



## STATE BOARD OF EQUALIZATION

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March 19, 2014

**Re: *Application of the Purchase Price Presumption to Sales of Fixtures  
Assignment No. 13-270***

Dear Mr. \_\_\_\_\_ :

This is in response to your letter requesting our opinion as to whether the purchase price presumption in Revenue and Taxation Code<sup>1</sup> section 110, subdivision (b) applies to an allocation of the purchase price of a business to fixtures.

**Facts**

You state as follows in your letter:<sup>2</sup>

1. All of B \_\_\_\_\_'s business assets—including fixtures, business personal property and intangibles—were purchased in two separate transactions.
2. The first sale occurred on April 12, 2006.
3. The second sale occurred during October 2007.
4. After each sale, B \_\_\_\_\_ reported its allocated purchase prices as the "acquisition costs" on its form 571-L business property statements filed with the applicable county assessors.
5. Those reported purchase prices were supported by appraisals provided.
6. Despite those reported purchase prices, county assessors continued to enroll the trended historical costs as the assessed values for B \_\_\_\_\_'s personal property and fixtures.

<sup>1</sup> All further statutory references are to the Revenue and Taxation Code unless otherwise specified.

<sup>2</sup> Although we are not certain as to some of the facts in your letter, we believe there are enough facts to provide responses to the questions you pose.

### Law & Analysis

California Constitution, article XIII, section 1, provides, in part, that all property "is taxable and shall be assessed at the same percentage of fair market value," and that "all property so assessed shall be taxed in proportion to its full value." (Cal. Const., art. XIII, § 1, subs. (a) and (b).) The standard of valuation prescribed by the Legislature is that all taxable property shall be assessed at its full cash value. (Rev. & Tax. Code, § 401.)

Full cash value or fair market value as defined in section 110 means the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither the buyer nor seller could take advantage of the exigencies of the other. (Rev. & Tax. Code, § 110, subd. (a).)

Subdivision (b) of section 110 (hereafter Section 110(b)) provides, in part, that:

For purposes of determining the 'full cash value' or 'fair market value' of real property . . . 'full cash value' or 'fair market value' is the purchase price paid in the transaction unless it is established by a preponderance of the evidence that the real property would not have transferred for that purchase price in an open market transaction. The purchase price shall, however, be rebuttably presumed to be the 'full cash value' or 'fair market value' if the terms of the transaction were negotiated at arms length between a knowledgeable transferor and transferee neither of which could take advantage of the exigencies of the other.

In estimating the full cash value of property, the assessor shall consider one or more of the five approaches to value as may be appropriate for the property being appraised. (Property Tax Rule<sup>3</sup> (Rule) 3, *Value Approaches*.) The three major appraisal approaches for estimating value – the cost approach, the comparative sales approach, and the income approach – apply to both real property and personal property. (Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures* (October 2002), p. 50.) The auditor-appraiser, therefore, should analyze all available information to determine the most applicable and reliable approaches. (*Ibid.*)

AH 504 states, in part:

The reproduction cost approach and the replacement cost approach, as discussed in Rule 6, are the variations most commonly used to value personal property and business fixtures at the county level. In general, these variations of the cost approach use historical or original cost information to estimate a . . . replacement cost new . . . . Then, the . . . replacement cost new is adjusted to reflect depreciation to arrive at an assessable value.

(See AH 504 at p. 52.)

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<sup>3</sup> Cal. Code Regs., tit. 18, § 3. All Rule references are to sections of title 18 of the California Code of Regulations.

Thus, the most common approach used by assessors to estimate the full cash value of personal property and fixtures is to use the original cost of the property factored up using price indexes to estimate replacement cost new, and then adjusted to account for depreciation using percent good factors. (See Rule 3, subd. (c); Assessors' Handbook Section 582, *Equipment and Fixtures Index, Percent Good and Valuation Factors* (January 2014).)

As you are aware, section 104 provides that real property includes improvements, and section 105, subdivision (a) provides that "improvements" includes "[a]ll buildings, structures, fixtures, and fences erected on or affixed to the land." Thus, for property tax purposes fixtures are considered real property and would generally be subject to the same constitutional, statutory, and regulatory provisions that apply to the valuation and assessment of other real property.

In this case, you ask whether the Section 110(b) purchase price presumption applies to the assessment of your client's fixtures and whether the assessor disregarded his obligation to apply the purchase price presumption to the purchaser's fixtures "absent additional appraisal evidence that those fixtures 'would not have transferred for the purchase price in an open market transaction?'"

In our view, Section 110(b) assumes an actual sale of the property being valued. Neither Section 110(b) nor Rule 2 states that the purchase price presumption applies to an allocation of a purchase price applied to individual assets purchased as a group of assets. This is consistent with the requirement for application of the purchase price presumption that the transaction be negotiated at arms-length between a knowledgeable transferor and transferee neither of which could take advantage of the exigencies of the other. In a sale of all of the assets of a business, typically each asset sold is not negotiated for separately. Instead, a total purchase price for all the assets is negotiated. Once that purchase price is agreed upon and the sale consummated, the purchaser allocates the purchase price to the individual assets purchased based on a number of potential considerations which may or may not include property taxation. We do not believe the purchase price presumption should apply in such situations because typically the purchaser alone controls the allocation of value and may do so with considerations other than property tax. For example, an allocation may be done for accounting purposes.<sup>4</sup> Therefore, AH 504 cautions that where a total purchase price has been allocated to various property types, the allocation may not be an accurate indication of market value. (AH 504, p. 55.) It also warns county assessors that:

Acquisitions of entire businesses, or total assets of an entity, should be given very close scrutiny. Frequently, liabilities are assumed, intangible property may be present, and the costs recorded on the books for the various acquired asset categories are merely allocations of the purchase price, and do not reflect the true market value of the taxable, tangible personal property, business fixtures, and leasehold or tenant improvements.

(*Ibid.*)

Therefore, where, as appears to be the case here, the total assets of an entity are sold and the aggregate purchase price includes many different assets, there is no assurance that the allocation to any individual asset is an accurate indication of fair market value.

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<sup>4</sup> See *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 567 [Accountants deal with past historical cost and the unamortized cost reflected on the balance sheet has no relation to the 'full cash value,' i.e., the price that a willing buyer would pay a willing seller].

This also summarizes our response to your question inquiring to what extent the reported purchase prices of your clients' personal property establishes fair market value evidence of that personal property – the allocated purchase prices of personal property are only the beginning and not the end of the inquiry. Since the Section 110(b) purchase price presumption does not apply to items of business personal property, the assessor may consider the allocated purchase price of personal property as one factor in determining its full cash value for property tax purposes.

The views expressed in this letter are only advisory in nature; 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.

Sincerely,

/s/ Susan Galbraith

Susan Galbraith  
Tax Counsel

SG:yg

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cc: Honorable

County Assessor

Mr. David Gau	MIC:63
Mr. Dean Kinnee	MIC:64
Mr. Todd Gilman	MIC:70