STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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DOUGLAS D. BELL
Executive Secretary

February 18, 1983

No. 83/21

TO COUNTY ASSESSORS:

INVESTMENT TAX CREDIT

Since 1962, the Internal Revenue Code has provided an investment tax credit (ITC) that may be claimed as a reduction of federal income taxes. The original credit amounted to a maximum of 7 percent of the cost of qualifying business property, was twice reduced to zero and later reinstated to 7 percent, and was increased to 10 percent (maximum) effective January 23, 1975.

Various arguments have been made that the ITC should be recognized as an element of market value for property tax purposes. The basic argument is that the ITC amounts to a direct, immediate reduction of the acquisition cost of business equipment, just as a manufacturer's rebate or cash discount reduces acquisition cost. The only difference between a purchase discount and the ITC is that the former is offered by the vendor and the latter by the federal government.

We cannot agree that the ITC is the same as a purchase discount or rebate. Discounts and rebates offered by a seller are a normal part of supply and demand in the process of setting market value, where the prudent buyer pays as little as reasonably possible and the seller charges as much as possible. The price paid for the property--after recognition of discounts and rebates--represents the amount received by the seller, as well as the cost to the buyer.

The ITC, by contrast, is simply a reduction of federal income tax liability. It is similar to depreciation or amortization charges against income for income tax purposes. The only real difference is that the tax benefits of depreciation vary according to the income tax rate bracket of the owner, whereas the ITC is not directly affected by the income tax rate.

Another important difference between purchase discounts and the ITC is that the discount is fully effective when the purchase is completed; the vendor who gave the discount has no interest in whether the purchaser keeps the equipment or disposes of it. The entire ITC is claimed for the year the property is acquired, but if the property is disposed of before a specified time, all or portions of the ITC must be "recaptured." The effect of this difference is that a person could sell a relatively new property at net price (list price less vendor's discounts) without losing money. However, the person would lose money if the property is sold for net price less the ITC because any ITC that was taken as a tax credit must be repaid.

Petitioners before our Board of Equalization have frequently urged our Board to reduce its assessment by recognizing a 10 percent reduction in acquisition costs due to investment tax credits. Our Board has consistently rejected such rationale and refused to reduce its assessments.

The ITC may be relevant for cash flow analysis or other processes where actual or estimated income tax liabilities are relevant. However, the ITC has no place in estimating replacement cost or market value of property.

Sincerely,

Verne Walton, Chief
Assessment Standards Division

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AL-08-1196A