Assembly Bill 1157 (Nazarian)
Program: Property Tax
Sponsor: California Assessors' Association (CAA)
RTC Sections 401.17, 441, and 1153.5
Effective January 1, 2016

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Summary: Extends for one-year property tax law provisions related to commercial air carriers[1] that detail certificated aircraft[2] assessment methodology and allow centralized administrative procedures at the local level using a "lead county" system.

Purpose: To extend aircraft valuation methodology provisions and streamlined administrative procedures for counties and airlines that will otherwise sunset.

Fiscal Impact Summary: The revenue consequence of extending the sunset date versus allowing these laws to expire is unknown.

Existing Law: The law permits assessors and commercial air carriers to use a streamlined administrative procedure. In addition, the law details the assessment methodology to value certificated aircraft. These provisions are as follows.

Centralized System - One Return/One Audit.[3] The law allows commercial air carriers operating in multiple California airports to file a single consolidated property statement (tax return) with a designated "lead" county. The law outlines the lead county selection process for each air carrier. The selected county notifies the air carrier it will serve as the lead county,[4] and each air carrier files its annual tax return with that lead county. The tax return details necessary information about the air carrier's property holdings (both certificated aircraft and other business personal property and fixtures)[5] that are subject to property tax in California. The lead county transmits return information related to non-aircraft personal property and fixtures to other relevant counties where the air carrier operates. The law requires an audit team directed by the lead county to audit the air carriers. When the statutes sunset on December 31, 2015, air carriers must file returns with each individual county. In addition, each county will be required to audit the air carrier, if the air carrier's assessment qualifies as a mandatory audit in that county.

Lead County Calculates Fleet Value.[6] The lead county calculates the total unallocated fleet value of the air carrier's certificated aircraft for each make, model, and series, as described below,[7] and transmits the calculated fleet value to the other counties. To assess the aircraft, each county determines its allocated portion of the calculated fleet value based on the flight data for its particular county. The allocation process limits each county's assessment to reflect the aircraft's physical presence in that county. The law repeals these provisions on December 31, 2015.

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[1] Commercial air carriers include both passenger airlines and freight delivery services.
[2] Certificated aircraft includes certificated aircraft per Revenue and Taxation Code (RTC) Section 1150 and scheduled air taxi operators per RTC Section 1154 (a) and (b).
[3] RTC Section 441(m).
[4] RTC Section 1153.5.
[5] Business personal property subject to property tax includes items such as unlicensed surface vehicles, ground and cargo handling equipment, ramp equipment, machinery and other equipment, spare parts, rotables, computers, furniture, fuel and other supplies.
[6] RTC Section 1153.5.
[7] RTC Section 401.17.

Aircraft Valuation Methodology.[8] The law specifies an aircraft valuation methodology county assessors must use that expires this year; next year, the law will be silent on assessment methodology for certificated aircraft. The law provides that preallocated fair market value will be the lowest of:

- Trended acquisition cost less depreciation,
- Wholesale prices listed in the *Airliner Price Guide*, a commercially published value guide, less 10%, or,[9]
- Original price paid.

The resulting value is rebuttably presumed to be correct. After the 2015-16 fiscal year, these provisions are no longer effective. Assessors will assess aircraft at the "fair market value," as generally provided under Property Tax Law, using any valid approach to value.[10]

Proposed Law: This bill extends the current commercial air carrier administrative procedure and the aircraft valuation methodology provisions for use in the 2015-16 fiscal year to the 2016-17 fiscal year and extends the repeal date from December 31, 2015 to December 31, 2016.

In General: **Business Personal Property.** All property, real and personal, is subject to property tax, unless a specific constitutional or statutory exemption applies. Generally, taxability is determined on the lien date, January 1, of each year. The Constitution allows the Legislature to exempt or provide for differential taxation of any personal property with a 2/3 vote.[11]

Personal property used in a trade or business is taxable. Proposition 13's valuation limitations do not apply to business personal property. Consequently, the law requires the assessor to determine its current fair market value every year as of January 1. Mass appraisal techniques generally are necessary given the enormity of this task. To aid in the task, the law requires property owners to annually report their personal property holdings having an aggregate acquisition cost of $100,000 or more on a business property statement.[12]

The assessor determines the fair market value of most business personal property using the property's acquisition cost. The assessor multiplies acquisition cost by a price index (an inflation trending factor based on acquisition year) to estimate reproduction cost new. Next, the assessor multiplies reproduction cost new by a percent good factor (from BOE-issued percent good tables) to estimate depreciated reproduction cost (reproduction cost new less depreciation). The assessor uses the reproduction cost new less depreciation value as the property's taxable value for the fiscal year. The personal property tax rate is the same as the real property tax rate, which is 1% plus voter approved indebtedness in the locality. The BOE's Assessors' Handbook Section 504 *Assessment of Personal Property* provides more detailed guidance.

Certificated Aircraft. Certificated aircraft used by air carriers is subject to taxation when in revenue service in California. Generally, certificated aircraft are commercial aircraft operated by air carriers for passenger or freight service. California law[13] defines "certificated aircraft" as

> [A]ircraft operated by an air carrier or foreign air carrier engaged in air transportation, as defined in Section 40102(a)(2), (5), (6), and (21) of Title 49 of the United States Code, while

[8] RTC Section 401.17.
[9] Generally, the "Used Price of Average Aircraft Wholesale" listed guide value less 10% for a fleet discount.
[10] RTC Section 110 defines "fair market value" as the amount of cash … that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other…"
[11] California Constitution, Article XIII, Section 2.
[12] RTC Section 441.
[13] RTC Section 1150

there is in force a certificate or permit issued by the Federal Aviation Administration, or its successor, authorizing such air carrier to engage in such transportation.

Certificated aircraft are valued under a "fleet" concept. This means that the assessed value basis is not the value of any single aircraft owned by an air carrier, but rather the value of *all* aircraft of each type that is flown into the state. Aircraft regularly fly in and out of California and the various California counties with major airports; typically no single or particular aircraft remains located in the state on a permanent basis. Under the "fleet" concept, aircraft types that have gained situs in California by their entry into revenue service in this state are valued as a fleet, while only an allocated portion of the entire fleet's value is ultimately taxed to reflect actual presence in California's counties.[14] Under the federal Due Process and Commerce Clauses, personal property taxes on these aircraft must be fairly allocated.

The Fleet Concept - Example. An individual air carrier, Blue Sky Airlines, operates the following aircraft types in its overall fleet: Boeing 737-300s and 737-500s; Boeing 747-400s; and Boeing 767-200s and 767-300s. Each of these aircraft types (Boeing 737, 747, 767) is considered to be a fleet type. Thus, Blue Sky Airlines may have a fleet of 100 Boeing 737-500s, but only 30 of those aircraft make any contact in Sacramento County during the year. For purposes of property taxation in Sacramento County, the full cash value of all 100 of Blue Sky Airline's Boeing 737-500 aircraft is determined and then the computed allocation ratio is applied to that value.

Valuation and Allocation. For fiscal years 2005-06 to 2015-16,[15] the law details the assessor's assessment methodology for determining the market value of commercial air carrier-owned certificated aircraft.[16] The law provides an allocation formula to determine the frequency and the amount of time that an air carrier's aircraft makes contact and maintains situs within a county.[17] A BOE regulation provides further explanation of the allocation procedure.[18] The allocation ratio is made up of two components: a ground and flight time factor, which accounts for 75% of the ratio, and an arrivals-and-departures factor, which accounts for 25% of the ratio. The sum of these two factors yields the allocation ratio, which is applied to the full cash value of a fleet of a particular aircraft type operated by an air carrier and, thus, the assessed value calculation for that aircraft type. The sum of the assessed allocated values for each make and model used by an air carrier results in the total assessed value of the aircraft for that air carrier for a particular county.

Background:

Settlement Agreement. Prior to January 1, 1999, California law did not specify an assessment methodology for valuing certificated aircraft, or for valuing the carrier's taxable possessory interest in the publicly owned airport in which the aircraft operated. In 1997-98, a group of counties and air carrier industry representatives met to resolve property tax issues on air carrier-owned and -used property. The end result was a written settlement agreement to dispose of outstanding litigation and appeals over the valuation of airport possessory interest assessments and certificated aircraft. The Legislature codified the settlement agreement in a three-piece package:

Aircraft Valuation Methodology and Monetary Settlement. AB 1807 (Stats. 1998, Ch. 86; Takasugi) outlined the valuation procedures[19] for certificated aircraft during a six-year period, and provided $50 million in tax credits against future tax liabilities,[20] as well as extensive uncodified legislative findings and declarations.

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[14] Article 6 (RTC Sections 1150 to 1156) enacted in 1968 after the BOE requested the Legislature determine an allocation method that would be uniform. Assembly Revenue and Taxation Committee, Volume 4, Number 22, *A Study of Aircraft Assessment in California* (January, 1968).

[15] For fiscal years 1997-98 to 2003-04, assessors used another detailed methodology outlined in RTC Section 401.15.

[16] RTC Section 401.17.

[17] RTC Section 1152.

[18] Property Tax Rule 202, subdivision (c).

[19] RTC Section 401.15.

[20] RTC Section 5096.3. The settlement agreement also contained the tax credit provisions.

Airport Possessory Interests. AB 2318 (Stats. 1998, Ch. 85; Knox) specified the assessment methodology for valuing the air carrier's taxable possessory interest in publicly-owned airports.[21]

Tax Credits. SB 30 (Stats. 1998, Ch. 87; Kopp) added general purpose provisions to allow counties and taxpayers to enter into written settlement agreements granting taxpayers tax credits.[22]

Centralized System and Valuation Refinements. Beginning in 2006, AB 964 (Stats. 2005, Ch. 699; J. Horton) established the centralized administrative procedure for air carriers and counties using the lead county system. AB 964 also added a new valuation methodology and specified that the lead county would calculate total unallocated fleet value. The new methodology refined and built upon the first valuation methodology as follows:

- **Aircraft Types.** It distinguished between passenger aircraft (main-line jets or regional jets) and freighter aircraft (production or converted).
- **Variable Components.** It added detail for the variable components. To calculate a reproduction cost new less depreciation value indicator (i.e., the historical cost basis) each variable component was addressed; specifically: (1) acquisition cost, (2) price index, (3) percent good factor, and (4) economic obsolescence.
- **Airliner Price Guide.** It changed the prices used in the *Airliner Price Guide*, (APG) a "blue book" value guide for aircraft from the average of retail and wholesale prices to the wholesale price and additionally provided a 10% discount from the wholesale price to recognize that air carriers generally receive a fleet discount not reflected in the guide's listed wholesale prices.
- **Economic Obsolescence Adjustment.** It added detailed procedures to make economic obsolescence adjustments to capture significant market value changes (such as occurred after 9/11) due to severe airline industry economic condition changes.

Another written settlement agreement between counties and airlines accompanied AB 964. The agreement provided airlines with tax credits worth $25 million. Additionally, the parties agreed not to pursue embedded software issues[23] until after the 2010-11 fiscal year. The agreement extended the valuation methodology for use in the 2004-05 fiscal year, a period not otherwise covered in statute due to the sunset.

In 2009, AB 311 (Ma), as introduced, would have made the valuation methodology and centralized provisions permanent and, as amended, would have extended the effective date. However, Governor Schwarzenegger vetoed AB 311 because one airline disagreed with extending the valuation methodology as is, and the timing of the sunset allowed another year before the provisions sunset for all the parties to reach consensus.

In 2010, AB 384 (Stats. 2010, Ch. 228; Ma) extended these provisions to the 2015-16 fiscal year and extended the repeal date provisions to December 31, 2015. In addition, AB 384 changed the valuation provisions as follows:

- **Rebuttable Presumption of Correctness.** Expressly provided that the fair market value of certificated aircraft determined using the specified assessment methodology only enjoys a *rebuttable* presumption of correctness. Previously, the methodology-produced value was deemed to be the aircraft's fair market value.
- **Evidence for Rebutting Presumption.** Specified that the preallocated aircraft fair market value produced using the delineated methodology may be rebutted by evidence including, but not limited to, appraisals, invoices, and expert testimony.

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[21] RTC Section 107.9.
[22] RTC Section 5103.
[23] A computer program that is not a basic operational program under RTC Section 995 and 995.2.

- **Original Cost - Maximum Value for Original Owner.** Provided that the value of an individual aircraft assessed to the original owner of that aircraft is not to exceed its original cost from the manufacturer.

The maximum value cap provision was added to appease the airline that opposed AB 311 in the prior year. In calculating total fleet values, this provision requires the county to substitute the original price paid when it is lower than wholesale price less 10% for any individual aircraft in the fleet. This reduces the total fleet value for any airline able to purchase new planes at deeper discounts.

In 2005, AB 964 (J. Horton) initially proposed transferring assessment responsibility for commercial air carriers from the local county assessor to the BOE. Those provisions were amended out of the bill on May 26, 2005. In 2003, SB 593 (Ackerman) also proposed transferring these assessments to the BOE. The Senate Appropriations Committee held the bill in committee. In 2004, the California Performance Review Report[24] recommended to Governor Schwarzenegger that the BOE assess commercial airline-owned aircraft to address certain inefficiencies, which were subsequently mitigated in 2005 by AB 964's new centralized lead county system.

Related Legislation. This year, SB 661 (Hill) proposes to transfer assessment jurisdiction for commercial air carrier personal property, including certificated aircraft, to the BOE using the same valuation methodology for certificated aircraft assessors currently use.

Commentary:

1. **The May 4, 2015 amendments** extended current law for one more year rather than five years. This amendment was taken when the bill was heard in the Assembly Revenue and Taxation Committee. During the interim, the desire is that the airline industry and county assessors reach consensus on air carrier assessments.

2. **Certificated aircraft valuation is complex and contentious.** The statute that codifies aircraft valuation methodology is expiring. Extending the provisions for one more year provides a period of stability and allows for methodology re-evaluation and adjustment. A statutory methodology has been in place for 16 years and helps reduce conflict. While prior statutory methodologies have not eliminated conflict, they have narrowed its scope.[25] As noted in the legislative findings and declarations of both AB 1807 and AB 964 (see above), the assessment of certificated aircraft is a difficult and contentious property tax assessment issue that has given rise to litigation and appeals challenging assessments. The findings noted the Legislature's need to address the uncertainty because of the disruption to both airline industry tax planning and local government and school finance.

3. **How have aircraft been valued historically?**

   - **Trended Cost.** Before 1998, assessors based aircraft values on trended costs pursuant to RTC 110 fair market value standard and Assessors' Handbook guidelines on personal property assessments.

   - **Blue Book – Average Wholesale and Retail Prices.** Between 1998 and 2004, assessors based aircraft values on the average wholesale and retail APG value pursuant to RTC 401.15.

   - **Blue Book – Wholesale Prices Less 10%.** Between 2005 and 2010, assessors based aircraft values at the lower of (1) trended cost or (2) wholesale APG value less 10% pursuant to RTC 401.17.

[24] GG19 – Centralize for Efficiency the Assessment of Commercial Aircraft and CAA response.

[25] Beginning in August 2013, some airlines filed numerous appeals, lawsuits and claims for refund related to economic obsolescence calculations under RTC Section 401.17(a)(1)(C) and (D). Counties report that they have prevailed and their assessments have been upheld in cases before the local assessment appeals boards. Airlines report that the 44 lawsuits have been consolidated into one case which is pending in Orange County Superior Court.

- **Blue Book – Wholesale Prices Less 10%.** Between 2010 and 2015, assessors based aircraft values at the lowest of (1) trended cost, (2) wholesale APG value less 10%, or (3) original cost if original owner pursuant to RTC Section 401.17. Most air carriers currently have an assessment based on the wholesale price less 10%, as that method produces the lowest value.

4. **Lead-county fleet value calculation ensures statewide consistency in the base valuation of the fleet.** Extending the centralized procedure's sunset date ensures continued uniform certificated aircraft assessments for each carrier statewide. Before the centralized procedures, air carriers contended that although counties used the same assessment methodology, the fleet value calculations differed. Counties countered that the value discrepancies could be traced to (1) differences in the air-carrier-reported-information provided to different counties and (2) audit-related changes resulting from an individual county audit.

5. **The lead county system promotes administrative efficiency for both air carriers and counties.**

   - **One Return.** This eliminates any airline-reporting discrepancies to counties. Since air carriers may report all information to a single county, which is then distributed, all counties can receive the same information. This also reduces airline tax return compliance costs by eliminating duplicative reporting. Non-aircraft personal property must still be identified by tax rate area to ensure that local jurisdictions receive their share of property tax revenue for property located within their boundaries.

   - **One Audit.** This limits the airline to a single audit by one multi-county audit team and reduces auditing costs incurred by both counties and air carriers for duplicative audits.

6. **The current reporting practices of airlines.** The law[26] requires aircraft information to be filed with the lead county and all airlines do so. While the law also requires airlines to file "one signed property statement for [the airline's] personal property at all airport locations and fixtures at all airport locations" in practice this does not always occur. With respect to flight activity information, some airlines report all flight activity segregated by airport location with the lead county and others instead report flight activity directly to each county. With respect to non-aircraft personal property and fixtures, many airlines continue to file with each county despite the streamlining provisions in law since 2006. Additionally, the law[27] gives airlines the option to file electronically via the California Assessor's Standard Data Record network.

7. **Rebuttable Presumption of Correctness.** The annual fair market value determined using the proposed methodology only enjoys a rebuttable presumption of correctness. Thus, either the assessor or the air carriers could rebut the presumption.

   - If the assessor deviates from the methodology, the assessor would lose the presumption of correctness before the appeals board should the air carrier appeal the assessment.

   - If the assessor uses the methodology and the taxpayer appeals those assessments, the taxpayer must provide sufficient evidence to overcome the presumption of correctness.

8. **What happens if the provisions sunset?** Administration returns to the pre-2006 system without unallocated fleet value calculations by a lead county. Without centralization, each county would calculate the total aircraft fleet value and audit each airline that lands in their county if the assessment qualifies as a mandatory audit. The valuation method returns to pre-1999 "fair market value" standard without a delineated methodology specific to certificated aircraft.

   - **Property Statements.** Airlines would file separate property statements with every county. Prior to 2006, air carriers' submitted duplicative aircraft fleet information to every county for every

[26] RTC Code Section 441(m)(1)
[27] RTC Code Section 441(m)(4)

location in which they operated. The one-stop reporting to a single lead-county reduced the carriers' administrative burdens.

- **Value Method.** Assessors could use any valid method (cost, income, comparable sales, published market value guides) to determine fair market value, as defined in RTC Section 110.
- **Uniformity**. The California Assessors' Association Aircraft Advisory subcommittee could continue to recommend valuation methodologies for all assessors to ensure statewide uniformity. Nonetheless, individual assessors still may use different valuation methods, such as trended cost basis or market/comparable sales basis using the *Airliner Pricing Guide.*
- **Audits**. Counties would need to perform, and airlines would endure, multiple audits.
- **Presumption of Correctness.** Only the assessor would enjoy the presumption of correctness in any appeal. The burden of proof would rest with the airline challenging assessed values.

9. **A codified valuation methodology addresses appraisal process variables.** Codifying a valuation methodology reduces conflict by specifying which of the many variables to use in the valuation process, such as:

   - Cost basis (i.e., trended cost, reproduction/replacement cost new less depreciation, historical cost less depreciation)
   - Trending. (The inflation rate benchmark selected to trend historical cost to current cost or eliminating any trending factor.)
   - Depreciation schedule (i.e., life term selected and method selected such as straight-line depreciation, declining-balance method, or booked depreciation)
   - Minimum value (i.e., floor percentage or remove any floor)
   - Functional and economic obsolescence adjustments
   - Embedded software adjustments
   - Nontaxable intangible adjustments
   - Maintenance costs, capitalized addition costs
   - Market basis:
     - Commercial blue book selected (APG, Avitas, or Avmarkinc)
     - Edition Selected (Winter or Spring)
   - Blue book application:
     - Retail or Wholesale Price, Average, Weighted Average
     - Fleet Discount (amount, if any, applied)

10. **This bill will provide more certainty and predictability in the valuation of aircraft for both assessors and commercial air carriers.** Absent a codified methodology, there is no guarantee that the values determined by each individual county assessor would be the same, higher, or lower than they would be without this bill.

Administrative Costs: The BOE would incur minor absorbable costs to update various publications and the BOE's website.

Revenue Impact:

Background, Methodology, and Assumptions. The law requires the assessor to value certificated aircraft annually at fair market value. Absent a codified methodology, there is no guarantee that the values determined by each individual county assessor would be the same, higher, or lower than they would be without this bill.

Summary. This bill maintains the status quo. The revenue consequence of extending the sunset date versus allowing these laws to expire is unknown. The revenue realized under the existing valuation methodology might be different from the revenue derived from the methodology used prior to 1998 or some other methodology. Extending the existing valuation methodology, which includes a rebuttable presumption of correctness, may be a reasonable method to determine fair market value of certificated aircraft given the uncertainty that would otherwise exist.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.