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September 26, 2001

JAMES E. SPEED
Executive Director

Honorable Lawrence E. Stone
Santa Clara County Assessor
County Government Center, East Wing
70 West Hedding Street
San Jose, California 95110-1770

Attention: Ms. Ginny Hamley
Chief Auditor-Appraiser

Re: *Sales Tax as a Component of Value When Valuing an Aircraft*

Dear Mr. Stone:

This is in response to your August 23, 2001, letter to Ms. Kristine Cazadd concerning sales tax as a component of value when valuing an aircraft. According to your letter:

Santa Clara County discovers an aircraft located in the county on the lien date in question and determines the full cash value based on the make, model, year of manufacture, and other available data. Published guides are consulted, and sales tax is included in the final opinion of value.

Taxpayer files an appeal contesting the valuation.

At the assessment appeals board hearing, the taxpayer testifies that the aircraft was acquired out of State, kept out of State for more than ninety days, and then brought into California. He testifies that this is a common practice of large corporations to avoid paying sales tax, and he further testifies that the State Board of Equalization sanctions such practice. Therefore, the taxpayer contends that since sales tax was not paid, sales tax should not be added to the value for property tax purposes.

As hereinafter indicated, we are of the opinion that you are correct in including sales tax in final opinions of value. For property tax assessment purposes, if sales/use tax is applicable to similar consumers using aircraft at a similar trade level, sales/use tax is included in the assessment even when not paid at the time of sale/purchase because the Board through its Sales and Use Tax Department has found the transaction exempt from sales tax or use tax pursuant to the provisions of the Sales and Use Tax Law.

Your Analysis

The assessor's inclusion of sales tax is based on the following legal references relative to appraisal and valuation practices:

1. *Article XIII*, Section 1 of the California Constitution states, "All property is taxable and shall be assessed at the same percentage of fair market value." In Assessors' Handbook Section 501, *Basic Appraisal*, on page 15, the following excerpt is found: "The appraiser ... may consider location and current characteristics of the property that would be recognized in the general marketplace when ... estimating its market value to potential purchasers." It has always been our understanding that the equalization concept requires that sales tax be imputed as a valid component of cost whether or not it is actually paid.

2. In the Board's Property Taxes Law Guide, Revenue and Taxation Code section 110 footnotes, *Xerox Corp. v. Orange County* (1977), 66 Cal. App. 3d 746 is cited: "Under the market value concept, where price is the basis of value, the sales tax and freight charges are elements of value."

3. Assessors' Handbook Section 577, *Assessment of General Aircraft*, page 7, under *The Cost Approach* heading, wherein it states, "Cost should be understood to include cash selling price, sales tax, and any delivery charges."

Further, in this handbook, page 7, under the heading *Market Value Guide*, there is a reference to use of Assessors' Handbook Section 587, *Aircraft Valuation Data*,¹ Here the statement is made, "From these sources, market values for many makes and models of aircraft have been estimated. These market values include sales tax."

4. Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures*, at page 55, states, "The general rule in determining market value is that where price is the basis of value, sales/use tax, freight, and installation cost are elements of value. These elements should be included in full economic cost since they are part of value when they are paid. However, if these costs would have been applicable to a similar consumer using the equipment at a similar

¹ As you know, this handbook was discontinued in 1996 when the Board decided to use commercial value guides. See January 31, 1997, Letter to Assessors No. 97/03, *General Aircraft Value Guide*, copy enclosed.

trade level, they may be assessable even when not paid. The costs apply at the same rate that would apply to that similar consumer whether actually paid or not."

Analysis

Initially, as you have noted, for property tax purposes, the general rule for determining market value is that, where price is the basis of value, sales tax is an element of value (*Xerox Corp. v. Orange County* (1977) 66 Cal. App. 3d 746). As stated by the court of appeal in that case:

"The Constitution of California provided on the lien dates applicable to these proceedings: 'All property in the State except as otherwise in this Constitution provided, not exempt under the laws of the United States, shall be taxed in proportion to its value, to be ascertained as provided by law, or as hereinafter provided.' (Cal. Const., art. XIII, § 1 [as amended in 1962].)

"(1) The legal standard of value in California, which has been described variously as 'value,' 'cash value,' and 'full cash value,' was defined on the lien date in question as:'. . . the amount at which property would be taken in payment of a just debt from a solvent debtor.' (Rev. & Tax. Code, § 110 [Stats. 1941, ch. 605, § 1, p. 2052].) This has been construed by the California Supreme Court to require that property be assessed at 'the price that property would bring to its owner if it were offered for sale on an open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other. It is a measure of desirability translated into money amounts [citation], and might be called the market value of property for use in its present condition.' (*De Luz Homes, Inc. v. County of San Diego*, 45 Cal. 2d 546, 562 [290 P. 2d 544].) (2) Thus, the standard of value for assessment is market value....(pgs. 752, 753)

X X X

"(6) Therefore, under the market value concept, where price is the basis of value, the sales tax is an element of value. The ultimate price the informed seller and buyer agree upon includes the amount of tax reimbursement. The retailer, absent exigent circumstances, would not sell for less, and the buyer purchases only if the value of the product to him justifies the total price." (pg. 758)

As to the assessment and valuation of general aircraft particularly, Revenue and Taxation Code sections 5301-5456, *Aircraft Assessment and Taxation*, apply to their assessment and valuation. Section 5364, *Board to Establish Assessment Standards*, states that the Board shall establish standards and fix guides or, after a public hearing, shall review and approve commercially available guides, to be used by the county assessor in the assessment of aircraft at market value. Section 5363, *Market Value*, states, in part, that in assessing aircraft, the county

assessor shall determine the market value of the aircraft in accordance with standards and guides to the market value of aircraft prescribed by the board.

Pursuant thereto, the Board in Assessors' Handbook AH 577, *Assessment of General Aircraft*, has stated as follows:

"CHAPTER 1: GENERAL

X X X

TAXATION

All property located in California is assessable unless specifically exempted. Since they have not been exempted, general aircraft are assessable and subject to property tax under California property tax law. General aircraft are taxed where they are habitually located at the same rate and in the same manner as all other taxable personal property....(pg. 1)

X X X

"CHAPTER 4: APPRAISAL

General

Market value is the standard of value that applies to general aircraft valuation. The fundamental principles of valuation which are applicable to other property apply equally to general aircraft.

The Market Approach

While the cost and income approaches are part of the appraisal process and each may contribute to the value conclusion, the market approach to value is by far the most reliable in the valuation of general aircraft.

The market approach involves an analysis of sales listings, offerings, opinions, and published market value guides of comparable aircraft or of the subject aircraft. Such data give an indication of what people in general are willing to pay for a particular model of aircraft at a certain time.

The Cost Approach

The cost approach employs the concept of replacement cost which is an estimate of the cost of replacing an aircraft with a similar one of equivalent utility.

The cost approach, to be useful, must also include an estimate of depreciation. Depreciation on aircraft is so variable that reasonable estimates are difficult.

The cost approach is used mostly with new aircraft that have list prices but no history of sales. The appraiser assumes that cost and value are the same in this circumstance. 'Cost' should be understood to include cash selling price, sales tax, and any delivery charges.

X X X (pgs. 7)

Market Value Guide

The standards and guides for valuing general aircraft may be found in the Assessors' Handbook section 587, *Aircraft Valuation Data*.² This handbook section has been developed in accordance with section 5364 of the Revenue and Taxation Code from sales, asking prices, rentals, leases, offers, and other data and is published annually. From these sources, market values for many makes and models of aircraft have been estimated. These market values include sales tax.

X X X" (pgs. 7-8)

Consistent therewith, former Assessors' Handbook Section 587, *Aircraft Valuation Data*,³ stated in this regard:

"I. Introduction

The 1987 market values shown in this handbook section are typical values for Federal Aviation Agency-licensed aircraft with a normal complement of equipment.

The values in this handbook apply to aircraft in consumers' hands and therefore include a 6 percent allowance for sales (or use) tax. Aircraft used by common carriers (airlines and air taxis) should be valued net of this tax allowance, as illustrated below:

Suggested		Sales/Use		Value if
AH 587		Tax		Used by
<u>Value</u>		<u>Adjustment</u>		<u>Air Taxi</u>
247,000	÷	1.06	=	233,000 (rounded)

X X X" (pg. 1)

Copies of the above-mentioned pages are enclosed.

² This handbook was discontinued in 1996 when the Board decided to use commercial value guides. See January 31, 1997, Letter to Assessors No. 97/03. However, the principles stated therein are still applicable.

³ See Footnotes 1 and 2, *infra*.

Finally in this regard, sales tax as a component of value when valuing aircraft, consistent with the Board's position that market values of general aircraft include sales tax, is one of the assessment areas reviewed by the Board's County Property Tax Division when conducting assessment practices surveys of county assessors' offices pursuant to Government Code sections 15640 et seq. For example, at page 21 of the October 1998 Modoc County Assessment Practices Survey, it is stated:

"We reviewed many of the assessor's boat and aircraft appraisals. The assessor's staff follows published value guides, including the *Aircraft Bluebook Price Digest* and the *ABOS* boat valuation guide. The assessor adjusts these published boat and aircraft value guides to local market conditions and adds sales tax. We have no recommendations or suggestions to make concerning the boat and aircraft assessment program."

Similarly, at page 24 of the July 2001 Lassen County Assessment Practices Survey, it is stated:

"The assessor's staff uses published value guides, including the *Aircraft Bluebook Price Digest*, *VREF* and the *ABOS* boat valuation guide. The assessor adjusts these values to include sales tax and to reflect local market conditions.

"X X X

"We have no recommendations or suggestions to make concerning the vessel and aircraft assessment program."

Copies of these pages and of pages 38-40 of the October 1999 Fresno County Assessment Practices Survey are enclosed for your review. The latter survey's pages provide a detailed discussion of circumstances in which market values of aircraft should include sales tax and circumstances in which they should not: if sales tax is typically included in the taxable value of the aircraft, it should be included in the value, whereas if aircraft are not subject to sales tax (common carriers), sales tax is not an element of their value.

The above is also consistent with the Board's position as to the assessment of personal property generally. It has long been the Board's position that typical, and valid, cost components of tangible personal property include sales tax or use tax, as the case may be. As stated in Assessors' Handbook AH 504, *Assessment of Personal Property and Fixtures*, on pages 52 through 53, sales tax may be either a direct or indirect cost, but it should always be included in the full economic cost:

"Valid Cost Components

A property's recorded purchase price does not necessarily reflect all costs required to estimate value for assessment purposes, nor does it necessarily exclude costs which do not contribute to value. In other words, not all costs contributing to value are booked and not all costs booked contribute to value....

It is important to be aware of all cost components. Rule 6 and Rule 10 define these costs as including labor, material, entrepreneurial services, interest on borrowed or owner-supplied funds, freight or shipping costs, installation costs, sales or use tax, and 'other costs typically incurred in bringing the property to a finished state (or to a lesser state if unfinished on the lien date).'¹⁰⁷

"Direct and Indirect Cost

Cost for assessment purposes may be thought of as *full economic cost*. Full economic cost should include all market costs, both direct and indirect, necessary to purchase or construct equipment and make it ready for its intended use. Costs which add value, direct and indirect, associated with manufacturing the equipment and/or making it ready for its intended use should be included in the full economic cost. Not all costs add value, for example, relocation costs are not costs contributing to the assessable value of the property. *Direct costs*, or "hard" costs, are expenditures for the labor, materials, and direct factory overhead required to construct the property whether purchased in the form of raw materials or a finished product. *Indirect costs*, or "soft" costs, include expenditures other than labor and material necessary to make the equipment ready for its intended use.

The following listing illustrates typical costs which should be included in full economic cost, that is, those costs typically incurred in bringing the property to a finished state. Some of the more common items are discussed in more detail in the pages following the table. These costs may be equal to, or more than, the cost to put the equipment in place.

<p style="text-align: center;">Table 4A Typical Valid Cost Components</p>

¹⁰⁷ Except personal property leased for a period of six months or less (Rule 10(c)) and for certain liquefied petroleum gas tanks as provided by Rule 153.

<u>PURCHASED EQUIPMENT</u>	
<u>DIRECT COSTS</u>	<u>INDIRECT COSTS</u>
<ul style="list-style-type: none">• Purchase price including sales tax, freight, trade-in allowances, and installation less discounts-- (with all features & attachments)¹⁰⁸	<ul style="list-style-type: none">• Unbooked sales/use tax,¹⁰⁹ freight-in,¹¹⁰ installation, etc.

XXX"

And at page 54, the handbook states that the assessor may presume fair market value from the property's full purchase price:

"Purchase Price

Normally, a recent purchase price is the best evidence of the value of an asset. The Revenue and Taxation Code permits the assessor to presume fair market value from property's full purchase price (less allowable discounts), but does not bind the assessor to rely upon it."¹¹¹

And at page 55, the general rule is stated, that sales tax must be included in the purchase price where price is the basis of value:

"Sales/Use Tax, Freight, and Installation

The general rule in determining market value is that where price is the basis of value, sales/use tax, freight, and installation cost are elements of that value.¹¹⁴ These elements should be included in full economic cost since they are part of value when they are paid. However, if these costs would have been applicable to a similar consumer using the equipment at a similar *trade level*, they may be assessable even when not paid.¹¹⁵ The costs apply at the same rate that would apply to that similar consumer whether actually paid or not.

However, there are exceptions to the general rule. Equipment rented to federal instrumentality's and aircraft used by common carriers (neither of which

¹⁰⁸ Purchase price total consideration whether money or otherwise; section 110.

¹⁰⁹ *Xerox Corporation v. County of Orange* (1977) 66 Cal. App. 3d. 746; *County of San Diego v. Assessment Appeals Bd. No. 2* (1983) 140 Cal. App. 3d. 52.

¹¹⁰ *Xerox Corporation v. County of Orange* (1977) 66 Cal. App. 3d. 746; *County of San Diego v. Assessment Appeals Bd. No. 2* (1983) 140 Cal. App. 3d. 52.

¹¹¹ *Dennis v. County of Santa Clara* (1989) 215 Cal. App. 3d 1019.

¹¹⁴ *Xerox Corp. v. Orange County* (1977) 66 Cal. App. 3d 746.

¹¹⁵ Property must be valued at the level situated on the lien date. This is the trade level concept. Thorough discussion of this topic is included later in this chapter.

are subject to sales tax), for example, are valued without sales tax as an element of value. The reason in both cases is that the consumer (federal government or air carrier) is never liable for sales tax on purchases of such equipment. Consequently, the replacement cost should not include sales tax, unless or until the property is put to private use or rented to a private party."¹¹⁶

Copies of pages 52-55 are enclosed for your information and review.

In sum, cost for assessment purposes is full economic cost, which includes all market costs, both direct and indirect, as defined, and which includes sales tax or use tax. And as indicated on page 55, above sales/use tax is a component of the full economic cost whether actually paid or not.

"...However, if these costs (sales/use tax) would have been applicable to a similar consumer using the equipment at a similar *trade level*, they may be assessable even when not paid.¹¹⁵ The costs apply at the same rate that would apply to that similar consumer whether actually paid or not."

Thus, even though the Board's Sales and Use Tax Division may have granted an exemption from sales tax or use tax on the sale or purchase of the aircraft pursuant to the provisions of the Sales and Use Tax Law which the Board administers, for property tax assessment purposes, if sales/use tax is applicable to similar consumers using aircraft at a similar trade level, sales/use tax is included in the assessment even when not paid at the time of sale/purchase.

The views expressed in this letter are advisory only. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

/s/ James K. McManigal, Jr.

James K. McManigal, Jr.
Tax Counsel IV

Enclosures

JKM:lg

Precedent/Valuadiv/01/05jkm.doc

¹¹⁶ See the Sales and Use Tax Law for more information regarding sales tax requirements.