State of California

Board of Equalization
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M e m o r a n d u m

Date: June 6, 2002

To: Mr. Dean Kinnee, MIC:64
Chief, Valuation Division

From: Mr. Robert Lambert
Senior Tax Counsel

Re: ***Correspondence of County Assessor's Office***

This is in response to your memorandum to Mr. Larry Augusta dated January 8, 2002. In that memorandum, you request our opinion on the following question: in calculating a cost indicator of value for certain equipment that has already been delivered to its location of use, should additional freight costs be added to the value indicator if the equipment is "returned for repair to Southern California and back?" As indicated below, we agree with your stated opinion that, while the costs necessary to transport the equipment to its ultimate location of use must be capitalized, any subsequent or additional transportation costs to return the equipment for repair should not be capitalized. Any such costs are beyond that necessary to merely place the property in service; and, thus, should not be included in applying a cost-based valuation methodology.

Background Information

The underlying facts are as follows: C (the taxpayer) buys vending machines and freezer boxes in bulk and then ships them to a central warehouse in Southern California. At that point, the taxpayer capitalizes the freight costs to date. Subsequently, the taxpayer ships each piece of equipment from the warehouse to its respective location of use. But the taxpayer does not capitalize the freight costs for these moves on the theory that they constitute "simply a relocation of equipment." The taxpayer goes on to ask the following question: "if freight is added for the shipment from the warehouse to location of use, then what happens when a machine has to be returned to Southern California for repair then returned – would freight be added again?"

Under these facts, in your opinion "freight should be added for the initial move from the warehouse in Southern California to the location of use in the county." But you state an additional conclusion that it "should be a one-time inclusion: freight should not be added if the machine is returned for repair to Southern California and back." You request our confirmation of this opinion.

Analysis and Opinion

As indicated above, under the given facts, we agree with your opinion. Pursuant to Board Property Tax Rule 10, "Trade Level for Tangible Personal Property," "tangible personal property held by a consumer shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level …." If a cost-based approach to valuation is used, then the "cost shall include the full economic cost of placing the property in service. Full economic cost …, includes costs typically incurred in bringing the property to a finished state, including labor and materials, freight or shipping cost ...." Rule 6, "The Reproduction and Replacement Cost Approaches to Value," is consistent. Subdivision (b) of rule 6 provides that the costs to be used include "other costs typically incurred in bringing the property to a finished state

The Assessors' Handbook Section 504, page 54, is to the same effect:

> 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. 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. The costs apply at the same rate that would apply to that similar consumer whether actually paid or not.

In *Xerox Corporation v. County of Orange* (1977) 66 Cal.App.3d 746, the court rejected the taxpayer's contention that freight charges were not a proper assessable element under the cost method of valuation. As stated by the court: "The addition of … freight charges to the list price of … equipment is consistent with an appraisal approach that gives consideration to the consumer's cost in arriving at market value." (*Ibid.* at 760.)

Turning to the facts in this case, the warehouse is not the ultimate location of use. C ships the equipment from the warehouse to other locations, where each vending machine and freezer box actually is "placed in service" as described in rule 10, or brought to a "finished state" pursuant to rule 6. Thus, we agree that the transportation or freight charges expended in bringing the equipment from the warehouse to the ultimate locations of use are properly capitalized to the cost of the equipment.

But if, after having been delivered to its location of use, a machine has to be returned to the warehouse for repair purposes, such additional freight charges cannot be considered to be "costs typically incurred in bringing the property to a finished state" within the meaning of rule 6. As indicated above, in theory, it is not the actual transportation costs that are to be included in the cost approach to value, but those theoretical costs that would have been applicable to a similar consumer using the equipment at a similar trade level. In this case, the typical costs necessary to bring the equipment to a similar trade level are only those freight charges necessary to bring the equipment to the location of use. Any additional or subsequent relocation costs should be considered as atypical and beyond that necessary to merely place the equipment in service.

Thus, as you indicate, such additional relocation costs should not be capitalized to the cost of the equipment in applying a cost-based appraisal methodology.

If you have any questions, please call me at (916)324-6593.

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