



STATE BOARD OF EQUALIZATION
PROPERTY TAX DEPARTMENT
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0061
916 274-3270 • FAX 916 285-0132
www.boe.ca.gov

SEN. GEORGE RUNNER (RET.)
First District, Lancaster

FIONA MA, CPA
Second District, San Francisco

JEROME E. HORTON
Third District, Los Angeles County

DIANE L. HARKEY
Fourth District, Orange County

BETTY T. YEE
State Controller

CYNTHIA BRIDGES
Executive Director

January 27, 2016

Mr. Peter Michaels
Law Office of Peter Michaels
6114 La Salle Avenue, #445
Oakland, CA 94611-2802

Dear Mr. Michaels:

Thank you for your October 2, 2015 letter identifying three areas of concern in the issue matrix sent to interested parties via email on September 16, 2015. As you know, that issue matrix followed the September 9, 2015 interested parties meeting discussing revisions to the *State Assessment Manual (Manual)*.

As a result of discussions we have agreed to the following to address your concerns.

Matrix Item 61

The summary of *Cardinal Health v. County of Orange* (2008) 167 Cal.App.4th 219 will be revised as follows:

Cardinal Health v. County of Orange (2008) 167 Cal.App.4th 219. The issue in this case was whether application software was exempt from property taxation even if it came "bundled" or "embedded" with taxable computer hardware. The Court of Appeal held that bundling by itself is not dispositive of whether application software is taxable under Rev. & Tax. Code, §§ 995, 995.2, as basic operational programming. Rather, the Court stated, "Rule 152, subdivision (f) clearly contemplates the possibility that a taxpayer can 'identify the nontaxable property and services and supply sale prices, costs or other information that will enable the assessor to make an informed judgment concerning the proper value to be ascribed to taxable and nontaxable components of the contract.' In other words, the sale or lease price is not *necessarily* what is taxable if the taxpayer carries that burden of identification." [Emphasis in original]

Matrix Item 62

The summary of *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593 will be revised as follows:

Elk Hills Power, LLC v. Board of Equalization (2013) 57 Cal.4th 593. The issue in this case was whether the Board properly considered applied (as opposed to "banked") emission reduction credits (ERCs) in determining the unitary value of Elk Hills' state-assessed electric power plant for purposes of property taxation under both the replacement cost less depreciation approach (RCLD) and the income approach. The Supreme Court concluded that "the Board directly and improperly taxed the power company's ERCs when it added their replacement cost to the power plant's taxable

value." The Supreme Court, however, clarified that "[w]here the taxpayer does not proffer evidence that the Board included the fair market value of an intangible right or asset in the unit whole, the Board would not have to make a deduction prior to assessment." With respect to the income approach, the Court distinguished between two lines of cases. "In the first line of cases, as in this case, courts have upheld income-based assessments that properly assumed the presence of intangible assets necessary to the productive use of taxable property without deducting a value for intangible assets. [¶ ...¶] The second line of cases disapproved assessments that failed to attribute a portion of a business's income stream to the enterprise activity that was directly attributable to the value of intangible assets and deduct that value prior to assessment." The Court concluded in this case that "the Board was not required to deduct a value attributable to the ERCs under an income approach."

Matrix Items 18 & 19

We understand that you have withdrawn your concern regarding this issue and also agree to withdraw the suggested amendments made at the conclusion of the September 9, 2015 interested parties meeting reflected in the issue matrix sent to interested parties via email later that same day. Therefore, no additions will be made to page 13 of the *Manual*.

We thank you again for your comments and your cooperative participation in the *State Assessment Manual* revision process. We anticipate the revised *Manual* will be scheduled to be heard by the Property Tax Committee at the March 29-30, 2016 Board meeting.

Sincerely,

/s/ John K. Thompson

John K. Thompson, Chief
State-Assessed Properties Division
Property Tax Department

JKT:sk

cc: Mr. Dean R. Kinnee
Mr. Richard Moon