.

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)(1):

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase “control over which is relinquished by the owner upon launch” means the transfer of control to a federal launch safety authority for space flight termination purposes.

In addition, in the formal issue paper, Board staff summarized the comments in support of and in opposition to its proposed amendments to Property Tax Rule 133. Board staff responded to the comments in opposition. Board staff also specifically explained that the proposed amendments clarifying the definition of “business inventories” will not apply to “reusable” space flight property. Board staff specifically explained that its proposed amendments are “very narrowly tailored to interpret [RTC] sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch.” Board staff specifically explained that the proposed amendments are more limited than the exemption afforded by Assembly Bill No. (AB) 777 (2013-2014 Reg. Sess.) because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all spaceflight property whether inventory or not. And, Board staff specifically explained that “[because the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of rulemaking.”

At the conclusion of the Board's discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is necessary to amend Property Tax Rule 133, as recommended by staff, to have the effect and accomplish the objective of addressing the application of the business inventory exemption to space flight property. Therefore, the Board agreed with staff's recommendation and the Board Members unanimously voted to propose the amendments to Property Tax Rule 133 recommended by staff, and requested that staff provide additional clarification regarding the "ceding of control" and additional analysis of the federal authority regarding the transfer of control, which is provided above and in the initial statement of reasons.

The Board anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

The Board has performed an evaluation of whether the proposed amendments to Property Tax Rule 133 are inconsistent or incompatible with existing state regulations. The Board has determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Property Tax Rule 133 is the only regulation implementing RTC sections 129 and 219, and the proposed amendments make Property Tax Rule 133 consistent with the statutes as discussed above. In addition, the Board has determined that there are no comparable federal regulations or statutes to Property Tax Rule 133 or the proposed amendments to Property Tax Rule 133.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will result in no direct or indirect cost or savings to any state agency, cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Property Tax Rule 133 will not have a significant, statewide adverse economic impact directly

affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Property Tax Rule 133 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will not affect the benefits of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Property Tax Rule 133 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Leslie Ang, Tax Counsel, by telephone at (916) 323-9856, by e-mail at leslie.ang@boe.ca.gov, or by mail at State Board of Equalization, Attn: Leslie Ang, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-

2130, by fax at (916) 324-3984 , by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on May 22, 2014, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Property Tax Rule 133 during the May 22-23, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Property Tax Rule 133. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underline and strikeout version of the text of Property Tax Rule 133 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Property Tax Rule 133 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

April 4, 2014

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Property Tax Rule 133, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's website at www.boe.ca.gov.

Sincerely,


Joann Richmond, Chief
Board Proceedings Division

JR:reb

**Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 133, *Business Inventory Exemption***

SPECIFIC PURPOSE AND NECESSITY

Current Law

California Constitution, article XIII, section 1 provides that, unless otherwise provided by the California Constitution or by the laws of the United States, all property is taxable. (See also Rev. & Tax. Code, § 201.) All property includes tangible personal property. However, Revenue and Taxation Code (RTC) section 219 provides that, “For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories.”

Under Government Code section 15606, subdivision (c), the State Board of Equalization (Board) is authorized to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Government Code section 15606, subdivision (f) authorizes the Board to prescribe “rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures.” The Board adopted California Code of Regulations, title 18, section (Property Tax Rule) 133, *Business Inventory Exemption*, pursuant to Government Code section 15606, to implement, interpret, and make specific the provisions, under article XIII of the California Constitution and the Revenue and Taxation Code, applicable to the exemption of business inventories.

In particular, Property Tax Rule 133 implements, interprets, and makes specific RTC sections 129 and 219. RTC section 129 defines “business inventories” as follows:

“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 also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

“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.

“Business inventories” shall also include goods held by a licensed contractor and not yet incorporated into real property.

As relevant here, subdivision (a)(1) of Property Tax Rule 133 further defines the term “business inventories” and also defines the phrases “ordinary course of business” and “goods intended for sale or lease,” as used in RTC section 129. The Board added the current provisions of subdivision (a)(2)(A), (C), and (D) to Property Tax Rule 133, in 2000, in order to provide a list of the specific types of property that the Board had previously determined are included within the meaning of the term “business inventories” prior to 2000. And, the Board added subdivision (a)(2)(B) to Property Tax Rule 133, in 2000, to clarify that the Board had recently determined that new and used oak barrels are business inventories, under specific circumstances.

Proposed Amendments

Need for Clarification

The transfer of control of space flight property to the federal government is required by Air Force Space Command (AFSPC).¹ AFSPC directs safety requirements for both range users and air force space command organizations and requires that control over space flight property be transferred to a federal launch safety authority for flight termination purposes upon launch.² The federal launch safety authority, in its sole discretion, may terminate the flight.³ Termination of the flight would result in destruction of the space flight property. Because the federal launch safety authority may, in its sole discretion, destroy the space flight property, all meaningful control over such property has been ceded to it.

Prior to December 2013, the Board had provided general guidance regarding the business inventory exemption and specific guidance regarding its application to various types of property; however, the previous Board guidance had not specifically discussed the

¹ Authority over space flight property launch is granted to the Air Force via the Commercial Space Launch Act of 1984, as amended in 1988 (49 U.S.C. §§ 2601-23, October 30, 1984) which grants regulatory authority over space flight property to the Department of Transportation, which through the Federal Aviation Administration Office for Commercial Space Transportation entered into an agreement with the United States Air Force regarding the implementation of procedures for commercial space transportation and range activities. (See Memorandum of Agreement Between Department of the Air Force and Federal Aviation Administration on Safety for Space Transportation and Range Activities, at https://www.faa.gov/about/office_org/headquarters_offices/ast/media/moa.pdf (as of March 18, 2014).)

² Chapters 6 and 7 of Launch Safety Requirements for Air Force Space Command Organizations, Air Force Space Command Manual 91-711 (February 1, 2007) (AFSPC Manual 91-711) provide mission flight control officers with power to issue flight termination commands.

³ AFSPC Manual 91-711, § 7.1.1.1.

application of the business inventory exemption to space flight property. By letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch. In the letter, the Board's Legal Department also noted that Property Tax Rule 133 should be amended to specifically address the applicability of the business inventory exemption to space flight property governed by federal statutes and regulations.

As relevant here, RTC section 129 includes as business inventory "goods intended for sale . . . in the ordinary course of business." The Property Tax Law (RTC § 50 et seq.) does not specifically define this phrase. Property Tax Rule 133, subdivision (a)(1)(A) provides, however, that, "The phrase 'ordinary course of business' . . . require[s] that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor." Due to the unique nature of the space flight industry, the determination of whether space flight property is a "good intended for sale in the ordinary course of business" must be based upon all the relevant facts and circumstances and take into account the heavy federal regulation which constrains the transfer of title of space flight property.⁴ Within that context, the Board's Legal Department determined that the transfer of control to the federal launch safety authority upon launch, for a consideration, is a "sale" and makes space flight property "goods intended for sale in the ordinary course of business" within the meaning of RTC sections 129 and 219 and Property Tax Rule 133. The Board's Legal Department also based its determination that space flight property is business inventory, under such circumstances, on that fact that it is consistent with the Sales and Use Tax Law (RTC § 6001 et seq.) as well as case law regarding the business inventory exemption from property tax.

In determining whether property qualifies as business inventory for property tax purposes, the Board's Legal Department found that courts have looked to whether sales tax is owed on transactions involving the property as an important factor in determining whether that property was in fact sold and intended for sale (i.e., was business inventory) prior to such sale. (See *Westinghouse Beverage Group v. County of San Diego* (1988) 203 Cal.App.3d 1442 (hereafter, *Westinghouse*) [soft drink manufacturer's reusable containers supplied to wholesale customers held not to be business inventory where manufacturer did not collect sales tax reimbursement⁵]; See also *Amdahl Corporation v. County of Santa Clara* (2004) 116 Cal.App.4th 604 [sales tax reimbursement not collected on rotatable spare parts – held not business inventory].) This is because sales tax is imposed on retailers and is measured by each retailer's gross receipts from each "retail

⁴ The Arms Export Control Act (AECA) (22 U.S.C. § 2778) authorizes the President to designate items as defense articles and defense services on the United States Munitions List (Munitions List) for purposes of promulgating regulations for the import and export of such articles. (22 U.S.C. § 2278, subd. (a)(1).) The Munitions List is contained in and regulated by the International Traffic in Arms Regulations (ITAR), which places a number of requirements on any company intending to export items on the Munitions List. (22 C.F.R. §§ 120-130.)

⁵ Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers as provided in Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*. (Cal. Code Regs., tit. 18, § 1700.)

sale,” which is defined as “a sale for any purpose other than resale in the regular course of business.” (RTC §§ 6006, 6007, and 6051.) And, it follows that if sales tax is owed on a transaction involving specified property that was entered into in the ordinary course of business, then the property was “sold” in a retail sale and that same property was necessarily, prior to sale, property that was “intended for sale in the ordinary course of business” (i.e., business inventory). Thus, the courts recognize that the definition of “goods intended for sale in the ordinary course of business” must have the same meaning for the same transaction, and thus the same definition is applicable to both sales and property tax. In other words, there is not one definition of inventory for sales tax purposes and a different definition of inventory for property tax purposes.

In addition, under the Sales and Use Tax Law, the term “sale” means any transfer of title to or possession of property for a consideration and the term “transfer of possession” includes those transactions found by the Board to be in lieu of a transfer of title. (RTC § 6006.) Due to the unique nature of the space flight industry, the Board’s Legal Department concluded that when a space flight property company transfers possession (control) of specified space flight property to the federal government at launch, for a consideration paid to the company by its customer, the transfer of possession is in lieu of a transfer of title. Accordingly, the transfer of space flight property to federal government control at launch, for a consideration, is a retail sale for sales tax purposes pursuant to RTC sections 6006 and 6007. And, but for a specific exemption, space flight property companies would owe sales tax on such transfers.⁶ Therefore, since for sales tax purposes, a retail sale has taken place under such circumstances, it necessarily follows that such goods, prior to sale, were intended for sale in the ordinary course of business, requiring the classifying of such property as business inventory.

Furthermore, the classification of space flight property as business inventory is also consistent with California property tax cases considering the element of control over the property in determining whether the property qualifies for the business inventory exemption. For example, in *Westinghouse, supra*, 203 Cal.App.3d 1442, the court considered syrup and CO2 containers. It held that such containers did not qualify as inventory since the seller retained control over the containers on the lien date even though the containers were in the physical possession of its customers. The court contrasted this situation with returnable bottles in which soft drinks are sold because the bottles were not within the seller’s control once sold. In *Transworld Systems v. County of Sonoma* (2000) 78 Cal.App.4th 713, 717 (hereafter, *Transworld*), the court opined that property transferred with a nonprofessional service constituted business inventory since the goods were transferred away from the business pursuant to a customer’s direction. Implicit in this reasoning is that the customer, not the business, had control, albeit indirect, of where the goods would be delivered. Also, in *Transworld*, the court explained that “[w]hile statutes granting property tax exemptions are generally construed strictly, that approach ‘does not require that the narrowest possible meaning be given to words descriptive of the exemption, for a fair and reasonable interpretation must be made of all laws, with due regard for the ordinary acceptance of the language employed and the object sought to be accomplished thereby. [Citations].’” (*Id.* at p. 716.) Therefore, based upon the heavy

⁶ RTC section 6380 exempts qualified property for use in space flight from sales and use tax.

federal regulation, which constrains the transfer of title to space flight property, and the above discussion of property and sales tax law, the Board's Legal Department concluded that space flight property to which control is ceded to the federal launch safety authority, for a consideration, is property that is intended to be sold in the ordinary course of business and is properly classified as inventory. And, as inventory, such property qualifies for the business inventory exemption under the current provisions of RTC sections 129 and 219.

Interested Parties Process and Property Tax Committee Meeting

In Letter to Assessors (LTA) 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, the Board's Property and Special Taxes Department advised interested parties that a project had been initiated to propose revisions to Property Tax Rule 133 due to "inquiries as to whether the business inventory exemption applies to certain space flight property regulated under the Arms Export Control Act (AECA) and the International Traffic in Arms Regulations (ITAR)" (footnotes omitted). The LTA also noted the Legal Department's December 24, 2013, letter regarding space flight property (discussed above), provided a link to a redacted copy of the letter posted on the Board's website, and gave the interested parties an opportunity to provide comments and suggestions by January 31, 2014.

Board staff conducted an interested parties meeting on February 6, 2014, to discuss the proposed revisions to Property Tax Rule 133. Staff subsequently prepared Formal Issue Paper 14-002, which included as attachments the comments received in support of and in opposition to Board staff's proposed amendments to Property Tax Rule 133, and submitted it to the Board for consideration during its February 25, 2014, Property Tax Committee meeting.

In the formal issue paper, Board staff recommended that the Board amend Property Tax Rule 133 to add subdivision (a)(1)(E), to clarify that space flight property, not operationally reusable and the control over which is relinquished by the owner upon launch, qualifies for the business inventory exemption. The formal issue paper recommended that the Board propose to add the following language to Property Tax Rule 133, subdivision (a)(1):

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase "control over which is relinquished by the owner upon launch" means the transfer of control to a federal launch safety authority for space flight termination purposes.

In addition, in the formal issue paper, Board staff summarized the comments in support of and in opposition to its proposed amendments to Property Tax Rule 133. Board staff responded to the comments in opposition (and those responses are hereby incorporated by reference). Board staff also specifically explained that the proposed amendments clarifying the definition of “business inventories” will not apply to “reusable” space flight property. Board staff specifically explained that its proposed amendments are “very narrowly tailored to interpret [RTC] sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch.” Board staff specifically explained that the proposed amendments are more limited than the exemption afforded by Assembly Bill No. (AB) 777 (2013-2014 Reg. Sess.) because Property Tax Rule 133 only applies to business inventory, while AB 777 would exempt all space flight property whether inventory or not. And, Board staff specifically explained that “[b]ecause the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of rulemaking.”

At the conclusion of the Board’s discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that there is an issue (or problem within the meaning of Gov. Code, § 11346.2. subd. (b)(1)) because Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is reasonably necessary to amend Property Tax Rule 133, as recommended by staff, for the specific purpose of addressing that issue. Therefore, the Board agreed with staff’s recommendation and the Board Members unanimously voted to propose the amendments to Property Tax Rule 133 recommended by staff, and requested staff to provide additional clarification regarding the “ceding of control” and additional analysis of the federal authority requiring the transfer of control, which is provided above.

The Board anticipates that the proposed amendments to Property Tax Rule 133 will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

The proposed amendments to Property Tax Rule 133 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Property Tax Rule 133.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-002, the attachments to the issue paper, and the comments made during the Board’s discussion of the issue paper during its February 25, 2014, Property Tax Committee meeting in deciding to propose the amendments to Property Tax Rule 133 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Property Tax Rule 133 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Property Tax Rule 133 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The proposed amendments to Property Tax Rule 133 clarify that, under current law, the business inventory exemption applies to space flight property, under specified circumstances. The proposed amendments are consistent with the current provisions of RTC sections 129 and 219 and the cases applying those sections, the current provisions of Property Tax Rule 133, and the Sales and Use Tax Law. And, the Board anticipates that the proposed amendments will promote fairness and benefit taxpayers, Board staff, and the Board, by clarifying that RTC sections 129 and 219 apply to non-reusable space flight property, the control over which is relinquished by the owner upon launch.

As a result, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business that is in addition to whatever economic impact the enactment of RTC sections 129 and 219 has had and will have on individuals and businesses. And, the Board has determined that the proposed amendments to Property Tax Rule 133 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period. Also, based on the above information and all the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Property Tax Rule 133 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

In addition, Property Tax Rule 133 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Property Tax Rule 133 will not affect the benefit of Property Tax Rule 133 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Property Tax Rule 133 will not have a significant adverse economic impact on business.

The proposed amendments may affect small businesses.

**Text of Proposed Amendments to
California Code of Regulations, Title 18, Section 133**

133. Business Inventory Exemption.

(a) Scope of Exemption.

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property, not operationally reusable, listed in the International Traffic in Arms Regulations on the United States Munitions List (22 CFR § 121.1), the control over which is relinquished by the owner upon launch.

(i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel.

(ii) The phrase “control over which is relinquished by the owner upon launch” means the transfer of control to a federal launch safety authority for space flight termination purposes.

(b) Exclusions. Property eligible for the “business inventories” exemption does not include:

(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased. Examples of property excluded from business inventories are office supplies, furniture, machines and equipment and manufacturing machinery, equipment and supplies such as dies, patterns, jigs, tooling or chemicals used to produce a chemical or physical reaction, and contractors’ supplies, tools, concrete forms, and other items that will not be incorporated into and become a part of the property. Also ineligible are materials that a contractor is holding to incorporate into real property that will be retained for his own use.

(2) Property being used by its owner for any purpose not directly associated with the prospective sale or lease of that property.

(3) Property actually leased or rented on the lien date.

(4) Property which has been used by the holder prior to the lien date, even though held for lease on the lien date.

(5) Property intended to be used by the lessor after being leased or during intervals between leases even though held for lease on the lien date.

(6) Property in the hands of a lessor who, with intent to enjoy the benefits of the inventory exemption, had leased the property for a period that expired shortly before the lien date but who renewed, extended or renegotiated the lease shortly thereafter.

(c) Service Enterprises. Property held by a person in connection with a profession which is primarily a service activity such as medicine, law, architecture or accountancy is not “business inventories” held for sale or lease even though such property may be transferred to a patient or client incidental to the rendition of the professional service. Property held by enterprises rendering services of a nonprofessional type such as dry cleaners, beauty shop operators and swimming pool service companies is to be regarded as “business inventories” held for sale if such property is delivered as an item regularly included in the service.

(d) **Repairers and Reconditioners.** Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and materials shall be regarded as holding said parts and materials as “business inventories.”

(e) **Agricultural Enterprises.** Animals, crops and feed held primarily for sale or lease in the ordinary course of business are included in the term “business inventories,” as are animals used in the production of food or fiber and feed for such animals.

(1) “Animals used in the production of food and fiber” includes all animals customarily employed in the raising of crops or for the feeding, breeding and management of livestock, or for dairying, or any other confined animals whose products are normally used as food for human consumption or for the production of fiber useful to man. Excluded are animals held by an owner or lessee principally for sport, recreation or pleasure such as show animals, horses held for racing or horses and other animals kept as pets.

(2) The term “crops” means all products grown, harvested, and held primarily for sale, including seeds held for sale or seeds to be used in the production of a crop which is to be held primarily for sale. It does not include growing crops exempted pursuant to Article XIII, section 3(h), of the California Constitution or fruit trees, nut trees, and grapevines exempted by section 223 of the Revenue and Taxation Code.

(3) The term “food” means property normally considered as food for human consumption.

(4) Feed for animals held primarily for sale or lease or for animals used in the production of food or fiber constitutes “business inventories” subject to exemption. It includes every type of natural-grown or commercial product fed to animals except medicinal commodities intended to prevent or cure disease unless the medicinal commodities are purchased as a component part of feed for such animals.

Note: Authority cited: Section 15606, Government Code. Reference: Sections 129 and 219, Revenue and Taxation Code.

Regulation History

Type of Regulation: Property Tax

Rule: 133

Title: *Business Inventory Exemption*

Preparation: Leslie Ang

Legal Contact: Leslie Ang

The proposed amendments clarify that the business inventory exemption applies to space flight property, under specific circumstances.

History of Proposed Regulation:

May 22, 2014	Public Hearing
April 4, 2014	OAL publication date; 45-day public comment period begins; Interested Parties mailing
March 25, 2014	Notice to OAL
February 25, 2014	Property Tax Committee, Board Authorized Publication (Vote 5-0)

Sponsor: NA

Support: Capitol Strategies Group, Commercial Spaceflight Federation, Los Angeles County Economic Development Corporation, Reliance Machine Products, Inc., United Launch Alliance, Westco Aircraft Hardware Corp.

Oppose: California Assessors' Association, Los Angeles County Assessor, Santa Clara County Assessor