



STATE BOARD OF EQUALIZATION
PROPERTY AND SPECIAL TAXES DEPARTMENT
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0064
916 445-4982 • FAX 916 323-8765
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

BARBARA ALBY
Acting Member
Second District, Sacramento

RAMON J. HIRSIG
Executive Director

No. 2010/037

August 9, 2010

TO COUNTY ASSESSORS AND INTERESTED PARTIES:

ASSESSORS' HANDBOOK SECTION 504,
ASSESSMENT OF PERSONAL PROPERTY AND FIXTURES

Board staff is initiating an interested parties project to revise Assessors' Handbook Section 504, *Assessment of Personal Property and Fixtures* (AH 504). Enclosed is a draft of proposed AH 504 with revisions shown in strikeout/underscore format. Please note that information regarding property tax audits has been removed from AH 504 and will be addressed in a separate audit handbook. We invite your comments and suggestions for items to be included in the new audit manual.

Interested parties are encouraged to participate in the drafting process of the AH 504 revision. Please provide suggested language changes and/or proposed additions in the form of alternative text. Identify the page and line number for all changes. Proposed changes/additions will be accepted until November 30, 2010 and should be submitted to Mrs. Ladeena Ford at ladeena.ford@boe.ca.gov or sent to the above address.

After reviewing comments received from interested parties, it is anticipated that the project will proceed as follows:

- Staff will distribute an agenda matrix summarizing proposed changes to the draft.
- Staff will meet with interested parties to discuss proposed changes to the draft.
- The Board's Property Tax Committee will hear any unresolved issues.

All documents regarding proposed AH 504 will be posted on the Board's website at www.boe.ca.gov/proptaxes/otherprojects10.htm. If you have any questions or comments regarding this project, you may contact Mrs. Ford at 916-445-0208.

Sincerely,

/s/ David J. Gau

David J. Gau
Deputy Director
Property and Special Taxes Department

DJG:sk
Enclosure

ASSESSORS' HANDBOOK
SECTION 504

ASSESSMENT OF
PERSONAL PROPERTY AND FIXTURES

~~OCTOBER 2002~~ AUGUST 2010

CALIFORNIA STATE BOARD OF EQUALIZATION

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FOREWORD

This edition of Assessors' Handbook Section 504 (AH 504), *Assessment of Personal Property and Fixtures*, is an update of the 2002 edition of AH 504, which constituted a complete rewrite and compilation of three original manuals no longer in circulation: Assessors' Handbook Section 571 (AH 571), *Appraisal of Equipment, Inventory, and Supplies*, Section 221 (AH 221), *Tax Situs of Property*, and Section 572 (AH 572), *General Audit Guidelines*. AH 504 includes some text from the original manuals and material concerning subjects not previously covered in the three prior handbook sections.

In this edition of the This manual, the chapter dealing with audits, as well as several appendices, have been removed since they will be included in other handbook sections is a complete reorganization of topics. The rewrite was undertaken by staff members of the County-Assessed Properties Division (CAPD) Assessment Policy and Standards Division (APSD) in conjunction with the staff of the Property Taxes Section Tax and Fees Program Division of the Legal Department of the State Board of Equalization and is the product of staff writing at the direction of the Board.

The objective of this manual is to give property tax appraisers, auditor-appraisers, and other interested parties an understanding of issues concerning personal property and fixtures for assessment purposes. The manual builds on the basic knowledge of generally accepted accounting principles and appraisal concepts. It should serve as a guide for the appraisal and assessment of personal property and fixtures.

If there is an inconsistency resulting from the absence of technical data in this manual and a more advanced, specific manual is available, the more specific manual controls. Moreover, in the interest of accuracy and thoroughness, appraisers, auditor-appraisers, and other interested parties are advised to consult with qualified experts and other authoritative sources regarding the technical aspects of valuing any complex property.

As part of the process of producing this manual, meetings were held with assessors, industry representatives, and other interested parties. Conflicts regarding the content of the manual were identified, and most were resolved. Those issues not resolved were voted on by Members of the Board of Equalization after hearing testimony from interested parties and Board staff. The results of the voting are reflected as Board positions on issues in the manual. The Board originally approved this manual on December 10, 1998. Subsequent updates were approved by and the Board approved an update on June 15, 2000, and . This second update of the manual was approved by the Board on October 3, 2002.

Under Government Code sections 15606 et seq., the Board is charged with the duty of administratively enforcing and interpreting the statutes governing the local assessment function.

While regulations adopted by the State Board of Equalization are binding as law, Board-adopted manuals are advisory only. Nevertheless, courts have held that they may be properly considered

1 as evidence in the adjudicatory process.¹ The citations and law references in this publication
2 were current as of the writing of the manual.

3 The Board approved this handbook section on _____.

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David J. Gau
Deputy Director
Property and Special Taxes Department
California State Board of Equalization
[Date]

¹ *Coco-Cola Co. v. State Board of Equalization* (1945) 25 Cal.2d 918; *Prudential Ins. Co. v. City and County of San Francisco* (1987) 191 Cal.App.3d 1142; *Hunt-Wesson Foods, Inc. v. County of Alameda* (1974) 41 Cal.App.3d 163.

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CHAPTER 1: INTRODUCTION

WHAT IS TAXABLE?

Article XIII, section 1 of the California Constitution defines taxable property:

Unless otherwise provided by this Constitution or the laws of the United States.

(a) All property is taxable and shall be assessed at the same percentage of fair market value. When a value standard other than fair market value is prescribed by this Constitution or by statute authorized by this Constitution, the same percentage shall be applied to determine the assessed value. The value to which the percentage is applied, whether it be the fair market value or not, shall be known for property tax purposes as the full value.

(b) All property so assessed shall be taxed in proportion to its full value.

All property is taxable (or assessable) unless it is exempt by the Constitution or statutes.² This taxable property may be defined as real property and personal property. This section of the Assessors' Handbook deals with appraisal and assessment procedures for taxable personal property and fixtures, and it includes discussions of ~~property tax audits~~, roll changes, and reporting requirements.

WHAT IS TAXABLE PERSONAL PROPERTY?

Real property is specifically defined by the law. Real property, or real estate, is:

(a) The possession of, claim to, ownership of, or right to the possession of land.

(b) All mines, minerals, and quarries in the land, all standing timber whether or not belonging to the owner of the land, and all rights and privileges appertaining thereto.

(c) Improvements.³

Personal property, on the other hand, is defined by exception; personal property is all property except real estate.⁴ Tangible personal property is defined as all "property that may be seen,

² The county assessor is responsible for the assessment of most property. However, the California Constitution (article XIII, section 19) requires the Board of Equalization to assess property (except franchises) owned or used by regulated railway, telegraph or telephone companies, car companies operating on railways in the state, and companies transmitting or selling gas or electricity. The California Constitution also requires the Board to assess pipelines, flumes, canals, ditches, and aqueducts lying within two or more counties. The assessed values as determined by the Board (except for the railway car companies) are allocated to the counties and other local tax jurisdictions.

³ Revenue and Taxation Code section 104. (All section references in this section of the Assessors' Handbook refer to Revenue and Taxation Code sections unless otherwise noted.)

1 weighed, measured, felt or touched, or which is in any manner perceptible to the senses" except
2 real property as defined above.⁵

3 Not all property defined as personal property is taxable. Unlike real property, personal property
4 may, in whole or in part, be exempted by the Legislature. Examples of current exemptions
5 provided by legislative statute include: business inventories, personal household furnishings
6 (including household furnishings owned by a homeowners' association),⁶ personal effects, and
7 pets. But, in general, personal property remains taxable.⁷

8 Assessment of taxable personal property relies on the same basic value concepts applicable to
9 real property, and both are taxed at the same maximum percentage (1 percent) of full cash value
10 (or market value).⁸ However, personal property is treated differently in many other respects.
11 Some of the most notable differences, also identified in Assessors' Handbook Section 501
12 (AH 501), *Basic Appraisal*,⁹ are:

- 13 • Special assessments are levied on real property only.¹⁰
- 14 • The Legislature has wide authority pursuant to article XIII, section 2, of the Constitution
15 concerning the taxation and/or exemption of personal property.
- 16 • Personal property cannot be assessed to insurance companies or banks;¹¹ fixtures are
17 assessable, however.
- 18 • Real property is governed by article XIII A (and assigned a base year value), while personal
19 property is appraised at market value annually.¹²

⁴ Section 106.

⁵ ~~Property Tax Rule 123 of Title 18 of the California Code of Regulations.~~ (All rule references to Rules refer to the Property Tax Rules in Title 18, Public Revenues, of the California Code of Regulations.)

⁶ Personal property owned by a homeowners' association for use by its members, who were homeowners in a planned residential community, used in connection with a common clubhouse, are exempt from taxation. See *Lake Forest Community Assn. v. County of Orange* (1978) 86 Cal.App.3d 39. Personal effects and household furnishings owned by a licensee of a residential care facility are exempt, but personal property used solely in connection with the care of the residents are taxable as property used in connection with a trade, profession or business. Additionally, household furnishings used in a summer rental home are taxable, and furnishings used on a television "reality show" filmed in a private residence are also taxable because the property is used in connection with a trade, profession or business.

⁷ Regarding the treatment of intangible assets and rights, see the discussion in Assessors' Handbook Section 502 (AH 502), *Advanced Appraisal*, commencing at page 150.

⁸ California Constitution, article XIII, section 1 and article XIII A, section 1. The Article XIII A, section 1(b) 1 percent limitation does not apply to bonded indebtedness.

⁹ All references to Assessors' Handbook sections refer to handbooks published and produced by the California State Board of Equalization. Publication dates will vary and will be noted, with page numbers, if specific to the discussion.

¹⁰ Section 3972 defines *special assessment* to mean "any assessment levied pursuant to any of the improvement acts of the State of California, whether or not represented by a bond, and which are liens upon a specific parcel of real property."

¹¹ California Constitution, article XIII, sections 27 and 28 and Revenue and Taxation Code section 23182.

¹² Manufactured homes and floating homes, although classified as personal property, are assessed in the same manner as real property. See section 229 and sections 5802 et seq.

- 1 • There is no taxable possessory interest in personal property, except as provided for in
2 section 201.5.
- 3 • Before declines in value can be recognized, machinery and equipment classified as
4 improvements must be separated from other improvements.¹³
- 5 An appraiser or auditor-appraiser assessing personal property should be familiar with the
6 differences listed herein, as well as other basic appraisal concepts as discussed in AH 501, *Basic*
7 *Appraisal*, and generally accepted accounting principles (GAAP). This handbook section builds
8 on that basic understanding with a focus on guidelines for the appraisal and assessment of
9 personal property, as it differs from real property, and fixtures.

10 GENERAL OVERVIEW OF THE SEVEN FACTORS OF AN ASSESSMENT

11 The making of an assessment requires the determination of seven factors for that assessment to
12 be proper and complete. These seven factors are especially important regarding personal
13 property and fixtures because they can be difficult to determine and they often tend to change.
14 The seven factors are *Assessability*, *Assessee*, *Situs*, *Description*, *Classification*, *Security*, and
15 *Value*.

16 A brief description of each of the factors is included here as a foundation for additional
17 information presented in the text. A more thorough study of *Situs*, *Classification*, and *Value* is
18 necessary to make an accurate assessment of personal property and fixtures; these factors are
19 each discussed in detail in separate chapters of this manual.

20 ASSESSABILITY OF PROPERTY

21 Taxable Property v. Versus Exempt Property

22 In the making of an assessment, the first determination is whether the property is taxable (or
23 assessable)¹⁴ or exempt. As previously noted, article XIII, section 1 of the California
24 Constitution states that, unless otherwise exempt as provided by the State Constitution or the
25 laws of the United States, all property is taxable. While real property may be exempt specifically
26 by the State or U.S. Constitution only, the Legislature has been granted general power to exempt
27 personal property in whole or in part. Article XIII, section 2 of the California Constitution states,
28 in part:

29 The Legislature may provide for property taxation of all forms of tangible
30 personal property, shares of capital stock, evidences of indebtedness, and any
31 legal or equitable interest therein not exempt under any other provision of this
32 article. The Legislature, two-thirds of the membership of each house concurring,
33 may classify such personal property for differential taxation or for exemption.

¹³ Section 51(d), Rule 461(e).

¹⁴ For purposes of property tax assessment and this text, "taxable" and "assessable" are used almost synonymously. "Assessable" has the same meaning as "taxable" as used earlier in this chapter and in AH 501.

1 Personal property is and can be exempt by reason of its *ownership, use, and/or type*. For
 2 example, personal property owned by banks, financial corporations, and insurance companies is
 3 exempt by *ownership*¹⁵ while property used by free public libraries is exempt by *use*.¹⁶ Business
 4 inventories and household personal property are exempt by *type*.¹⁷ Property may be exempt by
 5 one or more of these reasons. For instance, section 241 exempts from property taxation the first
 6 \$50,000 of employee-owned hand tools.¹⁸ This is an exemption by *ownership and use*.

7 Certain exemptions exist under the State or U.S. Constitution, apart from Legislative enactment,
 8 due to a *lack of tax assessment jurisdiction*. For example, personal property on certain military
 9 reservations (federal enclaves) and Indian reservations is immune from taxation due to *lack of*
 10 *jurisdiction*. This may include movable personal property that is used or leased off the
 11 reservation if the principal place of business is on the reservation. In other words, situs of the
 12 movable property is the reservation.¹⁹

13 Article XIII, section 3 and the 200 and 900 sections of the Revenue and Taxation Code identify
 14 real and personal property exemptions as granted by the California Constitution and the
 15 Legislature, respectively. It is important for an appraiser to be aware of exemptions in general in
 16 order to determine the assessability of the property being appraised. It is also important to note
 17 that not all exemptions are automatic. Some are allowed only if appropriate forms are filed
 18 timely.²⁰ In these cases, the property remains assessable unless an exemption claim is filed and
 19 approved.

20 **Statute of Limitations**

21 Sections 51.5 and 532 establish *Statutes of Limitations* on the assessor, which affect the
 22 assessability of property. Although a property itself is not exempt, an assessment must be made
 23 timely to be valid. Unless the assessee intentionally evades taxation, as discussed in sections 502,
 24 503, and subdivision (c) of 51.5, an assessment must normally be made within four years of the
 25 assessment period in which the property escaped assessment or was underassessed. (This topic is
 26 discussed further in Chapter 89, *Roll Procedures*.)

¹⁵ California Constitution, article XIII, section 28 prohibits taxation of personal property to insurance companies. California Constitution, article XIII, section 27 and Revenue and Taxation Code section 23182 provides for exemption of personal property owned by banks and financial corporations; this exemption does not apply to personal property owned by federal credit unions.

¹⁶ California Constitution, article XIII, section 3, subdivision (d).

¹⁷ Section 219 and section 224, respectively.

¹⁸ ~~Section 241. was amended to increase the exemption allowed from \$20,000 to \$50,000, beginning with the January 1, 2002 lien date.~~

¹⁹ See Chapter 3 and Rule 205 for information on determination of situs of movable property.

²⁰ ~~Contact the county assessor and/or see Assessors' Handbook Section 222 (AH 222), *Standard Form List*, Section 267 (AH 267), *Welfare, Church, and Religious Exemptions*, and Section 265 (AH 265), *Cemetery Exemption*, for information regarding exemptions and requirements necessary to qualify and receive an exemption.~~

1 Lien Date

2 Sections 2192 and 722 identify the lien date as January 1.²⁴ Personal property is assessable only
3 if taxable on this date.

4 Following is an example of how the lien date affects the assessment as determined by the
5 assessor:

EXAMPLE 1.1
LIEN DATE

On the lien date, January 1, 2002~~9~~, a boat owned by owner A is located in Sacramento. The assessee (owner A) sells the vessel to a boat dealer (owner B) on January 15, 2002~~9~~. It becomes inventory to owner B on that date.

Owner A receives a tax bill for the fiscal year July 1, 2002~~9~~, through June 30, 2003~~10~~, for the assessment of the vessel. The assessee does not own the boat during the fiscal year the bill covers, but the bill is valid based on ownership on the lien date (owner A was the owner on the lien date, January 1, 2002~~9~~). Taxes on unsecured property are due on the lien date.

If the sale were reversed, and the dealer sold the boat to owner A after the lien date, the boat would be exempt as inventory even though owner A owned the boat from January 15 through June 30, 2002~~9~~. Generally, ownership on the lien date determines the taxability, situs, and assessee of the property.

6 ASSESSEE OF PROPERTY

7 In determining the assessee, the assessor is not limited to only the fee owners of the property.
8 Sections 405, 610, and 611 authorize the assessor to assess the owners, persons in possession or
9 control of the property, persons claiming to own the property, joint assessees, and/or unknown
10 owners of any property.

11 Owner—One Who is in Possession or Control

12 Section 405 identifies the assessee as the "persons owning, claiming, possessing, or controlling it
13 on the lien date." Under most circumstances, this will be the owner. However, the assessee may
14 be one who is simply in possession or control although not the legal owner. This is often the case
15 with leased equipment and improvements related to business property.

16 It is important that the assessee's name is accurately spelled or abbreviated. A person must be
17 able to reasonably ascertain that he or she is the assessee. "A mistake in the name of an owner or
18 supposed owner of property on the unsecured roll which does not prevent the person from

²⁴ ~~Effective January 1, 1997, the lien date for locally assessed property was changed from 12:01 a.m. March 1, to 12:01 a.m. January 1.~~

1 reasonably ascertaining that he or she is the assessee does not render invalid an assessment or
2 any tax sale."²²

3 **Assessee of Leased Equipment**

4 With regard to leased equipment, either the lessor or the lessee may be the assessee. Typically:

- 5 • If the lease is a true lease, the lessor is considered the owner.
- 6 • If the lease is a finance lease or conditional sales contract, the lessee is technically the owner,
7 and may be the assessee.

8 However, in practice, leasing transactions can be complicated and the determination of the
9 assessee may not be straightforward. For example, if the lessor is unknown (in either case listed
10 above), the lessee may be assessed. If the lessor is a bank or financial institution (financial
11 corporation) which is exempt from personal property taxes, section 235 provides that the *lessee*
12 is the *owner* (and therefore the assessee) for assessment purposes. Communication with the two
13 parties to the lease and/or review of the lease or financing agreement helps to alleviate problems.
14 (See also discussion of leased equipment in Chapter 4 and Chapter 6).

15 **Assessee of Improvements**

16 Improvements can also cause similar problems in identifying the assessee. Improvements
17 installed by tenants may be assessed to either the landlord (the lessor) or the tenant (the lessee).
18 Nevertheless, improvements that are considered an integral part of the landlord's structure are
19 generally assessed to the landlord on the secured roll. Fixtures owned by the tenant, which are
20 improvements by definition (section 105), and tenant-owned fixed machinery and equipment are
21 assessed to the tenant on the unsecured roll. However, as with leased equipment, the assessee
22 should be determined according to facts specific to each case.

23 Again, communication with the two (probable) assessees is helpful, but the appraiser's and
24 auditor-appraiser's cooperation also assists in resolving problems and clarifying factual
25 questions. As will be discussed later in the manual, Chapter 2, *Classification*, and Chapter 5,
26 *Assessment of Improvements Related to Business Property*, the two appraisers should review the
27 lease agreement and coordinate their fact-gathering efforts where ambiguity exists.

28 **Joint Assesseees**

29 In every situation an effort should be made to determine the appropriate assessee. It is preferable
30 to assess only one party to avoid administrative difficulties, but the assessor has the authority to
31 assess taxable property to the lessor, the lessee, or both parties.²³

32 When both parties are assessed, tax bills are required to be sent to both parties. This requirement
33 presents a difficulty in that dual tax bills may result in dual payments. The assessor cannot
34 indicate primary and secondary liabilities; the property tax statutes do not recognize such

²² Section 613.

²³ Section 405(b).

1 differences. Should both persons pay the tax, the tax collector must accept the first payment and
 2 return the second. Therefore, the assessor should confine the joint assessment procedure to those
 3 cases in which a collection problem is anticipated.

4 **Unknown Owner**

5 In contrast to section 405, section 611 requires the assessor to assess property to unknown
 6 owners if the owner of the property is not known. If the property is assessed to unknown owners,
 7 the property may be seized and sold in order to pay property taxes.²⁴

8 **SITUS OF PROPERTY**

9 Pursuant to the California Constitution, article XIII, section 14, all property taxed by local
 10 government shall be assessed in the county, city, and district in which it is situated. Thus, situs
 11 determination is important.

12 Situs is seldom a problem with property that remains in one location, as in the case of real
 13 property, but many problems are encountered when determining the situs of movable property
 14 such as personal property. Rules 201 through 206 were adopted to deal with situs problems
 15 involving movable property. A complete discussion of these rules and situs in general is included
 16 in Chapter 3 of this manual.

17 **DESCRIPTION OF PROPERTY**

18 An accurate assessment requires a description of the property assessed. Personal property, as
 19 required by section 445, must be described in the detail requested on the property statement. The
 20 description includes the cost of the property if the information is within the knowledge of the
 21 assessee or is available to him/her from his/her own or other records.²⁵

22 The property statement, mandated by section 441, is a vital link in the communication system
 23 between the property owner and the assessor. It requests a variety of information regarding
 24 taxable property needed by the appraiser and/or auditor-appraiser for making an annual review
 25 and accurate assessment of the property. A detailed discussion of property statements, the nature
 26 of the reporting process, and variations of property statements related to different types of
 27 property is found in Chapter 7 of this manual.

28 **CLASSIFICATION OF PROPERTY**

29 In accordance with the California Constitution and related statutes, all property on the roll must
 30 be classified as land, improvements, or personal property.²⁶ Rules 121 through 124 identify the
 31 proper classification. Classification is one of the more complex and important of the seven
 32 factors of a legal assessment. It is covered in detail in ~~a separate chapter~~ (Chapter 2) of this
 33 manual.

²⁴ *Weyse v. Crawford* (1890) 85 Cal. 196.

²⁵ Section 445.

²⁶ California Constitution, article XIII, section 13 and sections 602 and 607 of the Revenue and Taxation Code.

1 SECURITY OF PROPERTY

2 An *assessment roll*, as defined in section 109, is the entire listing of all taxable property within
3 the county.²⁷ (The assessor actually prepares two separate rolls each year: the *regular assessment*
4 *roll* and the *supplemental assessment roll*.) The assessment roll consists of two parts—secured
5 and unsecured.

6 Secured Property Defined

7 The "secured roll" is that part of the roll containing state-assessed property and property the taxes
8 on which are a lien on real property sufficient, in the opinion of the assessor, to secure payment
9 of the taxes.²⁸ The taxes on the secured roll are a lien on the real property.

10 Unsecured Property Defined

11 The remainder of the roll is the "unsecured roll."²⁹ The taxes on the unsecured roll are a personal
12 liability of the assessee.

13 Assessments on the two parts of the roll have different due dates, delinquency dates, and tax
14 collection procedures. In addition, in any given year, the tax rates between the secured and
15 unsecured rolls may be different; the tax rate on the unsecured roll is the rate "for the preceding
16 tax year upon property of the same kind where the taxes were a lien upon land sufficient in value
17 to secure their payment."³⁰ Therefore, it is necessary to determine whether each assessment will
18 be listed on the secured or the unsecured roll.

19 Securing Personal Property

20 Most personal property has a degree of mobility; it can be moved from location to location or out
21 of the taxing jurisdiction in which it had situs on the lien date. This can create difficulties in tax
22 collection. It is therefore desirable to secure personal property to real property, which has a fixed
23 situs, to facilitate payment of the taxes.

24 In determining whether personal property may be placed on the secured roll, the assessor is
25 guided by sections 2189 et seq. and by Assessors' Handbook Section 201 (AH 201), *Assessment*
26 *Roll Procedures*. Under section 2189, personal property may be placed on the secured roll when
27 the property is physically located on the real property on the lien date and is assessed to the
28 person or entity which owned the real property. Upon assessee request, personal property at a
29 different location may also be secured to real property under section 2189.3; this is known as
30 *cross-securing*. When personal property is cross-secured, the assessor will determine whether or
31 not the real property is sufficient to secure the payment of the taxes. If so, a *Certificate of*
32 *Security* for taxes on personal property will be issued which must be recorded with the county
33 recorder on or before the lien date.

²⁷ The entire assessment roll includes the "local roll" which is the county assessor's duty to assess, and the "Board roll," which is part of the secured roll, containing state-assessed property.

²⁸ Section 109.

²⁹ Section 109.

³⁰ California Constitution, article XIII, section 12.

1 When personal property is secured to real property and the real property (but not the personal
 2 property) is sold after the lien date but before the assessment is made, administrative difficulties
 3 may occur. The new owner of the realty may be assessed for personalty that he or she never
 4 owned or possessed. In this case, even though the initial assessment was valid due to the
 5 conditions on the lien date, the assessor is required to transfer the personal property assessment
 6 to the unsecured roll.³¹

7 **VALUE OF PROPERTY**

8 Value, for property tax purposes, is *market value*. This is the price (the amount of money) that a
 9 property will bring when it is sold in an open market. It is a dollar amount determined by the
 10 utility of the property, as manifested through the purchasing power of those who are interested in
 11 acquiring it, the relative scarcity of the commodity, and the difficulty involved in overcoming
 12 this scarcity. In other words, value (market value) is determined by supply and demand.³²

13 The California Supreme Court, in a benchmark decision, defined the term *market value* as used
 14 in the context of property tax assessment.

15 It provides, in other words, for an assessment at the price that property would
 16 bring to its owner if it were offered for sale on an open market under conditions in
 17 which neither buyer nor seller could take advantage of the exigencies of the other.
 18 It is a measure of desirability translated into money amounts...and might be
 19 called the market value of property for use in its present condition.³³

20 Similarly, the Legislature has defined the term in sections 110 and 110.1. Section 110(a) states:

21 Except as is otherwise provided in Section 110.1, "full cash value" or "fair market
 22 value" means the amount of cash or its equivalent that property would bring if
 23 exposed for sale in the open market under conditions in which neither buyer nor
 24 seller could take advantage of the exigencies of the other, and both the buyer and
 25 the seller have knowledge of all of the uses and purposes to which the property is
 26 adapted and for which it is capable of being used, and of the enforceable
 27 restrictions upon those uses and purposes.

28 Of the seven factors in an assessment, value is consistently the most difficult. AH 501, ~~*Basic*~~
 29 ~~*Appraisal*~~, includes a comprehensive study of the value concept in general and an in-depth
 30 discussion of value as applied to real property.³⁴ In many respects, the same basic principles
 31 discussed in that section apply to personal property. However, unlike most real property,
 32 personal property is assessed at market value every year; it is not governed by the value
 33 limitations under Proposition 13 (California Constitution, article XIII A). Except for
 34 manufactured homes and floating homes, there is no base year value for personal property and

³¹ Section 2189.

³² Supply and demand are the market effects of scarcity and utility.

³³ *De Luz Homes Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 561-562.

³⁴ Valuation of personal property is also discussed briefly in AH 501, Chapter 7.

1 the appraisal date is always the lien date, January 1. Further discussion of value, specific to
2 personal property and fixtures, is a major portion of this section of the Assessors' Handbook. It is
3 included in Chapter 4, *Valuation of Personal Property*, Chapter 5, *Assessment of Improvements*
4 *Related to Business Property*, and Chapter 6, *Special Issues*.

CHAPTER 2: CLASSIFICATION

IMPORTANCE OF CLASSIFICATION

Classification is an important and required factor of the (local) assessment function for several reasons.³⁵ Principally, it is important because property tax law requires that land, improvements (including fixtures), possessory interests, personal property, and other classes of property (as defined by the Board) must have separately assessed values shown on the roll.³⁶ It is also significant because of the assessment differences between real property and personal property, which include the following: (1) special assessments are levied only on real property; (2) the tax rate on personal property on the unsecured roll is the rate of tax on personal property on the prior year's secured roll;³⁷ (3) personal property is appraised annually at market value and not governed by article XIII A of the California Constitution; and (4) fixtures are a separate appraisal unit when measuring declines in value.

GENERAL CLASSIFICATION TYPES AS REQUIRED BY LAW

Section 602 provides, in part, that the local roll shall show:

- (e) The assessed value of real estate, except improvements.
- (f) The assessed value of improvements on the real estate.
- (g) The assessed value of improvements assessed to any person other than the owner of the land.
- (h) The assessed value of possessory interests.
- (i) The assessed value of personal property, other than intangible.
- ...(l) Any other things required by the board.³⁸

This means that all property listed on the roll must be classified as (1) land, which is all real property except improvements, (2) improvements, (3) possessory interests, (4) personal property, or any other things required by the Board.³⁸

³⁵ Classification does not apply to state assessed properties. "The Board may use the principle of unit valuation in valuing properties of an assessee that are operated as a unit in a primary function of the assessee. In valuing such properties, the Board must appraise [them] at their full value[s] when put to [their] beneficial and productive use[s]...*Unit taxation prevents real but intangible value from escaping assessment and taxation by treating public utility property as a whole, undifferentiated into separate assets ([such as] land or buildings, vehicles, etc) or even separate kinds of assets [such as] realty or personalty.*" *GTE Sprint Communications Corp. v. Alameda County* (1994) 26 Cal.App.4th 992.

³⁶ Rule 252, and sections 602 and 607.

³⁷ California State Constitution, article XIII, section 12.

³⁸ ~~Section 602(1)~~. Per section 20, the word "Board" means the State Board of Equalization.

1 Each class of separately enrolled property is defined in the Revenue and Taxation code (sections
2 103, 104, 105, 106, and 107) and by Title 18 of the California Code of Regulations (Rules 121,
3 122, 122.5, 123, 124, and 131). Some of the definitions are summarized here for ease of use and
4 reference.

5 **LAND**

6 *Land* is identified by section 602(e) as real estate, or real property, except improvements. It
7 includes:

8 (a) The possession of, claim to, ownership of, or right to the possession of land.

9 (b) All mines, minerals, and quarries in the land, all standing timber whether or
10 not belonging to the owner of the land, and all rights and privileges appertaining
11 thereto.³⁹

12 **IMPROVEMENTS**

13 Section 105 defines *improvements* as:

14 (a) All buildings, structures, fixtures, and fences erected on or affixed to the land.

15 (b) All fruit, nut bearing, or ornamental trees and vines, not of natural growth, and
16 not exempt from taxation, except date palms under eight years of age.

17 Examples of property generally classified as improvements are listed in Rule 124(b). The listing
18 is a guide to classification of those named and similar items.

19 For valuation purposes, all improvements should be subclassified as structure items or fixtures.
20 This separation and distinction is extremely important and encompasses a large portion of the
21 discussion in the remainder of the chapter.

22 **PERSONAL PROPERTY**

23 *Personal property* includes all property except real estate.⁴⁰ It is property that may be exempted,
24 in whole or in part, by the Legislature. A discussion of personal property categories (taxable and
25 exempt) is included in a later portion of this chapter.

26 **CLASSIFICATION FOR VALUATION PURPOSES**

27 As required by law for enrollment purposes, property must be classified as land, improvements,
28 or personal property—pursuant to the definitions provided in the previous section. For valuation
29 purposes, however, property is categorized as land, structure items (improvements), fixtures
30 (improvements), ~~and~~ or personal property.

³⁹ Section 104(a) and (b). See also Rule 121.

⁴⁰ Section 106.

1 IMPROVEMENTS (STRUCTURE ~~V.~~ VERSUS FIXTURE)

2 Both structure items and fixtures are improvements; they are not taxed separately. However, they
3 are treated differently and separately for valuation purposes. It is therefore important to discuss
4 and understand the terms in order to classify the improvements properly.

5 **Structure Item**

6 A *structure item* (or improvement) is "an edifice or building; an improvement."⁴¹ It is an item
7 commonly referred to as an improvement. The business property statement defines *structure* as
8 an improvement whose:

9 ...primary use or purpose is for housing or accommodation of personnel,
10 personalty, or fixtures and has no direct application to the process or function of
11 the industry, trade, or profession.⁴²

12 **Fixture**

13 In contrast to structure, *fixture* is a somewhat vague term in that it has different meanings to
14 different people. For example, certain items (such as bathroom "fixtures") may be denoted as
15 "fixtures" by a business owner or an accountant, even though the property tax appraiser classifies
16 them as structure improvements (rather than fixture improvements) for assessment purposes.

17 For assessment purposes, pursuant to Rule 122.5, a *fixture*⁴³ is:

18 ...an item of tangible property, the nature of which was originally personalty, but
19 which is classified as realty for property tax purposes because it is physically or
20 constructively annexed to realty with the intent that it remain annexed
21 indefinitely.

22 In discussions with taxpayers and accountants, the auditor-appraiser should keep in mind that the
23 concept of fixtures for assessment purposes is not necessarily the same concept used by
24 taxpayers. Where there is a contradiction between the assessee's or accountant's concept of
25 classification and the express language of statutory and rule provisions, the statutes and rules are
26 controlling for assessment purposes.

27 ~~Three Tests for Determining Whether an Article is a Fixture~~

28 In determining whether an article is a fixture, the application of the three tests set forth in Rule
29 122.5 must be applied to the evidence available. The three tests are:

- 30 • Physical Annexation (manner of annexation),
31 • Constructive Annexation (adaptability), and

⁴¹ Appraisal Institute, *The Dictionary of Real Estate Appraisal*, s.v. "structure."

⁴² Form BOE-571-1, *Business Property Statement*.

⁴³ For property tax assessment purposes, fixtures include *trade fixtures* and *fixed equipment*. See also Chapter 5, *Assessment of Improvements Related to Business Property*.

- 1 • Intent

2 **Physical Annexation (Test)**

3 The term "affixed to land" is the key to the physical annexation test. Section 660 of the Civil
4 Code includes a definition of the term, which reads in part as follows:

5 A thing is deemed to be *affixed to land* when it is attached to it by roots, as in the
6 case of trees, vines, or shrubs; or imbedded in it, as in the case of walls; or
7 permanently resting upon it, as in the case of buildings; or permanently attached
8 to what is thus permanent, as by means of cement, plaster, nails, bolts, or
9 screws....

10 Thus, the test for physical annexation under Rule 122.5(b)(4) may be summarized as follows:

- 11 • If the property being classified cannot be removed without substantially damaging it or the
12 real property with which it is being used, it is considered physically annexed. It is classified
13 as a fixture.
- 14 • If the property can be removed without material damage but is actually attached, it is
15 classified as a fixture, unless there is an intent manifested by outward appearance or historic
16 usage, that the item is to be moved and used at other locations.
- 17 • Property may be considered physically annexed if the weight, the size, or both are such that
18 relocation or removal of the property would be so difficult that the item appears to be
19 intended to remain in place indefinitely.
- 20 • Property shall not be considered physically annexed to realty solely because of attachment to
21 the realty by "quick disconnect" attachments, such as simple wiring and conduit connections.

22 **Constructive Annexation (Test)**

23 An item may be classified as a fixture even if it is not physically fastened to a building or other
24 structure. This is the concept of constructive annexation, the second test. Constructive
25 annexation per Rule 122.5(c)(1) may be summarized as follows:

26 If the property is not physically annexed to realty, but is a necessary, integral, or working
27 part of the realty, it is constructively annexed.

28 Factors to be considered are: (1) is the nonattached item designed and/or committed for use with
29 specific realty, and/or (2) whether the realty can perform its desired function without the
30 nonattached item.

31 Constructive annexation, as well as physical annexation, is "installation specific." As such, visual
32 inspection of the actual annexation or relationship of the item to the real property or
33 improvements may be necessary. If the installation and/or removal aspects of the item remain
34 unclear even after visual inspection, further information should be requested from the assessee.
35 For instance, the assessee may be requested to provide the detailed procedures involved in the

1 installation or removal of the item and an accounting of all costs before a final determination can
2 be made.

3 Following is a list of items, which were formerly personal property, that are classified as
4 improvements due to constructive annexation based on decisions of the court (and information
5 specific to each case). The list should serve as a guideline for determining whether an item is
6 classified as an improvement using the test of constructive annexation.

EXAMPLE 2.1

PROPERTY CLASSIFIED AS FIXTURES (IMPROVEMENTS) DUE TO CONSTRUCTIVE ANNEXATION

- A ship anchored at a specially constructed pier. The support lines for water, sewage, air conditioning, heating, etc., were of a type used for permanent rather than temporary installation; motive power for the ship was partly removed and the rest permanently disabled; the ship could be moved only at great expense and could not be moved beyond the harbor; and extensive land-based facilities including roads, bridges, and a parking lot were constructed especially for the visitors to the ship. *Specialty Restaurants, Corp. v. Los Angeles County* (1980) 111 Cal.App.3d 607 (*Queen Mary* case).
- Cranes mounted on specially installed rails at a wharf area. The area of the wharf containing the rails was extensively reinforced to accommodate the great weight of the cranes. Without the cranes, the facility could not function in consonance with its purpose and design. *Seatrains Terminals of California, Inc. v. County of Alameda* (1978) 83 Cal.App.3d 69.
- Movable structures anchored to realty by the force of gravity. *Rinaldi v. Goller* (1957) 48 Cal.2d 276.
- Portable buildings, platforms, tracks, machinery and shipyard equipment owned by the government and located on private property. The government's contractual right to remove its buildings and fixed equipment did not affect classification of the items as improvements for property tax purposes. *Kaiser Co. v. Reid* (1947) 30 Cal.2d 610.
- ~~Pumps~~ Certain pumps, when of such a size they are not easily moved and from outward appearances, to third parties, appear to be permanent. *Bell v. Bank of Perris* (1942) 52 Cal.App.2d 66.
- Vault doors, although removable without damage to the vault, are functionally and physically integrated with the vault itself. Vaults alone without doors would not be useful as vaults and would fail in their intended purpose. *San Diego Trust & Savings Bank v. County of San Diego* (1940) 16 Cal.2d 142.
- Head sets and stools specially designed for use with affixed central telephone office equipment. *Southern California Telephone Co. ~~Company~~ v. State Board of Equalization* (1938) 12 Cal.2d 127.

7 **Intent (Test)**

8 Intent is the most important of the three tests and may be the deciding factor regarding
9 classification of property. Rule 122.5 (d)(1) states:

10 Intent is the primary test of classification. Intent is measured with—not separately
11 from—the method of attachment or annexation. *If the appearance of the item*

1 *indicates that it is intended to remain annexed indefinitely, the item is a fixture for*
 2 *property tax purposes.* Intent must be inferred from what is reasonably manifested
 3 by outward appearance. An oral or written agreement between parties, such as a
 4 contract between lessor and lessee, is not binding for purposes of determining
 5 intent. [Italics added.]

6 Intent must be determined by physical facts, and is the means of applying the physical and
 7 constructive annexation tests. For instance, great expense or difficulty in removal is indicative of
 8 intended permanence.⁴⁴ Intent cannot be a hidden matter, but is "reasonably manifested by
 9 outward appearances."⁴⁵ If an item appears physically attached to real property, an appraiser can
 10 assume that the intent of the annexation is that the item will remain attached unless there is other
 11 evidence that indicates the attachment is only temporary.

12 The guiding precedent for determining intent is the California Supreme Court case, *Crocker*
 13 *National Bank v. City & County of San Francisco* (1989) 49 Cal.3d 881. Here the Court found
 14 that computer equipment is personalty even when a newly constructed building includes a data
 15 processing center. The inclusion of safety, security, cooling, power, and fire suppression systems
 16 designed into the building specifically for the computer center did not change the classification
 17 of the equipment from personalty to a fixture. Excerpts from the decision provide instruction on
 18 the importance of intent:

19 ...in determining whether an item constitutes a fixture, three criteria must be
 20 taken into consideration: (1) the manner of its annexation to the realty; (2) its
 21 adaptability to the use and purpose for which the realty is used; and (3) the
 22 intention with which the annexation is made. It is also settled that for tax
 23 purposes, the "intention" must be determined by the physical facts or reasonably
 24 manifested outward appearances.

25 ...In resolving whether an item placed on the premises constitutes a fixture or
 26 personal property, the aforelisted three elements do not play equal parts. In
 27 making the determination in a particular case, the element of intent is regarded as
 28 a crucial and overriding factor, with the other two criteria being considered only
 29 as subsidiary ingredients relevant to the determination of intent...Because the
 30 legal problem here is taxability...and because the "intent" here is constructive and
 31 not actual, the test reduces itself to whether a reasonable person would consider
 32 the item to be a permanent part of the property, taking into account annexation,
 33 adaptation, and other objective manifestations of permanence....

34 Finally, there are no other objective manifestations of permanence that are
 35 sufficient to outweigh the manifestations revealed by the evidence bearing on

⁴⁴ *Morse Signal Devices v. County of Los Angeles* (1984) 161 Cal.App.3d 570; *Allstate Insurance Co. v. County of Los Angeles* (1984) 161 Cal.App.3d 877; *Security Pacific National Bank v. Los Angeles County* (1984) 161 Cal.App.3d 877; *Crocker National Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881.

⁴⁵ *Trabue Pittman Corp. v. County of Los Angeles* (1946) 29 Cal.2d 385, 397.

1 annexation and adaptation – viz., that the [computer] equipment did not constitute
 2 a permanent part of the building...Accordingly, we conclude that a reasonable
 3 person, taking into account annexation, adaptation, and other objective
 4 manifestations of permanence, would not consider the equipment at issue to
 5 constitute a permanent part of the building. [Emphasis added.]

6 **Importance of Classification as Structure Versus Fixture**

7 As mentioned earlier, it is important to sub-classify improvements as structure items or fixtures
 8 because they are treated differently for valuation and assessment purposes.⁴⁶ Structure items and
 9 fixtures are treated differently in that:

- 10 • Fixtures are a separate "appraisal unit" when measuring declines in value (~~Rule 461(e)~~).⁴⁷
 11 • Fixtures are treated differently than other real property (i.e., structure items) for supplemental
 12 roll purposes.
 13 • Fixtures and personal property values are components in the value criterion for ~~determination~~
 14 of a mandatory audit identifying the pool of taxpayers with the largest assessments for audit
 15 purposes.

16 Thus, care must be taken to properly classify improvements as structure items or fixtures. The
 17 danger with respect to improper classification of an item is that it could become subject to
 18 double assessment or may escape assessment. If an item such as a compressor, for example, is
 19 included in the real property appraisal of the building in which it is located (per Rule 124(b)),
 20 and the assessee lists the compressor on the business property statement as a fixture used in the
 21 trade or industry, it may also be included in the appraisal of the business property, subjecting it
 22 to a double assessment. While this problem is addressed in detail in Chapter 5, and Appendices
 23 A and B, it bears repeating that much caution must be exercised in compiling and comparing
 24 appraisal data and making accurate classifications in order to avoid escapes and duplicate
 25 assessments.

26 **Classification Guidelines**

27 An appraiser should consider all three tests when classifying property: physical annexation,
 28 constructive annexation, and intent. Each test affects the final classification of the property based
 29 upon the evidence available. However, intent, as the courts have stated, is the most important and
 30 must be measured with—not separately from—the method of physical attachment or
 31 constructive annexation.

32 Although the three tests (physical annexation, constructive annexation, and intent) for
 33 determining whether or not an item is classified as a fixture have been provided by the code and
 34 by the courts, lack of detailed statutory definitions has led to some confusion when attempting
 35 classification regarding improvements, structure versus fixture. Rule 463(c) defines a fixture in
 36 general ("an improvement whose use or purpose directly applies to or augments the process or

⁴⁶ See Chapter 5, *Assessment of Improvements Related to Business Property*.

⁴⁷ Rule 461(e).

1 function of a trade, industry, or profession"), but no specific examples are given in the statutes.
 2 Assessors' Handbook Section 581 (AH 581), *Equipment Index and Percent Good Factors*,
 3 provides some clarification by listing improvements by type; that is, when an improvement
 4 relates primarily to the structure (structure), and when an improvement relates mainly to the
 5 function of a trade, industry, or profession (fixture). ~~This list is included in Appendix A for~~
 6 ~~review and ease of use.~~ Each example in this list is classified only on the limited description
 7 offered. In practice, classification of a property should be based on all relevant facts concerning
 8 that property. For example, dual purpose improvements should be classified as to their primary
 9 purpose.

10 **Special Classification Issues**

11 Certain types of property consistently create classification problems: automatic teller machines
 12 (ATMs), billboards, telephone systems, partitions, service station fixtures, liquefied petroleum
 13 gas tanks (propane tanks), and wind machines. These categories of property and the
 14 classification issues involved with each are discussed below.

15 **Classification of ATMs**

16 ATMs may be classified as personal property or fixtures. The determination must be made on a
 17 case-by-case method. Most ATMs are owned by banks and financial institutions which by law
 18 are exempt from personal property tax (and are subject to an in-lieu franchise tax).⁴⁸ Therefore,
 19 classification of ATMs may determine taxability. Using the three tests of a fixture (physical
 20 annexation, constructive annexation, and intent) will aid an appraiser in the proper classification.

21 Rule 122.5(e)(9) classifies ATMs that are installed as free standing or counter-top units within a
 22 building (such as a bank, supermarket, or other retail establishment) as personal property. An
 23 ATM installed in a structure that was built primarily for the purpose of housing the ATM is a
 24 fixture, because the realty cannot perform its main function without the ATM. Similarly, an
 25 ATM installed through the wall of a building is a fixture because that portion of the realty was
 26 designed or modified for the specific purpose of housing the ATM.

27 **Classification of Billboards**

28 Billboards (off-premise outdoor advertising signs) are properly classified as fixtures under Rule
 29 122.5(a)(1). They are generally affixed to the ground, moved infrequently, and intended to
 30 remain annexed until the usual leasehold interest in the land terminates. The billboard appraisal
 31 unit consists of the billboard improvement (sign and foundation), the use permit allowing
 32 construction and operation of the billboard, and the leasehold interest in the land held by the
 33 billboard owner (lessee). The land lessor's interest in the billboard site is a separate appraisal
 34 unit.

⁴⁸ Exempt banks and financial institutions do not include federally chartered credit unions. Personal property and real property owned by federally chartered credit unions are not exempt from property taxes.

1 **Classification of Telephone Systems**

2 Telephone systems (not including state-assessed telephone companies) often pose problems
 3 because there may be many different components making up the system as a whole and each
 4 component must be analyzed and classified separately. The components integrated into the
 5 structure are physically annexed, generally having permanence (intended to be annexed
 6 indefinitely), and are therefore structure items. However, components that plug into the wiring
 7 system are not physically annexed to the structure. These components are necessary in order for
 8 the operation of the system (constructively annexed), but they are portable and can be used in
 9 other structures. Use of these components is not limited to only one system. The intent of the
 10 property owner is that these components be movable (i.e., when the realty is sold, the portable
 11 telephone components are not sold with it). This part of the telephone system is personal
 12 property.

13 **Classification of Service Station Improvements**

14 Service station improvements may also be made up of many components. Each component
 15 should be identified, tested, and classified individually consistent with existing statutory law,
 16 property tax rules, and standard appraisal principles. In general, fixtures include items such as
 17 signs, hoists, and tanks if they directly augment the function of the service station trade.
 18 Structure items include other improvements such as buildings, curbing, and landscaping; their
 19 primary use and purpose is for housing or accommodation of personnel, personalty, or fixtures.
 20 Items that have a dual purpose will be classified according to their primary purpose.

21 Following (Table 2A2.2) is a generalized listing of property typically found in connection with
 22 service stations and their appropriate classification as proposed by industry.⁴⁹ As technological
 23 advancements are made and other changes occur in this industry, these general categorizations
 24 may need to be modified.

TABLE 2A2.2	
CLASSIFICATION OF SERVICE STATION IMPROVEMENTS	
Structures	Fixtures
Buildings Curbing Paving Restrooms Walls Fencing Yard Lighting Landscaping Island Canopy	Island Curbing Signs Hoists Compressors Air & Water Wells Dispensers/Pumps Tanks & Related Equipment

⁴⁹ Classification recommendation supplied by the Western States Petroleum Association Marketing Property Task Force.

1 **Classification of Partitions**

2 Partitions may be classified as either personal property, structure items, or fixtures. Each
3 partition must be classified based on the physical characteristics of the item.

4 Most partitions currently used in office buildings are not permanently attached or built into the
5 structure. The partitions are designed to be rearranged easily to accommodate the current needs
6 of the business. These types of partitions are properly classified as personal property.

7 Partitions built into the structure or designed to function only in a specific structure are
8 improvements. They are physically annexed and can be classified as fixtures or structures as
9 appropriate. Partitions that are floor-to-ceiling height, and for the most part constructed at the
10 time the building is constructed, are structure improvements. Partitions in an office space that are
11 less-than-ceiling height, attached to the floor, and constructed with studs and sheetrock or
12 masonry materials are fixtures. In either case, the partitions may remain indefinitely.

13 **Classification of Liquefied Petroleum Gas Tanks**

14 Liquefied petroleum gas tanks, commonly referred to as propane tanks, may be classified as
15 personal property or fixtures. The determination must be made on a case-by-case basis
16 depending upon the facts available. The three tests for determining whether an article is a fixture
17 (i.e., physical annexation, constructive annexation, and intent), as discussed earlier in this
18 chapter, should be considered and applied by the appraiser in order to make this determination.
19 Rule 124 recognizes that propane tanks "which remain in place" are categorized as
20 improvements.

21 For example, if the tank and related equipment cannot be removed without material damage to
22 real property and the intent "manifested by outward appearances" or historic usage indicates that
23 the property will remain indefinitely, the property should be classified as a fixture. If, on the
24 other hand, the intent of the owner is to move the property and use it at other locations, the
25 property should be classified as personal property. Again, the determination must be made based
26 on the facts available in each individual situation.

27 **Classification of Wind Machines**

28 Wind machines may be classified as fixtures or personal property. Wind machines are used in the
29 agricultural industry to protect crops, trees, and vines from adverse weather conditions. These
30 machines consist of a large fan mounted on a tower, a motor to drive a fan, a fuel tank or
31 electrical hookup, and other related equipment necessary for operation.

32 A wind machine that is physically annexed to realty with the intent that it remains annexed
33 indefinitely is a fixture. Rule 122.5(e), Example (10), specifically states that wind machines
34 annexed to realty are not considered a building, structure, or a fence. For property tax assessment

1 purposes, they are fixtures. On the other hand, wind machines attached to or resting on a truck or
 2 other type of ~~moveable~~ movable equipment are properly classified as personal property.⁵⁰

3 **TANGIBLE PERSONAL PROPERTY (GENERAL CATEGORIES)**

4 *Tangible personal property* is defined in Rule 123 as:

5 All property that may be seen, weighed, measured, felt, or touched, or which is in
 6 any other manner perceptible to the senses, except land and improvements, is
 7 tangible personal property.

8 In general, personal property is sub-classified according to type as provided on property
 9 statements: equipment, supplies, vessels, aircraft, and manufactured homes. Each of these
 10 general categories is discussed below. Since not all personal property is assessable, it is
 11 important to sub-classify this property further (e.g., business inventory, licensed vehicles, etc.).
 12 In some cases, classification affects not only valuation but it affects taxability as well.

13 **Equipment**

14 The term *equipment* is a general term. The business property statement subdivides equipment
 15 into the following five primary categories: (1) *machinery and equipment*, (2) *office furniture and*
 16 *equipment*, (3) *other equipment*, (4) *tools, molds, dies, and jigs*, and (5) *computer equipment*.
 17 *Machinery and equipment* includes equipment that is directly related to a particular industry
 18 (including equipment that is driven and controlled by a computer that is an integral part of the
 19 production equipment). For example, washers and dryers are types of equipment that owners of
 20 laundromats would include in this category. The category titled *tools, molds, dies, and jigs* is
 21 limited to manufacturing industries; generally, it is self-explanatory to those industries. Other
 22 categories on the property statement, *office equipment* and *computer equipment*, ~~on the property~~
 23 ~~statement~~ represent equipment used by most types of businesses. Items such as desks, tables,
 24 chairs, and filing cabinets are included in *office equipment*. The ~~column entitled~~ *computer*
 25 ~~equipment~~ columns entitled *Personal Computers and Local Area Network (LAN) Equipment and*
 26 *Mainframes* ~~represents~~ represent not only non-production computer components but also related
 27 equipment.⁵¹

28 **Supplies**

29 Supplies are items that are used in the normal operation of the business and are not intended for
 30 sale or lease on the lien date. They are assessable as personal property at their current
 31 replacement cost, or market value. Assessable supplies do not, however, include any items that
 32 become a component part of a product that is manufactured or sold in addition to items that are
 33 sold with the product. Examples of supply items that are exempt inventory when they are sold

⁵⁰ Rule 122.5, *Fixtures*, was amended to include an example of wind machines, effective February 6, 2002. Please refer to the rule for ~~future~~ guidance on the proper classification of wind machines.

⁵¹ ~~The Business Property Statement requests computer equipment (and related equipment) be reported separately based on cost of the computer system~~ business property statement requires personal computers and local area network equipment and mainframes be reported separately.

1 with the product include packaging boxes, pallets, price tags, and cash register tapes. These items
 2 are inventory and are exempt.⁵² Examples of assessable supplies (items that do not become part
 3 of the product) include stationery and office supplies, chemicals, and precious metals used to
 4 produce a chemical or physical reaction, janitorial and lavatory supplies, fuel, and sandpaper.
 5 Medical,⁵³ legal, or accounting supplies held by a person in connection with a *profession* that is
 6 primarily a service activity may also be reportable as supplies. Items that are to be delivered to a
 7 customer as part of a *nonprofessional* service, such as chemicals added to a customer's pool by a
 8 swimming pool maintenance company, are inventory.

9 **Business Inventory Exemption**

10 It is important to distinguish supplies, which are assessable, from inventory items, which are
 11 exempt. Rule 133(a) identifies business inventory.⁵⁴ In short, business inventory includes all
 12 items of personalty that become part of or are themselves a product that is held for sale or lease
 13 in the ordinary course of business. The key phrases *ordinary course of business* and *goods*
 14 *intended for sale or lease* must apply for the property to qualify for the business inventory
 15 exemption. For example, a retailer in the business of selling shoes is also requesting a business
 16 inventory exemption on a vessel he/she is trying to sell on the lien date. Since the sale of vessels
 17 is not part of his/her *ordinary course of business*, the vessel would not qualify for the inventory
 18 exemption. If a copier leasing company holding machines for lease uses one of the machines
 19 prior to the lien date or intends to use the copier after the lien date, that copier is no longer part of
 20 the *goods intended for sale or lease* and would not qualify for the business inventory exemption
 21 even if it is held for lease on the lien date.

22 In general, basic provisions under Rule 133(a) are:

- 23 • Personal property (including animals, crops, and feed) sold in the ordinary course of business
 24 is exempt business inventory.
- 25 • Items incorporated into a product and held for sale in the ordinary course of business are
 26 exempt business inventory.
- 27 • Goods transferred incidental to the rendition of a professional service are not eligible for the
 28 business inventory exemption. (Examples are given later in this chapter.)
- 29 • Goods transferred in the rendition of a nonprofessional service are eligible for the business
 30 inventory exemption. (Examples are given later in this chapter.)
- 31 • Animals used in the production of food or fiber are exempt business inventories.
- 32 • Property held for lease in the normal course of business on the lien date is exempt business
 33 inventory.
- 34 • Tangible personal property that is owned or used rather than intended for sale or lease does
 35 not qualify for the business inventory exemption. Such equipment is assessable.

⁵² Sections 129 and 219; Rule 133.

⁵³ Some medical supplies are considered inventory.

⁵⁴ Rule 133(b) describes property not eligible (exclusions) for the business inventory exemption.

1 **Questions and Answers Regarding Classification of Supplies Versus Inventory**

2 Following are some common questions and answers regarding the business inventory exemption.
 3 The questions are grouped into five categories: manufacturing, retailing, professional and service
 4 enterprises, agricultural enterprises, and property held for lease.

5 **Manufacturing**

6 **QUESTION 1: DO MANUFACTURING SUPPLIES QUALIFY FOR THE BUSINESS INVENTORY** 7 **EXEMPTION?**

8 Yes. Manufacturing supplies, that will be incorporated in a product that is to be sold, such
 9 as welding rods, nuts, bolts, and screws, are eligible.

10 No. Supplies such as oxygen and acetylene for welding, drill bits, and similar items that
 11 are consumed in the manufacturing process but that are not physically incorporated into
 12 the product are not eligible. Also not eligible are catalysts used to accelerate chemical or
 13 physical reaction but which are not intentionally incorporated into the product.

14 **QUESTION 2: ARE OAK BARRELS USED IN THE MANUFACTURING OF WINE (OR BRANDY)** 15 **ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

16 Yes, if used to impart flavor or aroma. Particles of chemical components of oak barrels
 17 transfer to wine (or brandy) during the aging process, adding flavor, aroma, and color.
 18 This enhancement process is the primary purpose for aging wine (or brandy) in oak
 19 barrels instead of other containers. During the time oak wine barrels are used or held to
 20 be used as a raw material to impart the flavor and aroma-enhancing chemical compounds
 21 of the oak into wine (or brandy), such property is business inventory. (See Rule
 22 133(a)(2)(B).)

23 No, if used solely for storage. An oak barrel used in the manufacturing process is not
 24 eligible for the business inventory exemption when it is not, or is no longer, used to
 25 impart the flavor and aroma of the oak into the wine (or brandy). Such an oak barrel is
 26 used merely for the storage of wine and subject to assessment as property used in the
 27 "ordinary course of business." (See Rule 133(a)(2)(B).)

28 **QUESTION 3: ARE TOMATO PASTE BINS AND DRUMS ELIGIBLE FOR THE BUSINESS INVENTORY** 29 **EXEMPTION?**

30 Yes, if the bins or drums qualify as containers of the tomato paste and title to them passes
 31 to the purchaser of the tomato paste. These bins or drums appear to qualify as containers
 32 because they enclose the foil bags of tomato paste and are not safely removed until the
 33 purchaser is ready to consume or use the product. The bins or drums provide support and
 34 protection for the product that is sold, rather than simply transportation of the product.

35 Title to the bins or drums can be determined to pass to the purchaser if six indicia can be
 36 identified: title transfer provisions of the purchase contract; the amount of the container

1 deposit required; the inclusion of sales tax; distinctive container markings or
 2 construction; the seller's method of accounting for the containers; container return policy;
 3 and actual business practices relative to the containers.

4 **QUESTION 4: DO TOOLS, MOLDS, DIES, OR JIGS HELD FOR USE QUALIFY FOR THE BUSINESS**
 5 **INVENTORY EXEMPTION?**

6 No. Tools, molds, dies, or jigs are assessable property when used or intended to be used
 7 in the ordinary course of business.

8 **QUESTION 5: ARE PARTS HELD BY MANUFACTURERS TO PERFORM WARRANTY SERVICE OR ON**
 9 **PRODUCTS THEY SELL ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

10 ~~Yes. Although the parts are not sold outright, they are held for repair (replacement of~~
 11 ~~defective parts) of products that are sold. The selling prices of the products will include~~
 12 ~~amounts to cover normal warranty repairs.~~

13 Probably not. In a precedential court decision, a spare computer parts pool, used as a
 14 source of replacement parts under extended service contracts and for diagnosis of
 15 problems with particular computer equipment, did not qualify as business inventory. The
 16 assessee treated the spare parts as fixed assets rather than as inventory; customers were
 17 not charged for the replacement parts; and the spare parts pool was not reduced when a
 18 good part was swapped for a defective one.⁵⁵

19 **QUESTION 6: IS SAND AND GRAVEL HELD BY A LICENSED CONTRACTOR FOR INCORPORATION**
 20 **INTO A BRIDGE OR ROADBED ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

21 Yes. Business inventories include all materials held by a licensed contractor which will
 22 be incorporated into real property, except those to be incorporated into real property
 23 which the contractor is constructing for his/her own use.

24 **QUESTION 7: IF IS FACTORY BUILT HOUSING HELD FOR SALE BY THE MANUFACTURER**
 25 **ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

26 Yes. If held for sale as individual sections of a building, they would be eligible. They
 27 would also be eligible where the manufacturer is also a licensed contractor and assembles
 28 the sections at a building site, then sells the buildings.

29 **QUESTION 8: IS A MANUFACTURED HOME, LOCATED IN A DEALER-OWNED MOBILEHOME PARK**
 30 **AND HELD FOR SALE OR LEASE BY THE DEALER, ELIGIBLE FOR THE BUSINESS INVENTORY**
 31 **EXEMPTION?**

32 Yes. Pursuant to section 5801(b)(2), a manufactured home is personal property unless
 33 affixed to a permanent foundation as provided in Health and Safety Code Section
 34 18551(a). If the manufactured home either was installed on a conventional

⁵⁵ Amdahl v. County of Santa Clara (2004) 116 Cal.App. 4th 604.

1 (non-engineered) system of piers and blocks, or was installed on a permanent foundation
 2 but the appropriate documents were not recorded as specified in section 18551(a), the
 3 manufactured home would be classified as personal property and therefore eligible for the
 4 business inventory exemption under the specified circumstances.

5 **Retailing**

6 **QUESTION 9: IS FARM OR CONSTRUCTION EQUIPMENT, THAT WAS PREVIOUSLY USED BY A**
 7 **FARMER OR CONTRACTOR, ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION ONCE IT IS**
 8 **CONSIGNED TO AN AUCTIONEER FOR SALE?**

9 Yes, the equipment is held for sale by the auctioneer whose normal business is selling
 10 such goods.

11 **QUESTION 10: FARM OR CONSTRUCTION EQUIPMENT IS HELD AND ADVERTISED BY A FARMER**
 12 **OR CONTRACTOR FOR SALE AS A MEANS OF DISPOSING OF OLD OR EXCESS EQUIPMENT. IS SUCH**
 13 **EQUIPMENT ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

14 No. It is not held for sale in the normal course of business. His or her business is farming
 15 or contracting, not selling used equipment.

16 **QUESTION 11: ARE DISPLAY ITEMS ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

17 Yes, unless they have been altered to the point where it is unlikely they will be sold. An
 18 example of a display that is not eligible is a cut-away of a tire showing the interior
 19 construction. Such an item would not be sold by the retailer; thus, it is not eligible for the
 20 exemption.

21 **QUESTION 12: ARE SALESPERSON'S SAMPLES AND DEMONSTRATION EQUIPMENT ELIGIBLE FOR**
 22 **THE BUSINESS INVENTORY EXEMPTION?**

23 Yes, if items are sold from the samples and/or demonstration equipment or if the samples
 24 and/or demonstration equipment are periodically rotated and returned to stock for sale.

25 **QUESTION 13: A RETAILER SELLING OFFICE MACHINES AND EQUIPMENT PERIODICALLY**
 26 **REMOVES EQUIPMENT FROM INVENTORY FOR USE AS HIS/HER OFFICE EQUIPMENT. THE**
 27 **EQUIPMENT IS USED FOR A PERIOD OF TIME THEN RETURNED TO INVENTORY FOR SALE. IS THE**
 28 **EQUIPMENT BEING USED AS OFFICE EQUIPMENT BY THE RETAILER ELIGIBLE FOR THE BUSINESS**
 29 **INVENTORY EXEMPTION?**

30 No. The equipment is in use at the consumer level and is not being displayed or otherwise
 31 offered for sale. Property which has been used by the holder prior to the lien date is NOT
 32 eligible for the inventory exemption, even though held for lease on the lien date (see Rule
 33 133(b)(4)).

1 **QUESTION 14: ARE MEDICAL AND AMBULATORY EQUIPMENT THAT IS LEASED TO INDIVIDUALS**
 2 **FOR HOME USE ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

3 No. The business is the owner/lessor of medical and ambulatory equipment that is used in
 4 its leasing business for the production of income. The property owned is not eligible for
 5 the household furnishings exemption because the medical and ambulatory equipment is
 6 owned by it and used in connection with its business for the production of income.
 7 Property held or used in any way in connection with a trade, profession, or business
 8 and/or for the production of income by the owner/lessor or by the lessee is not eligible for
 9 exemption.

10 **QUESTION 15: ARE LIQUIDATED MACHINERY AND EQUIPMENT ELIGIBLE FOR THE BUSINESS**
 11 **INVENTORY EXEMPTION?**

12 Machinery and equipment that is sold as part of the liquidation of a plant may not qualify
 13 for the business inventory exemption unless it can be shown that, pursuant to an offer for
 14 sale, title to the equipment was transferred to the purchasing entity's parent company,
 15 subsidiary, or a broker that was regularly engaged in the business of selling or leasing
 16 equipment. Sales of such equipment, purchased from competing entities, that are
 17 conducted in order to eliminate competition and increase market share for the purchasing
 18 company, are not sales "within the ordinary course of business."

19 **Professional and Service Enterprises**

20 **QUESTION 16: GOODS TRANSFERRED IN THE RENDITION OF A "PROFESSIONAL SERVICE" ARE**
 21 **NOT ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION, WHILE GOODS TRANSFERRED IN**
 22 **THE RENDITION OF A "NONPROFESSIONAL SERVICE" ARE ELIGIBLE. WHAT CRITERION**
 23 **CRITERIA DETERMINES WHETHER A SERVICE IS PROFESSIONAL OR NONPROFESSIONAL?**

24 A "profession" is a vocation where the labor and skill is predominantly mental or
 25 intellectual, rather than physical or manual. A "professional" requires knowledge of an
 26 advanced type in a given field of science or learning gained by a prolonged course of
 27 specialized instruction and study.

28 A "nonprofessional service" is generally defined as a vocation requiring skill of a manual
 29 or mechanical nature. Courts tend to classify a "nonprofessional service" as a business as
 30 opposed to a profession. Examples may include barbers, carpenters, and plumbers.

31 Rule 133(c) gives examples of medicine, law, architecture, or accountancy as
 32 "professional services." It lists dry cleaners, beauty shop operators, and swimming pool
 33 service companies as examples of "nonprofessional services." There are, of course, many
 34 services in between that are more difficult to assign to one group or the other.

1 **QUESTION 17: ARE EMBALMING FLUIDS OF A MORTUARY ELIGIBLE FOR THE BUSINESS**
2 **INVENTORY EXEMPTION AS GOODS TRANSFERRED IN THE RENDITION OF A NON-PROFESSIONAL**
3 **SERVICE?**

4 Yes. The skills required of an embalmer are of a manual or mechanical nature.

5 **QUESTION 18: ARE MEDICINES THAT A DOCTOR KEEPS ON HAND BUSINESS INVENTORIES?**

6 No, because they are typically transferred to patients incidental to the rendition of the
7 professional service.

8 **QUESTION 19: ARE MEDICINES HELD BY A HOSPITAL PHARMACY ELIGIBLE FOR THE BUSINESS**
9 **INVENTORY EXEMPTION?**

10 Yes, if the hospital pharmacy holds medicines dedicated for sale to the general public
11 (out-patients and/or walk-in customers), that portion held for resale is eligible for the
12 business inventory exemption.

13 No, medicines held by the hospital pharmacy for issue to in-patients as part of a service
14 are not eligible for the business inventory exemption.

15 **QUESTION 20: IS THE FOOD HELD FOR SERVING TO HOSPITAL PATIENTS AS PART OF THE DAILY**
16 **HOSPITAL SERVICE ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

17 No. The meals are incidental to the rendition of the professional service. However, food
18 held for sale in the hospital cafeteria is eligible.

19 **QUESTION 21: AN ACCOUNTANT MAINTAINS A STOCK OF ACCOUNTING BOOKS WHICH HE OR**
20 **SHE PASSES ON TO HIS/HER CLIENTS AS A PART OF HIS SERVICE. HE/SHE HAS A RETAILER'S**
21 **PERMIT. DO THE BOOKS QUALIFY AS BUSINESS INVENTORIES?**

22 No. However, if the accountant regularly bills clients for the books as a separate item in
23 addition to his services, the books would qualify for the exemption.

24 **QUESTION 22: ARE CLOTHES HANGERS AND PLASTIC BAGS HELD BY DRY CLEANERS SUBJECT**
25 **TO THE BUSINESS INVENTORY EXEMPTION?**

26 Yes, because they are delivered to customers regularly as part of the non-professional
27 service performed.

28 **QUESTION 23: ARE CHLORINE TABLETS HELD IN STORAGE BY A SWIMMING POOL SERVICE**
29 **COMPANY BUSINESS INVENTORIES?**

30 Yes, because they are delivered to customers as an item regularly included in the non-
31 professional service.

1 **Agricultural Enterprises**

2 **QUESTION 24: ARE INSECTICIDES, FUEL, AND FERTILIZER HELD BY A FARMER SUBJECT TO THE**
 3 **BUSINESS INVENTORY EXEMPTION?**

4 No, because these items are held for use rather than for sale.

5 **QUESTION 25: IS FEED THAT IS HELD BY A FARMER FOR FEEDING TO ANIMALS THAT ARE USED**
 6 **IN THE PRODUCTION OF FOOD OR FIBER ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

7 Yes. See Rule 133 (a)(2)(D).

8 **QUESTION 26: ARE FARM ANIMALS HELD FOR BREEDING PURPOSES SUBJECT TO THE BUSINESS**
 9 **INVENTORY EXEMPTION?**

10 Yes, if their offspring are normally used as food for human consumption or for the
 11 production of fiber useful to man.

12 **QUESTION 27: ARE STALLIONS AND MARES HELD FOR THE PRODUCTION OF OFFSPRING**
 13 **ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION AS "ANIMALS HELD FOR THE BREEDING**
 14 **OF LIVESTOCK?"**

15 No. Those qualifying for exemption as "animals held for the breeding of livestock" are
 16 animals that produce offspring that will be used for food or fiber for human use or
 17 consumption.

18 **Property Held for Lease**

19 **QUESTION 28: ARE PACK ANIMALS USED BY A GUIDE TO PACK CAMPERS INTO THE MOUNTAINS**
 20 **ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

21 No. However, if the pack animals are held for lease to campers, are directly under the
 22 campers' control, and are not otherwise used by their owner, they would be eligible.

23 **QUESTION 29: ARE GOODS HELD FOR LEASE ELIGIBLE FOR THE BUSINESS INVENTORY**
 24 **EXEMPTION?**

25 Yes. "Held for lease" means that the property is not actually out on lease on the lien date
 26 and is not used by or intended to be used by the lessor for some purpose other than the
 27 prospective sale or lease of that property. Also, the property while on lease must be
 28 placed under the control of the lessee.

29 **QUESTION 30: ARE VENDING MACHINES HELD IN THE OWNER'S HANDS THAT ARE NORMALLY**
 30 **PLACED ON SITE TO DISPENSE FOOD ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

31 No, unless the machines are held for rent. Placing them on site does not constitute a
 32 rental. Sharing of the receipts with the site owner constitutes payment for use of the site.
 33 (Note: The food in the vending machines is exempt.)

1 **QUESTION 31: ARE ITEMS ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION IF HELD FOR**
 2 **LEASE BY A PERSON WHO LEASED THE ITEMS FROM SOMEONE ELSE?**

3 Yes. The determining factor is the status of the items on the lien date; i.e., they are held
 4 for lease in the normal course of business.

5 **QUESTION 32: ARE BOATS HELD FOR RENTAL PURPOSES ELIGIBLE FOR THE BUSINESS**
 6 **INVENTORY EXEMPTION IF, ON THE LIEN DATE, THE RENTAL OPERATION IS CLOSED FOR THE**
 7 **WINTER?**

8 Yes. When boats are rented, and control of the property transfers to the lessee during the
 9 rental term, the rental of this property qualifies as a lease for assessment purposes.
 10 Property leased or held for lease in the ordinary course of business is eligible for the
 11 business inventory exemption. Even though the boats are not "held for rent" on the lien
 12 date due to the operation being closed for the winter, they are still eligible for the
 13 exemption since they are held for rent in the normal course of business.

14 **QUESTION 33: ARE GOLF CARTS AVAILABLE FOR USE (RENTAL) ONLY ON A SPECIFIC GOLF**
 15 **COURSE ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

16 No. Assuming that the golf carts are only available for use on a golf course, the golf carts
 17 would not be eligible for the exemption. They are personal property, used in the ordinary
 18 course of business, assessable to the owner. To qualify as a lease, the property must be
 19 under the control of the lessee during the lease term.

20 **QUESTION 34: ARE THE SUPPLIES OF MOTOR FUELS HELD BY A RENTAL OPERATION ELIGIBLE**
 21 **FOR THE BUSINESS INVENTORY EXEMPTION WHERE THE FUELS WILL BE PROVIDED TO A**
 22 **CUSTOMER WITH THE RENTAL OF A MACHINE?**

23 Yes. The fuel supplies are eligible whether billed separately or included in the rental
 24 charge.

25 **QUESTION 35: ARE LINEN SUPPLIES THAT ARE LEASED OR RENTED TO CUSTOMERS ELIGIBLE**
 26 **FOR THE BUSINESS INVENTORY EXEMPTION?**

27 No, not if on lease, or committed to lease, or rented on the lien date.

28 **QUESTION 36: ARE MUSIC COMPILATION CDS THAT ARE LEASED OR RENTED TO CUSTOMERS**
 29 **ELIGIBLE FOR THE BUSINESS INVENTORY EXEMPTION?**

30 Yes, music compilations on compact discs that are leased by the manufacturer/distributor
 31 under a licensing agreement for a specified term of possession with stated monthly
 32 payments, and that remain the property of the manufacturer/distributor, are tangible
 33 personal property eligible for the inventory exemption. Those CDs in the hands of clients
 34 on the lien date, however, are ineligible for the business inventory exemption and are
 35 subject to property taxation.

1 Vehicles, Vessels, Aircraft, and Manufactured Homes

2 Vehicles, vessels, aircraft, and manufactured homes not on permanent foundations are also
3 classified as personal property. They are assessable personal property to the owner, whether the
4 owner is an individual, a business, or otherwise. To be assessable, there is no requirement that
5 they be used for business purposes as required for other types of personal property.

6 Vehicles⁵⁶

7 Vehicles are broadly defined by both the statutes and case law. Section 670 of the Vehicle Code
8 defines a vehicle as:

9 A "vehicle" is a device by which any person or property may be propelled,
10 moved, or drawn upon a highway, excepting a device moved exclusively by
11 human power or used exclusively upon stationary rails or tracks.

12 ~~Motor~~ Owners of motor vehicles (including trailers and recreational vehicles), that are "of a type
13 subject to registration under the Vehicle Code," pay licensing fees to the Department of Motor
14 Vehicles (DMV) which are in lieu of payment of property tax.⁵⁷ However, vehicles exempt from
15 DMV registration requirements, ~~per Vehicle Code Section 4000-4020~~, are assessable personal
16 property.⁵⁸

17 Based on the Vehicle Code and court decisions, a device could be illegal to operate on the
18 highway and exempt from vehicle registration but may still be a *vehicle*. Thus, the court held that
19 a forklift met the definition of a vehicle in *Travelers Indemnity Co. v. Colonial Ins. Co.* (1966)
20 242 Cal.App.2d 227.

21 Transport argues that a forklift is neither designed nor used to haul persons or
22 property on a public highway; that the forklift here involved was not so used; and
23 that the Vehicle Code provisions exempting forklifts from registration show a
24 legislative intention not to include them in the definition of "motor vehicle." We
25 disagree.

26 Accordingly, tractors, backhoes, forklifts, crawler loaders, golf carts, riding lawnmowers,
27 unlicensed racecars, and any other type of equipment that is self-propelled or is designed to be
28 moved by something other than "exclusively human power" may qualify as vehicles. These
29 items, therefore, do not qualify for the exemption provided by section 224.

30 Vehicles such as golf carts and riding lawn mowers are not exempt either as personal effects or
31 as vehicles ~~which~~ where the owners of such items pay in lieu fees to the Department of Motor

⁵⁶ See also Chapter 6.

⁵⁷ Section 10758. Section 225 specifically exempts from personal property taxation a trailer, semitrailer, logging dolly, pole or pipe dolly, or trailer bus, that have valid identification plates issued pursuant to section 5014.1 of the Vehicle Code, or any auxiliary dolly or tow dolly. However, this exemption does not apply to a logging dolly that is used exclusively off-highway. This exemption also applies to commercial trailers licensed or registered in other states.

⁵⁸ Vehicle Code sections 4000 through 4020.

1 Vehicles. Section 155.20 authorizes the county board of supervisors to provide for a low-value
2 exemption ordinance of up to \$5,000. Such an exemption, if implemented in a county, will
3 eliminate assessment of most household vehicles. However, no exemption would be available for
4 vehicles such as tractors or backhoes with a market value greater than a county's low-value
5 exemption. Accordingly, Such such vehicles are not exempt as household personal property.

6 **Vessels, Aircraft, and Manufactured Homes**

7 Assessment of vessels, aircraft, and manufactured homes are discussed in separate handbooks to
8 give each subject the attention required. Vessels are discussed in Assessors' Handbook Section
9 576 (AH 576), *Assessment of Vessels*. Aircraft are discussed in Assessors' Handbook Section 570
10 (AH 570), *Assessment of Commercial Aircraft*, and Section 577 (AH 577), *Assessment of*
11 *General Aircraft*. Manufactured homes are discussed in Assessors' Handbook Section 511
12 (AH 511), *Assessment of Manufactured Homes and Parks*.

CHAPTER 3: SITUS OF PERSONAL PROPERTY

"All property taxed by local government shall be assessed in the county, city, and district in which it is situated."⁵⁹ Situs, the place where property is legally situated, is therefore one of the essential factors of a valid assessment. For real property, situs usually needs to be determined only once. It will always be the same. Personal property, however, is mobile property with no fixed situs. Situs may always be the same or it may be different year to year, month to month, or day to day.

A property tax appraiser or auditor-appraiser is concerned with the property's tax situs on the January 1 lien date.⁶⁰ On the lien date, property with a tax situs in California is assessable in California; property with a tax situs outside of California, almost without exception, is not assessable here. Similarly, property with a tax situs in the jurisdiction of a taxing agency is assessable by that agency.

WHAT IS TAX SITUS: PERMANENT VERSUS TEMPORARY SITUS

Article XIII, section 14 of the California Constitution, provides that a property's tax situs is the location where the property is "situated." "Situated" connotes a more or less permanent location, or situs. Thus, taxation of property in the state must be based on the fact that it is to some extent kept or maintained in California rather than here casually or in transit.⁶¹ The statute does not refer to the temporary location of property, but to its permanent situs.⁶²

If property stays in one place, as does real property, this location is the permanent and tax situs. However, when property is moved periodically, a tax situs is established at a given location on the lien date. For example, property which is normally located in a taxing jurisdiction, moved on the lien date, and then immediately moved back, does not avoid taxation at this situs. Although gone on the lien date, the property has not established permanent situs elsewhere. Therefore, its permanent situs, and thus taxable situs, remains at the original location.

Since there is no requirement to keep one's property in a specific jurisdiction where it is subject to taxation, an assessee may move property in an attempt to avoid taxation. In doing so, the property must attain situs elsewhere. A degree of permanency must attach to that situs before that can happen.⁶³ Again, the word "situated" connotes a more or less permanent location or situs. Property may be removed to avoid the imposition of taxes if the removal is permanent. "If the removal is intended to be temporary, only for tax reduction purposes or otherwise, the property remains taxable at its permanent situs."⁶⁴

⁵⁹ California Constitution, article XIII, section 14.

⁶⁰ ~~Prior to 1997, the lien date was on March 1. In 1997, the lien date was changed to January 1.~~

⁶¹ *People v. Niles* (1868) 35 Cal. 282.

⁶² *Rosasco v. County of Tuolumne* (1904) 143 Cal. 430.

⁶³ *Brock & Co. v. Board of Supervisors* (1937) 8 Cal.2d 286.

⁶⁴ ~~*Ibid.*~~ *Brock & Co. v. Board of Supervisors* (1937) 8 Cal.2d 286.

1 On the other hand, property that is in California temporarily but has a permanent tax situs outside
 2 of California is not assessable in California. The California constitutional requirement (article
 3 XIII, section 1) that all property be taxed in proportion to its full value does not require or allow
 4 assessment of all property temporarily in this state. Property is assessable only in the county,
 5 city, and district in which it is situation or has situs.⁶⁵ At all times there is property that is being
 6 transported across this state, from one foreign state to another, that no one would claim should be
 7 assessed in California.⁶⁶

8 In summary, permanent versus temporary situs must be considered when determining tax situs
 9 for property tax purposes. This principle was upheld in the case of *Seegmiller v. County of*
 10 *Nevada* (1997) 53 Cal.App.4th 1397. An assessee moved his business property from a permanent
 11 location in California to a permanent location in the State of Nevada during August of the fiscal
 12 tax year. There was no dispute that the location of the equipment on the ~~March 1~~ lien date was
 13 Nevada County, California, but the assessee sued for a prorated assessment to avoid possible
 14 duplicate assessment of the property at the new location. The court found Nevada County's entire
 15 assessment valid based on permanent situs of the property (in that county) on the ~~March 1~~ lien
 16 date. A permanent situs on the lien date is the basis for the assessable situs.

17 **DETERMINING SITUS OF MOVABLE PROPERTY**

18 Property which is frequently moved, such as transportation equipment and construction
 19 equipment, is defined as *movable property* under Rule 205.

20 Movable property is all property which is intended to be, and is, moved from time
 21 to time from one location to another.

22 The situs of ~~such-movable~~ property should be governed by the duration of its stay at any location
 23 as discussed ~~generally~~ in Rule 205, *Movable Property*, and referenced further in Rule 204,
 24 *Leased Equipment*, and Rule 203, *Property in Transit*. These rules are discussed below.

25 **GENERAL SITUS RULES (RULE 205)**

26 **Over Six Months Prior to the Lien Date**

27 Movable property has situs where located on the lien date if (1) it has been in the county for
 28 more than 6 of the 12 months immediately preceding the lien date; and (2) the objective facts
 29 indicate it will remain in or return to the county for any substantial period during the 12 months
 30 immediately succeeding the lien date. (Rule 205 does not apply to vessels, certificated aircraft,
 31 and racehorses. Situs for each of these exceptions is discussed later in this chapter.)

⁶⁵ California Constitution, article XIII, section 14.

⁶⁶ *City and County of San Francisco v. Talbot* (1883) 63 Cal. 485.

1 **Less Than Six Months Prior to the Lien Date**

2 Movable property which has been in the county for less than 6 of the 12 months immediately
3 preceding the lien date, but which is committed to use in the county for an indeterminate period
4 or for more than 6 months, has situs there regardless of whether the use extends through or
5 commences with the lien date.⁶⁷ (~~Rule 205.~~)

6 If the property does not meet the qualifications for situs as discussed above, the situs of the
7 property is the location where it normally returns between uses.

8 **Movable Property In-Transit**

9 Movable property may be in-transit on the lien date, and this may affect the property's assessable
10 situs. As explained later in this chapter, situs and even assessability may be based on the
11 destination of the property (whether in interstate, intrastate, or foreign commerce) and the terms
12 of transit.

13 **Situs Other Than at Location**

14 Movable property that does not have permanent situs where it is located on the lien date has
15 assessable situs at the location where it is normally returned between uses. If there is no such
16 location, the situs is the principal place of business of the owner.⁶⁸ (~~Rule 205.~~)

17 **Habitual Presence of Substantial Average Rule**

18 In cases where property does not remain in one location long enough to establish a permanent
19 location or situs, and does not have a location to which it normally returns to, its assessable situs
20 is the place where it is frequently present or habitually located.⁶⁹ Instruments of commerce
21 (commercial aircraft, railroad cars, barges, etc.), linen supplies, and returnable containers are
22 common examples of property that attain assessment situs because there is a substantial average
23 or habitual presence at a specific location.

24 Special rules have evolved for assessing and determining situs for most types of instruments of
25 commerce. Where such statutes or rules do not exist, the courts have traditionally supported any
26 reasonable method of apportionment. In *Sea-Land Services, Inc. v. County of Alameda*⁷⁰ the
27 court found that an assessment of cargo containers based on an "average presence" was proper.
28 In another case involving cargo containers, the United States Supreme Court also approved the
29 concept of a property tax assessment based on average presence.⁷¹ The assessment in this case
30 was voided by the Court, however, because the cargo containers were foreign-owned
31 instrumentalities of international commerce and a state may not tax such property.⁷²

⁶⁷ Rule 205.

⁶⁸ Rule 205.

⁶⁹ *GeoMetrics v. County of Santa Clara* (1982) 127 Cal.App.3d 940.

⁷⁰ (1974) 12 Cal.3d 772.

⁷¹ *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434.

⁷² All ocean-going cargo containers of 1,000 cubic feet or more are now exempt under section 232. This exemption does not affect the principle of tax situs due to habitual or average presence however.

1 **Habitual Situs at More Than One Location in California**

2 The habitual presence rule is applicable only to property which is (1) used in California *and* in
3 other states or foreign nations and (2) not assessable under other regulatory formulas. Property
4 that has tax situs in California on the lien date is assessable at only one location, based on its
5 value as of that date, even though the property may have substantial presence at more than one
6 location.⁷³ Thus, if a property is in county "A" for seven months and County "B" for five
7 months, County "A" will assess the entire property and County "B" will not assess the property
8 at all. No apportionment of the assessment is required.

9 **Habitual Situs Both in California and in Another State or Nation**

10 The rules of situs are often affected by the requirements of apportionment where the property has
11 a substantial presence in more than one state. Apportionment is a process used to allocate or
12 eliminate, ~~based on the time of presence~~, the assessments or the taxes for time spent out of the
13 state based on the time of presence. Apportionment is allowed under current law and is expressed
14 in relatively recent court decisions which are discussed below. ~~First, however,~~ Following is a
15 brief discussion of federal law versus ~~a state's power to tax~~ state law and when it is appropriate
16 for a state to tax.

17 ***Federal Law Versus State Law***

18 Federal and state law must both be observed when determining situs and assessability of items
19 ~~which concern or that~~ have a tax situs in states other than California because in several matters
20 the federal government regulates interstate commerce. For example:

- 21 • The "commerce clause" (United States Constitution, article I, section 8, clause 3) grants to
22 Congress the power to regulate interstate and foreign commerce;
- 23 • The "import-export clause" (United States Constitution, article I, section 10, clause 2)
24 prohibits states from levying taxes on imports or exports without the consent of Congress;
25 and
- 26 • The President of the United States (United States Constitution, article II, section 2, clause 2)
27 has the power, with the advice and consent of the Senate, to make treaties with foreign
28 nations.

29 While federal statutes do not limit ad valorem taxation by the states⁷⁴ and federal courts are
30 prohibited from taking jurisdiction in tax assessment cases (unless it can be proved that a plain,
31 speedy, and efficient remedy does not exist under state law),⁷⁵ related federal law does take
32 precedence if a controversy arises.

⁷³ An exception to this rule is certificated aircraft, scheduled air taxis, and inter-county ferryboats. See *Other Special Situs Situations* later in this chapter.

⁷⁴ With the exemption of railroads under the 4-R Act (section 306 of the Railroad Revitalization and Regulatory Reform Act of 1976) which prohibits discriminatory taxation against railroad cars traveling interstate.

⁷⁵ 28 U.S.C. section 1341.

1 It is clear that neither federal law nor the courts prohibit taxation of property that has presence in
 2 more than one state. However, apportionment may be required. Although there have been many
 3 state and federal court cases that deal with apportionment of taxes on instruments of interstate
 4 commerce,⁷⁶ neither the courts nor the Congress has ever specified any particular method of
 5 allocation or taxation. Several courts have commented that a slight overlapping of taxes (which
 6 occurs accidentally because different states have different rules regarding situs) is permissible.⁷⁷
 7 In general, the courts have only said that the state's tax system must provide for fair
 8 apportionment, not discriminate against interstate commerce, and be fairly related to the services
 9 provided by the state.

10 ***Apportionment Between States and/or Foreign Nations***

11 As a result of *Ice Capades, Inc. v. County of Los Angeles*,⁷⁸ it became necessary to apportion
 12 taxes on property that has established tax situs (1) in California and (2) in another state. The
 13 court's ruling in this case (resulting in the *Ice Capades Rule*) made it clear that where multiple
 14 tax situs between states exists, taxes must be apportioned. This apportionment should be based
 15 on the time of the property's presence, regardless of whether or not the other state(s) are actually
 16 assessing the property.

17 *Ice Capades, Inc. v. County of Los Angeles* involved a touring ice show that owned and operated
 18 facilities in both California and New Jersey. The California Appellate Court held, among other
 19 things, that:

- 20 • Apportionment applies only where property has a tax situs in more than one state;
- 21 • An assessee contending that some portion of property is not taxable by the state of domicile
 22 has the burden of proving by sufficient evidence that situs has been established elsewhere;
- 23 • In a borderline situation, it is reasonable to apportion the tax if the other jurisdiction actually
 24 levied a tax;
- 25 • Transitory contact with other states does not establish tax situs even though the visits were
 26 annual; and
- 27 • The transitory contact of certain types of property with various states is different than
 28 "habitual presence" of other types of property (instruments of commerce) typically present at
 29 a given location.

30 When property has situs in California but has its permanent or primary situs in another state or
 31 country, it is taxable here only to the extent of time spent here. When property is here on a
 32 transitory basis this rule does not apply; the property is not assessable here. Apportionment
 33 should be calculated based on the time that property had tax situs in California versus total time
 34 (for example, 60 days in California divided by 365 days) when a sufficient quantum of contact
 35 has established (assessable) situs here and in another state. When the multiple situs' are verified,

⁷⁶ See Assessors' Handbook Section 570, *Assessment of Commercial Aircraft*, for discussion of several cases involving allocation of instruments of interstate commerce.

⁷⁷ *Auerbach v. Los Angeles County Assessment Appeals Board No. 2* 167 Cal.App.4th 1415; *TWC Aviation, Inc.*

⁷⁸ (1976) 56 Cal.App.3d 745.

1 apportionment may be appropriate. A tax bill from another state, for example, is one method of
2 verifying a situs out of state. It may be relevant evidence in determining multiple tax situs,
3 although the dollar amount of the other state's tax bill is irrelevant.

4 Consistent with *Ice Capades*, if a California property has a substantial presence in another
5 nation, the California assessment should be apportioned to eliminate that time the property has
6 established situs outside the state, whether or not the foreign nation actually taxed the property.⁷⁹
7 However, the assessee must provide that such substantial presence exists. Transitory contact,
8 such as may occur when a vessel or aircraft makes a round-the-world voyage, does not establish
9 substantial presence. Tax situs of the property would remain in California.

10 **Example: Situs of Movable Property**

11 Following is an example of situs determination using movable property owned by an assessee
12 whose primary business location is outside of California. General rules of situs were employed to
13 make the determination.

⁷⁹ *GeoMetrics v. County of Santa Clara* (1982) 127 Cal.App.3d 940. (This case involved aircraft which were not "instruments of commerce." They were involved in airborne geophysical surveys. The assessor was required to apportion the value of aircraft physically abroad for all or substantial parts of the year, though domiciled in California.)

EXAMPLE 3.1
OUT-OF-STATE CONSTRUCTION COMPANY

An out of state construction company worked on a two-year gas pipeline project in California.

- The equipment did not leave California during the project.
- The equipment used on the project moved into ABC County in December 2004⁸.
- The equipment used on the project moved out of ABC County in March 2002⁹.
- It was typical that the equipment moved in and out of a county in less than six months.

DID THE PROPERTY ESTABLISH SITUS IN CALIFORNIA FOR THE 2009 LIEN DATE, JANUARY 1?

Since the property was not in transit, Rule 203 does not apply. Nor does Rule 205 specifically cover this sequence of uses. However, the uninterrupted two-year presence of the equipment in California establishes its situs in this state under article XIII, section 14 of the California Constitution. Further, the equipment's presence in ABC County on the lien date, coupled with the likelihood that the equipment's future short uses in other counties will not establish its situs in another county, warrants its assessment by the ABC County Assessor.

A federal court decision addressed a similar situation. When property is moved from the state of the owner's domicile to another state with the intention that it remain there for an indefinite period or for a relatively long time, then the place where the property is physically located is its tax situs.⁸⁰

DID THE PROPERTY ESTABLISH SITUS IN ABC COUNTY ON THE 2002 LIEN DATE, JANUARY 1?

Under Rule 205, the property established a tax situs in California but did not establish a tax situs in a specific county. (The property was not in transit; therefore Rule 203 does not apply.) The equipment moved frequently, but remained in California on the lien date and for a time period both before and after, although the equipment did not remain in any county long enough to meet the six month test required in Rule 205.

Situs in the appropriate county becomes dependent on article XIII, section 14 of the California Constitution; property is taxable in the county, city, and district in which it is situated or has situs. Thus, the property established a tax situs in **ABC County, California** on the 2002 lien date.

1 SITUS OF LEASED OR RENTED PROPERTY (RULE 204)

- 2 Situs of leased equipment is determined not only on the basis of physical location of the
3 property, but also on the intent of the owner. Determination of situs regarding this type of
4 property is governed by Rule 204, *Leased Property*, which provides in part:

⁸⁰ *Minnesota v. Blasius* (1933) 290 U.S. 1.

1 (a) Property leased or rented on a daily, weekly or other short-term basis has situs
2 at the place where the lessor normally keeps the property. Temporary absences
3 from that location do not change the situs of the property.

4 (b) The situs of property leased or rented for an extended, but unspecified, period
5 or leased for a term of more than six months shall be determined on the basis of
6 the lessee's use....

7 The intent of the lessor and the lessee as demonstrated by objective facts is the determining
8 factor in ascertaining the situs of leased or rented property. For example, property leased to a
9 contractor for a period of one month has situs at the lessor's location. It is clearly the intent of
10 both parties that the property returns to this original location; this is its permanent and tax situs.
11 However, where the contractor has leased the equipment for an unspecified period which would
12 appear to extend beyond six months, the equipment is taxable at its actual location on the lien
13 date.

14 **Single Assessment for Leased Personal Property**

15 When a property owner has multiple taxable items leased throughout a county, *precise* situs of
16 each lease becomes less important. Section 623 ~~provides a definition for situs by allowing~~ allows
17 assessors to combine ~~the~~ multiple assessments for leased ~~equipment~~ personal property located in
18 the county and, owned by the same lessor, ~~into one assessment~~. Section 623 states:

19 The assessor may place a single assessment on the roll for all leased personal
20 property in the county that is assessed with respect to the same taxpayer. Any
21 property assessed pursuant to this section shall, in the absence of evidence
22 establishing otherwise, be deemed to be located at the taxpayer's primary place of
23 business within the county.

24 A "primary place of business" is the taxpayer's headquarters, office, or facility within the county.
25 If the company has more than one facility within the county, the facility with the largest
26 equipment value is the situs that should be used for all leased equipment. In the absence of a
27 "primary place of business within the county," the location having the greatest value of a
28 company's leased equipment should be considered that company's primary place of business
29 within the county. On the other hand, if a company has an office, warehouse, or other "primary
30 place of business within the county," but has nearly all of its leased equipment located at a single
31 site in a different tax rate area, the situs where the majority of the equipment is located should be
32 used for all of the company's leased equipment in the county.

33 Section 623 only applies to leased personal property assessed to the same assessee. It does not
34 ~~affect~~ apply to personal property that is not leased, and combining assessments in the manner
35 authorized by section 623 is strictly an option for assessors to use, not a requirement.

1 **SITUS OF PROPERTY IN-TRANSIT (RULE 203)**

2 Although property is normally taxable at the location where it has established permanent situs on
3 the lien date, what is the situs of property in transit on the lien date? The answer is determined by
4 the destination of the property, the legal owner of the property on the lien date, and the
5 application of Rule 203, *Property in Transit*.

6 **Property Moving in Interstate or Foreign Commerce**

7 Property in transit on the lien date, to or from interstate or foreign destinations, is exempt from
8 taxation. However, it is important that the property actually be *in* transit to be exempt. Property
9 that is otherwise taxable remains taxable until transit has commenced and may become taxable
10 once again when transit has ended. For example, property being held or stored in railroad cars for
11 the convenience of the owner is not in interstate transit even though it remains in the shipping
12 cars. Property is not in interstate transit if the holding by the carrier is not incidental to its
13 transportation.

14 Note that the exemption of property in interstate or foreign transit does not include instruments
15 of commerce or property that has a permanent situs but is leaving or entering the state on a
16 temporary basis as of the lien date. This exemption applies to property that is being moved from
17 one established situs to another, such as equipment being shipped from a distribution warehouse
18 to a retail store or otherwise being relocated from one factory to another.

19 **Commencement of Transit**

20 Transit commences when property has either started moving on its interstate or foreign journey
21 or has been committed to a common carrier for that purpose. However, property deposited at the
22 point of shipment in interstate commerce but not committed to a carrier is still subject to
23 taxation.⁸¹

24 **Termination of Transit**

25 In general, transit has terminated when the property reaches the hands of the owner at the
26 destination point. Property brought into the state is taxable at the point transit ends. For property
27 tax purposes, "reaching the hand of the owner" does not, however, always mean physically. For
28 example, when the carrier becomes entitled to make storage, demurrage, or other charges for
29 keeping the property or when the carrier acts as a warehouse by operation of law, the property is
30 considered to have reached the owner. Likewise, when the owner is notified that property is
31 available for unloading, it has reached the hands of the owner. If the holding of the property by
32 the carrier is not merely incidental to its transportation, then the transit has most likely
33 terminated.

34 **Interruption of Transit**

35 If the temporary suspension of the movement of the property is required in order to facilitate its
36 transportation, to prevent its destruction, or to change the method of its carriage, it is still

⁸¹ *Coe v. Errol* (1885) 116 U.S. 517.

1 considered in transit and remains exempt. Property may be subject to taxation when the
 2 interruption in transit is for purposes unconnected with its transportation. Otherwise, it remains
 3 exempt. The courts have distinguished between suspension and termination of transit, stating:

4 Where property has come to rest within a state, being held there at the pleasure of
 5 the owner, for disposal or use, so that he may dispose of it either within the state,
 6 or for shipment elsewhere, as his interest dictates, it is deemed to be a part of the
 7 general mass of property within the state and is thus subject to its taxing power.⁸²

8 **Property Moving in Intrastate Commerce**

9 Unlike property in interstate or foreign commerce, property remains taxable while in transit
 10 within California (in intrastate commerce). Tax situs of this property among counties therefore
 11 becomes the issue.

12 **Situs of Property Being Transported by an Owner**

13 If an owner of property is transporting his or her own property on the lien date, the property has
 14 situs at the point of origin of the shipment regardless of the mode of transportation or the
 15 ownership of the means of conveyance.⁸³

16 **Situs of Property Being Transported to a Buyer**

17 Property being transported to a buyer has its situs at the point of destination unless the buyer
 18 demonstrates that the seller had title until delivery, in which case it has situs at the point of
 19 origin.

20 Title transfer is normally an agreed upon item in the purchase agreement; property will be
 21 purchased and shipped "F.O.B. shipping point" or "F.O.B. destination." F.O.B. (free on board)
 22 designates whether the seller or the purchaser will pay freight or transportation charges and
 23 determines when title transfers. "F.O.B. shipping point" means the purchaser is responsible for
 24 the property, and title transfers, at the point of origin (at the shipping point). "F.O.B. destination"
 25 means that title remains with the seller, and he/she bears the cost of transportation, until the
 26 property reaches its destination. The Uniform Commercial Code provides that the free on board
 27 (F.O.B.) designation, unless otherwise agreed between a seller and buyer, constitutes a term of
 28 delivery. Title to property remains with a seller until he or she has completed delivery by making
 29 the property available for disposition by the buyer at the F.O.B. point. Retention of a security
 30 interest by a seller must be disregarded for purposes of determining situs.⁸⁴ If questions arise
 31 regarding situs or assessee, a buyer should provide the purchase agreement and/or shipping
 32 agreement in order to demonstrate the timing of the title transfer.

⁸² *Minnesota v. Blasius* (1933) 290 U.S. 1.

⁸³ Rule 203(a)(1).

⁸⁴ Rule 203(a)(2).

1 **Interruption of Transportation**

2 As previously discussed, the interruption of transportation for purposes incidental to
3 transportation does not remove property from its "in-transit status." Interruption of transportation
4 for business purposes or profit of the property owner terminates the transportation and generally
5 creates a situs for taxation at the place where the property is situated on the lien date.⁸⁵

6 **OTHER SPECIAL SITUS SITUATIONS**

7 **AIRCRAFT**

8 The guidelines for situs of aircraft depend on aircraft type. For assessment purposes, aircraft are
9 typed or classified as *general aircraft*, *certificated aircraft*, or *air taxis*. Each is briefly defined
10 below in order to properly discuss situs in relation to this property.⁸⁶

11 **Definitions**

12 **General Aircraft**

13 General aircraft is "any contrivance used or designed for the navigation of or for flight in the air
14 which has been flown at least once...."⁸⁷ It is not a parachute or similar emergency safety device,
15 a rocket or missile, or a certificated aircraft or scheduled air taxi as defined below.

16 **Certificated Aircraft**

17 Certificated aircraft is "aircraft operated by an air carrier or foreign air carrier engaged in air
18 transportation... while there is in force a certificate or permit issued by the Civil Aeronautics
19 Board of the United States, or its successor [Federal Aviation Administration], or a certificate
20 issued by the California Public Utilities Commission, or its successor, authorizing such air
21 carrier to engage in such transportation."⁸⁸

22 **Air Taxi**

23 Air taxi means aircraft used by an air carrier which (1) does not utilize aircraft having a
24 maximum passenger capacity of more than 30 seats, (2) does not have a maximum payload
25 capacity of more than 7,500 pounds in air transportation, and (3) does not hold a certificate of
26 public convenience and necessity or other economic authority issued by the Civil Aeronautics
27 Board of the United States, or its successor, or by the California Public Utilities Commission, or
28 its successor.⁸⁹ This definition can be further broken down to scheduled and unscheduled air
29 taxis. Scheduled air taxis are treated similar to certificated aircraft and unscheduled air taxis are
30 treated similar to general aircraft.

⁸⁵ Rule 203(a)(2).

⁸⁶ For a complete in-depth discussion and definition of aircraft types, see AH 570, *Assessment of Commercial Aircraft* and AH 577, *Assessment of General Aircraft*.

⁸⁷ Section 5303.

⁸⁸ Section 1150.

⁸⁹ Section 1154.

1 **Situs of Aircraft**

2 **General Aircraft and Unscheduled Air Taxis**

3 General rules of situs apply to general aircraft and unscheduled air taxis similar to the rules that
 4 apply as they do to other personal property.⁹⁰ Situs is the location where the aircraft is habitually
 5 kept or to which it returns, when not in service.⁹¹ When an aircraft substantially divides its time
 6 between two or more airports in California, situs becomes determinable based on a time test but
 7 no apportionment is necessary. Rule 205(b) states:

8 ... An aircraft that spends a substantial amount of ground time at each of two or
 9 more airports has its tax situs at the airport where it spends the greatest amount of
 10 ground time.

11 If an aircraft establishes tax situs both in California and outside California, apportionment may
 12 be necessary and the rules established in *Ice Capades, Inc. v. County of Los Angeles* and
 13 *GeoMetrics v. County of Santa Clara* apply.

- 14 • For California aircraft, the assessment must be apportioned to eliminate the time the aircraft
 15 has established tax situs outside California. All the remaining time—whether or not in
 16 California—is allocated to the California airport where it spends the greatest amount of
 17 ground time.
- 18 • For an aircraft that has a primary situs outside of California, but has established some situs in
 19 this state, the California assessment is based on the time actually in this state—at the airport
 20 where it spends the greatest amount of ground time—and all other time is allocable
 21 elsewhere.

22 **Certificated Aircraft and Scheduled Air Taxis**

23 Certificated aircraft and scheduled air taxis using airports within this state while engaged in
 24 interstate, intrastate, or foreign commerce are taxable for an apportioned value of the aircraft
 25 based on time in this state when tax situs has been established in California.⁹² Specific statutes,
 26 sections 1150 through 1156, govern the method of apportionment when tax situs is established
 27 here. To establish tax situs within California, intentional physical contact involving actual
 28 embarking or disembarking of crew, passengers, or freight must be made. Emergency contact
 29 does not, in and of itself, establish situs any more than does flying over the state without
 30 landing.⁹³ The apportioned value is justified, even though an instrument of commerce, by the
 31 fact that the taxing jurisdiction extends opportunities, benefits, and protection to the property (the

⁹⁰ One exception is found in section 220, *Aircraft Being Repaired*. Out-of-state aircraft in California solely to undergo repairs are exempt from property taxation under this section even though they may be in California on the lien date.

⁹¹ Rule 205(b).

⁹² *Flying Tiger Line, Inc. v. County Los Angeles* (1958) 51 Cal.2d 314.

⁹³ Rule 202(b).

1 aircraft) engaged in interstate or foreign commerce during the pro rata time that the property is
2 physically present within that jurisdiction.⁹⁴

3 However, where an aircraft is foreign-owned, based, registered, and serving California airports
4 exclusively in foreign commerce, the state is precluded from taxation. No permanent, tax situs
5 has been established here and thus it is not taxable.⁹⁵

6 **Aircraft Repair and Replacement Parts**

7 Aircraft parts have situs where habitually located pursuant to Rule 201, in most circumstances,
8 but aircraft components may occasionally acquire situs elsewhere. The following example
9 identifies one of these situations.

<p>EXAMPLE 3.2 SITUS OF AIRCRAFT REPAIR AND REPLACEMENT PARTS</p>
<p>An air carrier at all times rotates eight engines between storage repair and installation. Two engines are normally found at the place of storage, two at another location for repair, and four are installed in operating aircraft at any one time. The number of engines normally located at each location has situs and is assessable there.</p>

10 **VESSELS**

11 Vessels are classified as personal property for property tax purposes. Similar to other property,
12 vessels may be assessed the ad valorem tax or qualify for full or partial exemptions depending
13 upon their value, ownership, use, and/or type. Similar to many other types of personal property,
14 identifying a vessel's property taxing authority is a central issue many assessors contend with –
15 that is, determining the tax situs for this type of transitory property. Therefore, a brief discussion
16 of vessel types and situs related to various vessels follows. See AH 576, *Assessment of Vessels*
17 for more information and for a discussion on vessels qualifying for exemptions.

18 **Definition of Documented and Nondocumented Vessels**

19 ~~The Revenue and Taxation Code~~ Section 130(a) defines vessels as "every description of
20 watercraft used or capable of being used as a means of transportation on water, but does not
21 include aircraft."⁹⁶ Vessels are sub-defined as *documented vessels* and *nondocumented vessels*
22 for assessment purposes.

23 A *documented vessel* is defined by section 130 as:

24 ... any vessel which is required to have and does have a valid marine document
25 issued by the Bureau of Customs of the United States or any federal agency

⁹⁴ See Rule 202(c) *Allocation Formula* and AH 570, *Assessment of Commercial Aircraft*, for discussion of allocation formulas for various types of aircraft.

⁹⁵ *Scandinavian Airlines Systems, Inc. v. County of Los Angeles* (1961) 56 Cal.2d 11.

⁹⁶ Section 130(a).

1 successor thereto, except documented yachts of the United States, or is registered
2 with, or licensed by, the Department of Motor Vehicles....

3 *A nondocumented vessel* is defined by exception in section 1141 as any vessel not required to be
4 documented.

5 It is important to understand the meaning of both terms for the purposes of applying vessel situs
6 statutes. The term *documented vessel* has a different meaning to non-property tax agencies. To
7 the U.S. Coast Guard and the Department of Motor Vehicles (DMV), the term *documented* refers
8 only to a vessel that is required to and does have a valid marine document issued by the U.S.
9 Coast Guard and not to vessels licensed by DMV.⁹⁷ For property tax assessment purposes,
10 however, the definition of *documented vessels* in section 130 includes all vessels required to be
11 registered with DMV, as well as those documented with the U.S. Coast Guard. Therefore, to the
12 property tax appraiser, both U.S. Coast Guard registered vessels and DMV licensed vessels are
13 *documented vessels* and are within the provisions of sections 130, 1139, and 1140. Although
14 documented by the Coast Guard, vessels of more than 50 tons net burden and engaged in the
15 transportation of freight or passengers are not subject to the statutes set forth for other
16 documented vessels, as such vessels are wholly exempt from taxation.⁹⁸

17 **Situs of Documented Vessels**

18 A vessel, although transitory in nature, is assessable in California if the vessel has established
19 situs here. Thus, the determination of where a vessel is legally situated has an effect on whether
20 or not a vessel is assessable by a California county. As with aircraft, situs may depend on vessel
21 type. A documented vessel shall be assessed at the place of documentation unless the place of
22 documentation does not represent the situs of the vessel.⁹⁹ Such cases may occur when:

- 23 • A vessel owner has permanently removed the vessel from its original designated situs to
24 another location where the vessel has become habitually moored and the owner has so
25 informed the property assessor in writing.¹⁰⁰
- 26 • An assessor can show, despite the place of documentation, original situs designation, or a
27 notice that a vessel has been removed, that the vessel is permanently located in his/her
28 county, provided the original county indicated that the vessel is not assessed there.¹⁰¹
- 29 • Coast Guard documentation of a new vessel occurred after 1995. Since that time, all
30 documentation occurs at the National Vessel Documentation Center in West Virginia rather
31 than in regional centers in this state. For these vessels, the place of documentation does not
32 represent the situs of a vessel. For example:

⁹⁷ Vehicle Code section 9840 sets forth a list of all types of vessels and prescribes which ones must be registered with DMV (and are thereby documented as defined by the assessor).

⁹⁸ California Constitution, article XIII, section 3, subdivision (I).

⁹⁹ Sections 1137-1141.

¹⁰⁰ Section 1139.

¹⁰¹ Article XIII, section 14 of the California Constitution ("... in the county ... in which it is situated") takes precedence over provisions of sections 1139 and 1140 of the Revenue and Taxation Code.

- 1 • A vessel shall be assessed in this state if it is documented outside of the state, but travels
2 regularly in California waters, and the owners reside in this state.¹⁰²
- 3 • A vessel shall be assessed in this state if it ~~that~~ is documented in this state or when the
4 vessel's owner is domiciled in California, but the vessel ~~may~~, by being indefinitely and
5 exclusively employed within the waters of another state, has acquired an actual situs in
6 that other state, and that other state ~~there that will~~ permits the vessel to be taxed in that
7 state.

8 The county where the DMV registers a vessel, the place of documentation, is typically the
9 county where the vessel is located and assessed. The address indicated on the registration
10 certificate is the mailing address of the registered owner but it does not indicate where the vessel
11 is habitually moored, which may be different from the owner's mailing address. The DMV stores
12 the situs information in its computer system and passes the information along to the assessors in
13 their reports. To facilitate the tracking of vessel owners and vessel locations, many assessors
14 have also established an on-line communication link with the DMV to access its database.

15 **Situs of Nondocumented Vessels**

16 Nondocumented vessels, those not required to be documented by the DMV or by the U.S. Coast
17 Guard, establish situs in the county where they are habitually moored when not in service.¹⁰³
18 Smaller boats that are not habitually kept at a mooring but are lifted from the water and kept in a
19 boathouse or transported by trailers to the owner's residence or another location are taxed at the
20 location where the boat is habitually kept.

21 **Situs of Intercounty Ferryboats**

22 The tax situs of intercounty ferryboats is regulated by statute. When a ferry connects ports in
23 more than one county, it is assessed in equal proportions in each of the counties. The wharves,
24 storehouses, and stationary property ancillary to the ferryboat operation are assessed in the
25 county or counties where they are located.¹⁰⁴

26 **Situs of Seagoing Vessels / Home Port Doctrine**

27 Vessels plying the high seas may constantly move between ports throughout the year. Such
28 vessels are generally bound by the "home port" doctrine that permits only the taxing authority of
29 a home port to impose a tax. No other jurisdiction, including those ports visited by the vessel
30 during its voyages, has the power to tax it.¹⁰⁵

31 The "home port" doctrine, established under common law, is a doctrine which permits vessels
32 engaged in foreign or interstate commerce to be taxed at the domicile of the owner or at the port
33 of registration regardless of where the vessel actually happens to be located on the lien date. This
34 doctrine has limited application in modern times, as both the United States Supreme Court, in

¹⁰² Section 1138.

¹⁰³ Section 1141.

¹⁰⁴ Section 1137.

¹⁰⁵ *Hays v. Pacific Mail S.S. Co.* (1855) 47 How. (58 U.S.) 596.

1 *Japan Line, Ltd. v. County of Los Angeles*,¹⁰⁶ and the California Supreme Court, in *Sea-Land*
 2 *Service, Inc. v. County of Alameda*,¹⁰⁷ have described the home port doctrine as anachronistic;¹⁰⁸
 3 however, the home port doctrine may be applied to seagoing vessels when no permanent situs
 4 has otherwise been established for a vessel. Prior to 1995, owners typically documented these
 5 vessels at the port nearest to their place of domicile, which was considered the vessel's tax situs.

6 Annual renewal of a Certificate of Documentation for vessels documented prior to 1995 will
 7 continue to show the original port of documentation on the certificate. Since 1995, a "hailing
 8 port," as opposed to a "home port," is now used on the Certificate of Documentation. As a result,
 9 the tax situs for seagoing vessels put into service since 1995 is the domicile of the owner.

10 The home port doctrine was developed for and applied to the taxation of vessels, as distinguished
 11 from the apportionment rule that has been applied to railroad rolling stock and aircraft. The
 12 United States Supreme Court granted the domiciliary state the power to tax in full and denied the
 13 power to tax to all other jurisdictions, regardless of where the vessel happened to be actually
 14 located on the lien date.¹⁰⁹ This ruling has been consistently applied to vessels by California
 15 courts.

16 Despite the home port designated by an owner, a vessel's home port should be determined by a
 17 ship's actual operations and not by the fictitious home port created solely by registry. A home
 18 port is to be distinguished from a "port of convenience." A port of convenience has no taxing
 19 authority as it is a port where a vessel primarily at sea enters temporarily between ocean voyages
 20 to deliver goods, obtain provisions, and make repairs.¹¹⁰ If a seagoing vessel is inactive and not
 21 engaged in any kind of commerce for a period of time that cannot be considered temporary,
 22 however, it acquires a tax situs where it is anchored or moored, irrespective of any so-called
 23 home port.¹¹¹

24 Due to the nature of interstate or foreign commerce and travel, the physical presence of a vessel
 25 may not establish permanent situs. A vessel may establish a habitual or significant presence at
 26 one or more locations. However, unlike some other types of personal property, vessels (other
 27 than intercounty ferries) are not subject to apportionment. When sites are temporary, even when
 28 a habitual or significant presence is established, tax situs is not acquired for property tax
 29 purposes. The tax situs of a vessel is not determined by an owner's designation of a home port
 30 but depends upon the existence of sufficient contacts, such as the use and employment of a
 31 vessel within the jurisdiction and the opportunities, benefits, or protection afforded a vessel by
 32 the jurisdiction, to satisfy due process.¹¹²

¹⁰⁶ (1979) 441 U.S. 434, 443 (1979).

¹⁰⁷ (1974) 12 Cal.3d 772, 786-787 (1974).

¹⁰⁸ Both the *Japan Line, Ltd.* and *Sea-Land Service, Inc.* cases addressed the taxability of cargo containers.

¹⁰⁹ *Hays v. Pacific Mail S.S. Co.*, supra, 58 U.S. 596

¹¹⁰ *Martinac v. County of San Diego* (1967) 255 Cal.App.2d 175.

¹¹¹ *Continental Dredging Co. v. County of Los Angeles* (C.D.Cal. 1973) 366 F.Supp. 1133.

¹¹² *County of San Diego v. Lafayette Steel Company* (1985) 164 Cal.App.3d 690.

1 A sea-going vessel, therefore, regardless of whether the vessel has a "home port" or a "hailing
2 port" designation, can acquire a new tax situs, if the vessel becomes habitually moored at a new
3 location.

4 **Application of Situs Determination**

5 The following is an example of making a determination of tax situs for a vessel using the
6 sections and rules described above. The conclusion regarding situs is specific to the information
7 given.

EXAMPLE 3.3 SITUS OF VESSEL

An assessee/vessel owner purchased a boat December 1, 2001~~8~~, and registered it with the California Department of Motor Vehicles (DMV) using a mailing address in XYZ County. On February 1, 2002~~9~~, the assessee filed a vessel property statement with XYZ County using the same address for purposes of registration as the assessee's mailing address and habitual place of mooring. However, on the back of the form, he noted that the boat was now moored in Mexico.

To determine situs and taxability, the assessor contacted the assessee and gathered the following information:

- The boat was purchased in San Jose, California on December 1, 2001~~8~~.
- The boat was registered January 1, 2002~~9~~, and the registration address (in XYZ County) shown was the domicile of the owner's son.
- The assessee claims (without documentation) that the boat is now habitually moored in Baja, Mexico, but is unable or unwilling to verify the date or permanent address (situs) of the new habitual mooring location. The situs address on the DMV registration certificate in XYZ County remains unchanged.
- Assessee claims permanent domicile in the State of Washington.
- The State of Washington will not register vessels without a physical inspection.

BASED ON THE FACTS PROVIDED, THE TAX SITUS OF THIS VESSEL ON LIEN DATE JANUARY 1, 2002~~9~~ IS XYZ COUNTY FOR THE FOLLOWING REASONS (IN ORDER OF IMPORTANCE):

- Application for a CF number and registration with the DMV establishes situs for vessels; thus, the tax situs is XYZ County, since the assessee indicated an XYZ County address as both his mailing address and the place of habitual mooring on the registration for his vessel (section 1139). Under California law: "Every undocumented vessel using the waters or on the waters of this state shall be currently numbered." (Vehicle Code section 9850). The assessee's intention was to use the boat in the waters of this state.
- The assessee stated on the property statement that the boat was located in XYZ County. This statement was signed under penalty of perjury. (The remarks on the back of the form are not sufficient documentation verifying a different situs for the vessel.)
- If a vessel is (permanently) moved from the registered situs, an owner is required to notify the DMV by changing the address on the registration certificate or by filing another property statement or other documentation notifying the assessor pursuant to section 1139. Since this did not occur, the situs of the vessel for property tax purposes is **XYZ County**.

1 **SITUS OF LINEN SUPPLY**

2 Towels, uniforms, and other laundered linen are items normally supplied by linen supply
 3 companies.¹¹³ For a monthly rental fee, the company supplies linen with the understanding that
 4 the items will be replaced periodically with a fresh supply. Soiled linen is taken back to the
 5 owner's business location for cleaning and redistribution. In general, these linens are exempt
 6 business inventory items when no committed to lease on the lien date.¹¹⁴ Linens that are
 7 committed to lease; i.e., the lessee has a contractual right to a *specific quantity of linens* or
 8 *specific linens* (company uniforms, towels, etc.), and under the contract has a right to control the
 9 use of the linens, the *specific linens* are not eligible for the inventory exemption.

10 Tax situs of linens must be determined based on the type and length of the lease involved
 11 pursuant to Rules 204 and 205. According to these rules, if the linens are rented on a short-term
 12 basis (six months or less or substantially shorter than the life of the property), they are to be
 13 assessed at the location where they are returned for cleaning. On the other hand, if the linens are
 14 rented on a long-term basis (more than six months, or for a major portion of the expected life),
 15 they attain a situs at the lessee's location. For example, laundries often lease readily identifiable
 16 industrial garments to service stations on a continuous basis. Often, these garments are
 17 temporarily taken to the laundry for normal maintenance and cleaning, but ~~they~~ are returned to
 18 the same user (lessee) where they are used until worn out. As such, these items are retained by
 19 the lessee for the major portion of their lives and attain a situs at the service station where they
 20 are used. Trade level per Rule 10 and the provisions of section 623 concerning a single
 21 assessment of leased property should be considered.

22 **SITUS OF VENDING EQUIPMENT/GAMES**

23 Vending machines (such as coin-operated pinball machines, food and drink vending machines,
 24 and music machines) are typically placed at various locations for extended periods of time and
 25 are only returned to the owner's business location for repair or for storage prior to disposition.
 26 Since these machines are more or less permanently situated at various locations, they have situs
 27 where located on the lien date.

28 ~~**SITUS OF CONTAINERS**~~

29 **SITUS OF RETURNABLE CONTAINERS**

30 Cylinders, beer barrels, and steel drums are types of returnable containers.¹¹⁵ Typically,
 31 returnable containers require a deposit as they are not intended for sale. The sole purpose of such
 32 containers is to provide a ~~moveable~~ movable vessel to hold ~~for their~~ contents that have been sold,
 33 such as compressed gas, beer, or ~~and~~ solvents. The situs of such containers is the location to
 34 which they are returned for reprocessing or refilling (i.e., the owner's business location).

¹¹³ Similarly, linen supply hardware such as towel cabinets, soap dispensers, and soiled rag containers are supplied to remain at the customers' locations for the duration of the contract. Situs of these items is typically the lessee location based on general situs rules.

¹¹⁴ Rule 133.

¹¹⁵ It should be noted that containers held for sale or lease are exempt from property taxation under the business inventory exemption. See section 129 and Rule 133.

1 Returnable containers for soft drink beverages, pursuant to section 996 ¹¹⁶, "shall be assessed
 2 only to the person in possession thereof on the lien date." Therefore, situs of this type of
 3 returnable container is the place of possession.

4 Where returnable containers originate from out-of-state and are returned to the out-of-state
 5 location for refilling, the "average presence" rule set forth in *Sea-Land Service, Inc. v. County of*
 6 *Alameda* ¹¹⁷ is applicable in determining tax situs.

7 **SITUS OF SEMI-PERMANENT CONTAINERS**

8 There are various containers that are more or less permanently located at a particular site.
 9 Examples are butane or propane tanks used for fuel storage. These tanks are refilled at the
 10 respective locations and remain there for considerable periods of time. Situs for assessment
 11 purposes is the place where they are located on the lien date.

12 **SITUS OF ARTIFICIAL SATELLITES**

13 "An artificial satellite permanently located in outer space does not have a tax situs in this
 14 state."¹¹⁸ Satellites are launched into outer space and guided to their FCC approved orbital
 15 assignment where they remain until they are no longer operative. After satellites are launched,
 16 they never return to earth. Satellites no longer operative are moved to a location known as a
 17 "space graveyard."

18 **SITUS OF RACEHORSES**

19 Section 5720.6 states that the tax situs of racehorses, subject to in-lieu taxation, is the home
 20 ranch of the owner or other place where the racehorses are quartered or domiciled and to which
 21 they normally return when not racing or in training at a race track. If the racehorses are not
 22 quartered at a home ranch or other location when not racing or in training to race, the situs is the
 23 residence of the owner. This determination is made at 12:01 a.m., on the lien date January 1,
 24 each year.

¹¹⁶ This is true unless that person has a legally enforceable duty to return the containers for reuse. A person, however, is not under a legally enforceable duty to return returnable containers for reuse merely because such person has the right to return such containers at his or her election for a sum of money equal to the deposit or similar charge paid upon acquisition of the containers. See section 996(a).

¹¹⁷ (1974) 12 Cal.3d 772.

¹¹⁸ Rule 206, *Assessment of Artificial Satellites*, effective January 1, 2002.

1 SITUS OF PERSONAL PROPERTY OWNED BY MEMBERS OF THE ARMED FORCES

2 The ~~Soldiers' and Sailors'~~ Servicemembers Civil Relief Act provides that non-business personal
3 property owned by active duty service personnel and their spouses has a tax situs in the state of
4 the owner's legal residence.¹¹⁹ Under this act, a property's physical location may be in California,
5 but its tax situs may be in New York if the owner's legal residence is in that state. The personal
6 property of a service member or spouse who files a statement with the assessor declaring his or
7 her legal residence to be in another state is therefore exempt from taxation in this state.

¹¹⁹ ~~Title 50 United States Code Annotated, section 574.~~ 50 U.S.C. Appen. § 571(d)

CHAPTER 4: VALUATION OF PERSONAL PROPERTY

AH 501, *Basic Appraisal*, includes a personal property chapter that gives a basic overview of the appraisal of personal property for property tax assessment purposes. Generally, as indicated in that chapter, basic appraisal principles apply to both real property and personal property. However, there are differences between the two.

This chapter focuses on basic and advanced valuation issues as related to personal property specifically. In order to discuss the topics in a complete manner, some review of information previously covered in other Assessors' Handbook sections is necessary.

REVIEW OF THE VALUE CONCEPT

Value is defined as the present worth of anticipated future benefits, or the monetary worth of a property at a given time. It is one of the most important and complex appraisal concepts. AH 501 includes a comprehensive discussion of the topic. This chapter discusses value as it applies specifically to personal property. Although the approaches to value are similar, real property and personal property differ significantly in that auditor-appraisers must estimate the market value of personal property on the lien date every year. Annually, it must be taxed in proportion to its value as defined in section 110(a):

... the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and the seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used, and of the enforceable restrictions upon those uses and purposes.¹²⁰

Unlike real property, personal property (with the exception of manufactured homes and floating homes) is not governed by the base year value limitations of article XIII A of the California Constitution (Proposition 13).

The annual lien date value of personal property, which must reflect market value, is unrelated to net book value (capitalized cost less depreciation) reflected on an assessee's books. Fair market value as defined in appraisal terms and net book value as defined in accounting terms are separate concepts. Any similarity is merely coincidental. It is important to recognize the differences. The California Supreme Court has said;

The accountant deals with past historical cost to the present owner and by the process of amortization spreads the cost of property over its useful life. The unamortized cost reflected on the balance sheet has no relation to the "full cash

¹²⁰ ~~Section 110(a).~~

1 value," i.e., the price that a willing buyer would pay a willing seller. (Citations
2 omitted.)¹²¹

3 As mentioned earlier, an appraiser's concept of value is full cash value, or fair market value, or
4 simply market value, as of the lien date. In contrast, the accountant's concept of value is normally
5 the book value of the property, the capitalized asset's acquisition cost less depreciation. This may
6 or may not be the same as market value, as stated by the court in *De Luz Homes, Inc. v. County*
7 *of San Diego*. In some cases, the "historical" cost basis for property tax purposes is different
8 from what is recorded as the book cost of the asset. (Costs applicable to valuation for assessment
9 purposes are discussed later in this chapter.)

10 APPROACHES TO VALUE

11 Rule 3, *Value Approaches*, which applies to both real property and personal property, discusses
12 five approach to value. The three major appraisal approaches for estimating value (cost,
13 comparative sales, and income) as discussed regarding real property, are applicable to personal
14 property as well. Although all three approaches to value should be considered, the use of all three
15 may not always be appropriate. The nature of the property, its market, and the availability of data
16 will normally indicate which approach(es) is most applicable. This is supported by Rule 3, which
17 states, in part:

18 In estimating value as defined in section 2, the assessor shall consider one or more
19 of the following [approaches to value], *as may be appropriate for the property*
20 *being appraised*. (Italics added.)

21 The auditor-appraiser, therefore, should analyze all available information to determine the most
22 applicable and reliable approach(es). An appraiser should have knowledge of each approach as it
23 applies to personal property and business fixtures to make this determination.

24 COST APPROACH

25 The cost approach to value estimates the value of an asset or a group of assets as the original or
26 historical cost of the asset (or group of assets), adjusted to account for changes in value since
27 purchase and/or installation. It is the method of valuation used most frequently to value personal
28 property and business fixtures for assessment purposes because it lends itself to mass appraisal¹²²
29 and is employed based on information provided on yearly property statements. As stated in
30 Rule 6(a), the cost approach is particularly appropriate for property that is not over- or under-
31 improved, and is not affected by other forms of depreciation or obsolescence. Use of the cost
32 approach is preferred if the following conditions exist: (1) no reliable sales data are available, (2)
33 no reliable income data are available for the property being valued, and (3) the income of the

¹²¹ *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 567, superseded by statute on other grounds as stated in *Oryx Energy Co. v. County of Kern* (1993) 17 Cal.App.4th 48.

¹²² *Mass appraisal* is "the process of valuing a universe of properties as of a given date utilizing standard methodology, employing common data, and allowing for statistical testing" according to See the Appraisal Institute. The Dictionary of Real Estate Appraisal, ~~Third Edition~~ (3d ed 1993) p. 224.

1 property being valued is not so regulated as to make current replacement costs irrelevant to
2 value.¹²³

3 Rule 6 allows and prescribes more than one type of cost approach that an appraiser may use. The
4 ~~three two~~ variations of the cost approach ~~provided discussed in this manual~~ are reproduction
5 cost; ~~and~~ replacement cost; ~~and historical cost. Although an appraiser may not utilize each~~
6 ~~variation, general knowledge of the terms and concepts associated with each is important to a~~
7 ~~thorough understanding of value in the context of property tax appraisal. Each variation is briefly~~
8 ~~described below.~~

9 **Reproduction Cost Approach**

10 The reproduction cost approach, as a variation of the cost approach, has limited usefulness
11 because it uses reproduction cost (the cost to replace an existing property with an identical
12 property, a replica) as a basis for estimating value. It is frequently not possible or desirable to
13 duplicate an existing property, due either to the lack of certain materials or trade skills or the
14 functional obsolescence of a property.

15 The difficulty of using reproduction cost increases as a property ages. When a property would
16 not be exactly duplicated, as is often the case, reproduction cost loses validity as an indicator of
17 market. This lack of validity can be overcome if depreciation is accurately estimated, but this can
18 be somewhat difficult to determine for an exact replica.

19 **Replacement Cost Approach**

20 *Replacement cost* is the cost to replace an existing property with a property of equivalent
21 utility¹²⁴ as of a particular date. The replacement cost concept is the most meaningful as far as
22 the principle of substitution is concerned.

23 In the replacement cost approach, elements of a property that would clearly not be included in a
24 substitute of equal utility are excluded from the estimated replacement cost. For example, a
25 buyer may not look for an identical new property to replace an older property. The buyer would
26 look instead for the best way to perform the same function(s). The best way may be to use the
27 latest state-of-the-art technology and materials, or may be another used piece of equipment able
28 to perform to specifications of equivalent utility. In making this decision, a buyer would look at
29 various aspects of available properties. These considerations include, but are not limited to, the
30 cost to acquire each property, to age of the properties, the remaining expected lives of the
31 properties, and the expected cost to operate each in comparison to the property being replaced
32 and to each other.

¹²³ Rule 6(a).

¹²⁴ Rule 6(d) provides that "[t]he "replacement cost of a reproducible property may be estimated ... by applying current prices to the labor and material components of a substitute property capable of yielding the same services and amenities, with appropriate additions...."

1 **Historical Cost Approach**

2 ~~*Historical cost* reflects the level of cost at the time of a property's original construction or~~
 3 ~~acquisition, and is discussed in Rules 3 and 6 in two contexts: (1) as a method of estimating~~
 4 ~~reproduction cost or replacement cost and (2) as the *historical cost/historical cost less*~~
 5 ~~*depreciation approach* used in the valuation of rate-regulated properties.~~

6 ~~The replacement or reproduction cost approach is applicable to any property whose earnings or~~
 7 ~~benefits are not regulated; that is, the assessor may use historical or original cost as a method of~~
 8 ~~estimating reproduction or replacement cost new using price indexes or data on current prices for~~
 9 ~~similar property. (The estimate must then be reduced by the amount of estimated depreciation to~~
 10 ~~arrive at an indicator of fair market value.)~~

11 ~~The *historical cost/historical cost less depreciation approach* referred to in Rule 3(d), is a~~
 12 ~~variation of the cost approach frequently applied to investor-owned, regulated public utilities.~~
 13 ~~The approach has little application to the county assessor and is not discussed in this manual.~~

14 **Variations of the Cost Approach**

15 The reproduction cost approach and the replacement cost approach, as discussed in Rule 6, are
 16 the variations most commonly used to value personal property and business fixtures at the
 17 county level. In general, these variations of the cost approach use historical or original cost¹²⁵
 18 information to estimate a reproduction cost new (current cost new to reproduce an *identical*
 19 property) or replacement cost new (current cost new to replace a property with a *similar* property
 20 of the same utility). Then, the reproduction or replacement cost new is adjusted to reflect
 21 depreciation to arrive at an assessable value.¹²⁶ AH 582, *Explanation of the Derivation of*
 22 *Equipment Percent Good Factors*, and the yearly update of AH 581, *Equipment Index and*
 23 *Percent Good Factors*, discuss this procedure in detail and provide suggested index factors and
 24 percent good tables for use by auditor-appraisers. Use of indexes and percent good factors
 25 provided in the AH 581 based on the indicated remaining economic life of the subject property
 26 give an estimate of what the market value *should* be for a property based on a broad, but similar
 27 "market basket." In most cases it is a practical method to apply for mass appraisal purposes,
 28 although it does not always reflect all types of depreciation for all types of property; additional
 29 adjustments are necessary. Market data may also be used to develop such factors, when data are
 30 available.

31 When using the factors and valuation method contained in the Assessors' Handbook, an appraiser
 32 should not only estimate a full economic cost (replacement cost new or reproduction cost new)
 33 and consider all forms of depreciation that apply to a particular property, but should also be
 34 aware of the limitations inherent to this approach. It is important for an appraiser to recognize the

¹²⁵ Rule 6 uses the terms historical cost and original cost synonymously, the cost of the property when new. The term *acquisition cost* is, in the Rule, used as the cost to the current owner. For purposes of this manual, the terms are used as defined in Rule 6.

¹²⁶ Alternatively, one factor may be developed and used to estimate value using one mathematical operation (*original/historical cost x value factor = value estimate* as opposed to *original/historical cost x index factor x percent good factor = value estimate*).

1 limitations of the cost approach in regard to a specific property because adjustments may be
 2 needed, or a different approach to value utilized. The annual ~~B~~business ~~P~~property ~~S~~statement
 3 allows property owners to identify all property specific conditions that would warrant adjustment
 4 beyond normal appreciation and depreciation guidelines. Supplemental information that may be
 5 presented by the assessee may be valid, whether or not submitted with the business property
 6 statement. Cost components, depreciation, and the limitations of the cost approach are discussed
 7 below.

8 **Valid Cost Components**

9 A property's recorded purchase price does not necessarily reflect all costs required to estimate
 10 value for assessment purposes, nor does it necessarily exclude costs ~~which~~ that do not contribute
 11 to value. In other words, not all costs contributing to value are booked and not all costs booked
 12 contribute to value. For example, the booked cost may represent acquisition cost as opposed to
 13 historical cost, (acquisition cost being the cost to the current owner, and historical cost being the
 14 original cost when new). If either the historical cost or the cost to the current owner does not
 15 accurately reflect all valid cost components or market value at the time the property was
 16 purchased,¹²⁷ ~~the~~ resulting cost approach value estimates may not be good indicators of value.¹²⁸

17 It is important to be aware of all cost components. Rule 6(b) and Rule 10(b) define these ~~costs~~
 18 components as including labor, material, entrepreneurial services, interest on borrowed or owner-
 19 supplied funds, freight or shipping costs, installation costs, sales or use tax, and "other costs
 20 typically incurred in bringing the property to a finished state (or to a lesser state if unfinished on
 21 the lien date)."¹²⁹

22 With regard to freight costs, it should be noted that only those charges necessary to place the
 23 property in service should be capitalized; subsequent transportation costs to return equipment for
 24 repairs should not be included;. Since ~~they~~ these changes are above and beyond what is
 25 necessary to transport the equipment from a warehouse to its ultimate location of use.

26 **Direct and Indirect Costs**

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

¹²⁷ ~~*Dennis v. County of Santa Clara* (1989) 215 Cal.App.3d 1019.~~

¹²⁸ *Dennis v. County of Santa Clara* (1989) 215 Cal.App.3d 1019.

¹²⁹ Personal property leased for a period of six months or less (Rule 10(c)) and certain liquefied petroleum gas tanks as provided by Rule 153 are treated differently. See the discussion of these issues in Chapter 6.

1 "soft" costs, include expenditures other than labor and material necessary to make the equipment
2 ready for its intended use.

3 The following listing illustrates typical costs ~~which~~ that should be included in full economic cost,
4 that is, those costs typically incurred in bringing the property to a finished state. Some of the
5 more common items are discussed in more detail in the pages following the table.

TABLE 4A
TYPICAL VALID COST COMPONENTS

<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)¹³⁰ 	<ul style="list-style-type: none"> • Unbooked sales/use tax,¹³¹ freight-in,¹³² installation, etc.
<u>Self-Constructed Equipment</u>	
<u>Direct Costs</u>	<u>Indirect Costs</u>
<ul style="list-style-type: none"> • Materials • Labor used in construction • Sub-contractor's fees • Charges for equipment or equipment rentals • Materials storage facilities (on site) • Profit (if appropriate) • Direct overhead • <u>Sales Tax on Materials</u> 	<ul style="list-style-type: none"> • Freight-in • Installation (foundations, pilings, utility connections, trial runs, debugging) • Trade-in allowances • Interest on borrowed or owner supplied funds for construction only (finance charges for purchased equipment are not components of cost) • Testing costs, sometimes referred to as <i>debugging costs</i> (in some instances) • Indirect labor (construction supervision, engineering fees, administration, etc.) • Legal fees • Indirect overhead • Other costs required to make equipment ready for its intended use

1

2

¹³⁰ Purchase price is the total consideration whether money or otherwise, section 110.

¹³¹ *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; but see *Auerbach v. Los Angeles County Assessment Appeals Bd. No. 2* (2008) 167 Cal.App.4th 1428, 1444, distinguishing *Xerox*, holding that: "Sales tax should not be included as an element of value in the assessment of a common carrier aircraft, exempt from sales or use tax."

¹³² *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.

1 Purchase Price

2 Normally, a recent purchase price is the best evidence of the value of an asset. The Revenue and
3 Taxation Code permits the assessor to presume fair market value from a property's full purchase
4 price (less allowable discounts), but does not bind the assessor to rely upon it.¹³³

5 Rule 6 contemplates the use of the original cost of the property and adjusted for subsequent price
6 level changes. However, ~~the~~ Rule 6(c) states: "If the property was not new when acquired by its
7 present owner and its original cost is unknown, its acquisition cost may be substituted for
8 original cost in the foregoing calculations." The calculations referenced here ~~is~~ are the ones
9 involving the application of price index factors to the original cost to determine replacement or
10 reproduction cost new.

11 However, the assessor should determine whether the purchase price accurately represents market
12 value at the time of acquisition. If evidence shows that price is not a good indicator of value, it
13 should not be used.¹³⁴ For example,

- 14 • ~~if~~ If a seller were in dire straits and was required to sell an asset, the price might be below the
15 maximum value a "willing" buyer in the market would pay in other circumstances; in other
16 words, the asset may have been sold for less than "fair market value";¹³⁵
- 17 • ~~if~~ If the transaction was between related parties (i.e., not an "arms-length" transaction), the
18 price might be below the maximum value a "willing" buyer in the open market would pay;
- 19 • ~~a~~ A total sales price may have been allocated to various property types (e.g., land,
20 improvements, equipment, and goodwill); the allocation may not be an accurate indication of
21 market value; or
- 22 • ~~if~~ If the sale is of an ongoing business or operation, or includes non-assessable intangible
23 property, the sales price might be above the value of the assessable property.

24 Therefore, the circumstances surrounding a sale should be considered: For example: Was the
25 property or business offered for sale in the open market? Was this an "arms length" transaction?
26 ~~w~~ Was the sale between related parties? Was the business in financial distress?

27 If the acquired property includes personalty, and/or business fixtures, the auditor-appraiser must
28 then estimate the remaining economic life of the acquired property, to determine the fair market
29 value at valuation dates subsequent to the acquisition date. Acquisitions of entire businesses, or
30 total assets of an entity, should be given very close scrutiny. Frequently, liabilities are assumed,
31 intangible property may be present, and the costs recorded on the books for the various acquired
32 asset categories are merely allocations of the purchase price, and do not reflect the true market
33 value of the taxable, tangible personal property, business fixtures, and/or leasehold or tenant
34 improvements.

¹³³ *Dennis v. County of Santa Clara*, (1989) *supra*, 215 Cal.App.3d at 1027-1031, 1019.

¹³⁴ Section 110(b) discusses use of purchase price in relation to valuation of real property. This section can be applied to personal property where appropriate.

¹³⁵ Section 110(b).

1 Sales/Use Tax, Freight, and Installation

2 The general rule in determining market value is that where price is the basis of value, sales/use
3 tax, freight, and installation costs are elements of that value.¹³⁶ These elements should be
4 included in full economic cost since they are part of value when they are paid. Moreover, if these
5 costs would have been applicable to a similar consumer using the equipment at a similar *trade*
6 *level*, ~~they~~ these costs may be assessable even when not paid.¹³⁷ The costs apply at the same rate
7 as those that apply to a similar consumer, whether actually paid or not.

8 However, there are exceptions to the general rule. Equipment rented to federal instrumentalities
9 and aircraft used by common carriers (neither of which are subject to sales tax), for example, are
10 valued without sales tax as an element of value. The reason in both cases is that the consumer
11 (the federal government or the air carrier) is never liable for sales tax on purchases of such
12 equipment. Consequently, the reproduction or replacement cost of such property should not
13 include sales tax, unless or until the property is put to private use or rented to a private party.¹³⁸

14 Other exceptions to the general rule include a partial sales tax exemption on the purchase and
15 lease of farm equipment and machinery, commercial timber harvesting equipment and
16 machinery, and racehorse breeding stock. Beginning September 1, 2001, qualified sales and
17 purchases (including lease payments made after that date) of these types of property are exempt
18 from the state general fund portion of the sales tax.¹³⁹ (The partial exemption also applies to the
19 repair and replacement parts for these categories of equipment and machinery.) The partial
20 exemption does not apply to any local, city, county, or district taxes. Local, city, county, and
21 district portions of the sales tax will continue to be included in the full economic cost of the
22 property for property tax valuation purposes.

23 With regard to the exemption allowed on the equipment, the property must be purchased by a
24 *qualified person* to be used *primarily* in the industry identified in the exemption. *Qualified*
25 *person* means any person engaged in the line of business described in each exemption and

¹³⁶ *Xerox Corp. v. Orange County* (1977) *supra*, 66 Cal.App.3d 746; but see *Auerbach v. Los Angeles County Assessment Appeals Bd. No. 2, supra*, 167 Cal.App.4th at 1444.

¹³⁷ 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.

¹³⁸ *Auerbach v. Los Angeles County Assessment Appeals Bd. No. 2* (2008) 167 Cal.App.4th 1428, 1444; see also the Sales and Use Tax Law for more information regarding sales tax requirements.

¹³⁹ ~~It should be noted that~~ There is a difference between the state sales and use tax rate ("state rate") and the state general fund portion of the sales and use tax rate. For example, as of January 1, 2002, the state rate is 6.00%, while the state general fund portion of the sales and use tax rate is only 5.00%, as 1.00% of the state rate is directed towards local revenue funds. The partial exemption discussed above is limited to the state general fund portion of the sales and use tax rate. Please see the table attached to LTA No. 2002/029 for the appropriate adjustment to a property's full economic cost, based upon the asset's acquisition date.

1 *primarily* means used 50 percent or more of the time for such purposes. Property qualifying for
2 this partial exemption includes:

- 3 • Farm equipment and machinery purchased to be used by a person engaged in the
4 agricultural industry and used for producing and harvesting agricultural products.¹⁴⁰
- 5 • Commercial timber harvesting equipment and machinery purchased to be used by a
6 person engaged in the commercial timber harvesting industry and used for harvesting
7 timber.¹⁴¹
- 8 • Racehorse breeding stock capable of reproduction and for which the purchaser states that
9 it is the purchaser's sole intent to use the horse for breeding purposes.¹⁴²

10 For all three partial exemptions, the purchaser must complete a partial exemption certificate (as
11 described in Sales and Use Tax Rule 1667) in order for the retailer to claim the partial
12 exemption. Therefore, if the purchaser qualifies for the exemption and completes an exemption
13 claim, their reported cost should only include a sales tax component for any local, city, county,
14 or district tax. The reported cost should not include a sales tax component attributed to the state
15 general fund portion of the sales tax.¹⁴³

16 A similar partial sales tax exemption is also available for diesel fuel used in farming activities or
17 food processing.¹⁴⁴ This partial exemption also requires that a fuel purchaser supply the retailer
18 with a certificate authorizing the exemption.

19 Trade-In Allowances

20 In some cases, a buyer will pay for property in part or in whole with a trade-in of older property
21 or equipment. This is a *trade-in allowance* and an element of value when using the cost
22 approach. This allowance is part of the price paid for the property, although the price was not
23 paid in cash. Had the trade-in allowance not been accepted as payment, the cash price would
24 have been higher. Appraisers must, therefore, add-back any trade-in allowances subtracted from
25 the purchase price or booked cost.

26 Capitalized Interest (Interest During Construction)

27 Self-constructed property, property constructed by the user and put to productive use in that
28 business, has an interest cost associated with it regardless of whether the source of funds is debt
29 or equity and whether or not the interest is actually incurred. Therefore, an increment of interest

¹⁴⁰ Section 6356.5 provides the exemption for farm equipment and machinery; in addition, see Sales and Use Tax Rule 1533.1.

¹⁴¹ Section 6356.6 provides the exemption for timber harvesting equipment and machinery; in addition see Sales and Use Tax Rule 1534.

¹⁴² Section 6358.5(a)(2), in part, see code section for further information regarding this exemption; in addition, see Sales and Use Tax Rule 1535.

¹⁴³ ~~For further guidance on how this sales tax exemption affects the economic cost of property for property tax purposes, see LTA 2002/029.~~

¹⁴⁴ ~~See Regulation~~ See Regulation Sales and Use Tax Rule 1533.2 and section 6357.1.

1 must be identified and included when valuing self-constructed property.¹⁴⁵ This only applies to
 2 financing costs during the construction period. Financing costs, actual or imputed, attributable to
 3 the holding of the property after the completion of construction, including purchase financing,
 4 should not be included in the cost of construction. Care must be taken to include only the interest
 5 attributable to the piece of equipment under construction.

6 When identifying the cost of the capital rate to apply, the following criteria should be considered:

- 7 • The rate derived should be the typical rate for the specific industry of the assessee.
- 8 • The rate should be the weighted average cost of capital, taking into consideration the
 9 typical debt-equity ratio for the industry.
- 10 • The cost of debt for long-term capital projects in most industries typically relates to
 11 long-term bonds, rather than short-term prime rate borrowing.
- 12 • Interest cost is related to, and measured against, the typical pattern for use of funds on
 13 any given project.

EXAMPLE 4.1
COMPUTING CAPITALIZED INTEREST

FACTS:

- A candy company constructed candy manufacturing equipment. The construction activity started on March 1, 2004~~8~~, and the equipment was ready for use on December 1, 2004~~8~~ (a nine-month acquisition period).
- On March 1, 2004~~8~~, at the beginning of construction, the company borrowed \$400,000 at 15 percent for five years to pay for the parts and material acquired for use in construction.

WHAT IS THE INTEREST COST COMPONENT NECESSARY TO INCLUDE WHEN USING THE COST APPROACH TO VALUE?

Funds Borrowed to Begin Construction x Interest Rate x Time = Interest Cost

$$\text{\$400,000} \times 0.15 \times 9/12 = \text{\$45,000}$$

WHAT IS THE TOTAL ORIGINAL COST OF THE EQUIPMENT (BASED ON THE INFORMATION PROVIDED)?

Funds Borrowed to Begin Construction + Cost During Construction = Total Cost

$$\text{\$400,000} + 45,000 = \underline{\underline{\text{\$445,000}}}$$

Note: No interest cost is capitalized after the equipment is placed in use on December 1, even though interest continues to accrue on the \$400,000 loan for the acquisition of parts and material needed for the construction of the equipment.

¹⁴⁵ Rule 6(b).

1 Testing Costs

2 *Testing costs* are those costs incurred during construction or installation of a production line or
3 equipment. Some of these costs may be assessable.

4 *Machinery testing costs* are costs incurred in the process of verifying that the production line is
5 working correctly. They are part of the installation process and are necessary in bringing the
6 property to a finished state. Machinery testing costs are assessable as valid cost components.

7 *Product testing costs*, on the other hand, are costs incurred in the research and development stage
8 of a product, rather than during the construction or installation of the equipment. Product testing
9 costs would be incurred when a product is developed, for example. These costs should not be
10 included in an appraiser's estimate of the full economic cost of the assessable equipment. These
11 costs are part of inventory (part of the product) and are unrelated to the matter of bringing the
12 manufacturing equipment to a finished state.

13 FDA Validation Costs

14 The FDA (Federal Food and Drug Administration) defines *validation* as "confirmation by
15 examination and provision of objective evidence that the particular requirements for a specific
16 intended use *can be* consistently fulfilled."¹⁴⁶ It is the responsibility of the user to develop and
17 conduct such examinations to ensure compliance with FDA guidelines specific to the industry or
18 to a property. Equipment or processes ~~which~~ that must be validated may include, for example,
19 processes such as sterilization, molding, and welding. Thus, *FDA validation costs* are those costs
20 incurred to establish:

21 ~~... evidence which provides a high degree of assurance that a specific process will~~
22 ~~consistently produce a product meeting its predetermined specifications and~~
23 ~~quality characteristics...by objective evidence that a process consistently~~
24 ~~produces a result or product meeting its predetermined specifications.~~¹⁴⁷

25 These costs are not assessable attributes of the property to which they are associated. Validation
26 costs are generally incurred once at the start of a process, as distinguished from *verification costs*
27 which may continue periodically over the life of a process. The FDA defines *verification* as
28 "confirmation by examination and provision of objective evidence that specified requirements
29 *have been* fulfilled (itals. added);"¹⁴⁸ a cost associated with maintaining property.

30 Research and Development Costs

¹⁴⁶ 21 C.F.R. §820.3(Z); www.accessdata.fda.gov/scripts/cdrh/cfdocs/cfCFR/CFRSearch.cfm?fr=820.3, Dec. 22, 2009-2002.

¹⁴⁷ www.fda.gov/MedicalDevices/DeviceRegulationandGuidance/PostmarketRequirements/QualitySystemsRegulations/MedicalDeviceQualitySystemsManual/ucm122439.htm#return Dec.22, 2009

¹⁴⁸ 21 C.F.R. § 820.3(aa); www.accessdata.fda.gov/scripts/cdrh/cfdocs/cfCFR/CFRSearch.cfm?fr=820.3, Dec 22, 2009-2002.

1 Research and development (R&D) costs are appropriately included as elements of full economic
 2 cost only when they relate to machinery or other assessable property. Even then, R&D may be
 3 assessable or non-assessable depending on the specific set of facts involved. For example, R&D
 4 relating to design or development of a tangible product ~~which~~ that the taxpayer intends to sell is
 5 inventory and therefore non-assessable.

6 R&D costs may be appropriately included in assessable property when they relate specifically to
 7 the successful development and construction of machinery or other assessable property used to
 8 produce a product. However, the appraiser must carefully scrutinize these R&D costs to
 9 determine the appropriate value added rather than simply including the total cost incurred. R&D
 10 often involves a trial and error process, with success following a number of failed attempts.
 11 Moreover, the appraiser must be careful not to include in the value of assessable tangible
 12 personal property the value of non-assessable property created by the R&D, such as patents,
 13 trade secrets, etc.

14 Finally, there may be timing and allocation questions to consider. For example, R&D costs may
 15 be incurred to successfully design, develop, construct, and test a piece of equipment to be used in
 16 a manufacturing or testing process. To the extent that R&D is properly includable in the cost of
 17 the tangible personal property, some reasonable method should be used to recognize the
 18 contribution of the includable R&D to the value of the initial and each subsequent machine. It
 19 would be inappropriate to allocate includable R&D costs to the first such self-constructed piece
 20 of equipment where the taxpayer plans to build additional machines of the same or similar type
 21 utilizing such R&D information.

22 **Discounts/Adjustments**

23 The purchase price of equipment may reflect discounts allowed due to payment within a pre-
 24 determined period or due to the quantity purchased. For example, a seller may offer a discount
 25 (say, 2 two percent) if the equipment is paid ~~for~~ in-full within a short time (say, 30 days). If the
 26 purchaser takes advantage of this discount and pays timely, the booked value of the asset would
 27 reflect the discount. Likewise, the seller may offer discounts that escalate based on the quantity
 28 purchased, and would exceed that which may be offered on smaller orders.

29 Discounts and rebates offered by a seller are a normal part of supply and demand in the process
 30 of setting market value, where the prudent buyer pays as little as reasonably possible and the
 31 seller charges as much as possible. The price paid for the property after recognition of discounts
 32 and rebates represents the amount received by the seller as well as the cost to the buyer.¹⁴⁹
 33 (Discounts between related parties may require further examination.) Discounts and rebates are
 34 therefore excluded from the full economic cost of equipment for property tax assessment
 35 purposes.

¹⁴⁹ The price paid by the buyer may include a sales tax component and is a valid cost component for valuation purposes. Sales tax is not part of the compensation retained by the seller.

1 Income tax credits, by contrast, are simply reductions of federal income tax liability. They are
 2 similar to depreciation or amortization charges against income for income tax purposes. Other
 3 allowances that are treated similarly to income tax credits include energy tax credits and
 4 manufacturers' investment credits. These items are therefore included in the full economic cost of
 5 equipment for property tax assessment purposes.

6 The purchase agreement may include a clause that provides liquidated damages in the event of
 7 the untimely delivery of equipment. *Liquidated damages* means:

8 An amount contractually stipulated as a reasonable estimation of actual damages
 9 to be recovered by one party if the other party breaches. If the parties to a contract
 10 have agreed on liquidated damages, the sum fixed is the measure of damages for a
 11 breach, whether it exceeds or falls short of the actual damages.¹⁵⁰

12 In certain situations, timeliness of delivery is a critical component of a transaction. The company
 13 purchasing the property may be in a situation where money may be lost if the equipment is not
 14 delivered by a certain date. Consequently, a clause may be included in the purchase contract that
 15 provides for a stated amount of damages to be recovered by the purchaser if the property is not
 16 delivered by that stated date.

17 Liquidated damages are not part of the consideration paid for a property. The damages a
 18 company may receive if the property is not delivered timely ~~is~~are not a valid adjustment~~s~~ to
 19 market value. Liquidated damages are not the same as discounts, which are a normal part of
 20 supply and demand. Discounts, a reduction in the purchase price of equipment, may be due to a
 21 payment received within a pre-determined period or due to the quantity purchased. Liquidated
 22 damages are amounts recovered due to a breach in contract.

23 Other items are excluded from a property's full economic cost when "other assets" are included
 24 in a purchase contract. Full economic cost does not include extended service plans or extended
 25 warranties, supplies, or other assets or business services that may have been included in a
 26 purchase contract.¹⁵¹ Adjustments to a purchase price for these items should be made if they
 27 contribute value to the total contract purchase price. In addition, the effect on the purchase price
 28 for any included financing should be considered and an adjustment made, if appropriate.

29 The following chart is an outline of types of adjustments discussed above and the proper
 30 treatment for assessment purposes.

¹⁵⁰ *Black's Law Dictionary*; Seventh Edition (1999), page 395.

¹⁵¹ Rule 10(b) and (e).

TABLE 4B
DISCOUNTS/ADJUSTMENTS

Description	Excluded from Full Economic Cost	Included in Full Economic Cost
Quantity discount	X	
Cash discount	X	
"Other" assets or business services included in purchase contract ¹⁵²	X	
Seller rebates	X	
Income tax credits		X
Energy tax credits		X
Manufacturers' investment credit		X
Liquidated damages		X

- 1
- 2 **Other Applicable Costs**
- 3 Other costs, whether booked or otherwise, should be considered on an individual basis in relation
- 4 to how they affect a property's market value.
- 5 Other costs may include, for example, those incurred in a major overhaul of a piece of
- 6 equipment. If an overhaul extends the life of an asset or increases its utility, the value of the asset
- 7 may be affected. (This should not be confused with minor repairs, overhauls, and maintenance
- 8 required to continue the existing use of a piece of equipment; these costs do not represent
- 9 assessable property.) The costs associated with a major overhaul may be expensed or may be
- 10 booked as a capitalized asset. In any event, it is important to consider major overhaul costs in the
- 11 valuation of equipment if the costs add value.
- 12 **Trade Level**
- 13 Consistent with the definition of full cash value, property must be assessed at the proper level of
- 14 trade based on its location and use on the lien date. An appraiser must recognize that property
- 15 normally increases in value as it progresses through production and distribution channels, and to
- 16 the consumer, whether or not the cost or value added is booked.
- 17 The trade level concept is applicable when book cost does not provide adequate information for
- 18 making a fair market value appraisal. It is a cost component which is most frequently applicable
- 19 to leased equipment and self-constructed equipment. Rule 10(a), *Trade Level for Tangible*
- 20 *Personal Property*, explains the concept of trade level and reads in part:

¹⁵² Full economic cost does not include extended service plans or extended warranties, supplies, or other assets or business services that may have been include din a purchase contract. (Rule 10(b) and (e).)

1 In appraising tangible personal property, the assessor shall give recognition to the
 2 trade level at which the property is situated and to the principle that property
 3 normally increases in value as it progresses through production and distribution
 4 channels. Such property normally attains its maximum value as it reaches the
 5 consumer level. Accordingly, tangible personal property shall be valued by
 6 procedures that are consistent with the general policies set forth herein.

7 Under the provisions of the rule, personal property is assessed on the basis of how it is situated
 8 or used on the lien date rather than at the book cost of the owner. In effect, the rule provides for
 9 equal value for properties equally situated.¹⁵³

10 This concept is more easily understood using the following example.

EXAMPLE 4.2
TRADE LEVEL

FACTS:

- ABC Grading Company purchases a bulldozer for \$250,000 and uses it to prepare land for subdivision development.
- At the same time, Dozer Sales, a bulldozer dealer, purchases an identical bulldozer for \$200,000 (dealer's cost) and rents it on a one-year lease to JKL Grading Company. JKL uses the bulldozer to prepare land for subdivision development, in competition with ABC.
- Concurrently, the bulldozer manufacturer (GHI) provides an identical bulldozer to its subsidiary, RST Grading Company (a competitor of ABC and JKL). The manufacturer's cost is \$150,000. RST uses the bulldozer to prepare land for subdivision development, in competition with ABC and JKL.

Logically, the full economic cost for each piece of equipment should be the same. In each situation, the bulldozer is used for the same purpose or at the same trade level. If no trade level adjustments were made and the book costs were used as the sole basis for appraising the equipment, the assessments would not be the same; they would be substantially different. The trade level principle, per Rule 10, requires the assessor to estimate fair market value for the three machines and provide uniformity of assessment.

Based on the information above, Dozer and GHI's costs would require two different trade level adjustments to arrive at the \$250,000 (consumer level) value. Dozer's cost (\$200,000) is a dealer cost that would not include retail items such as sales tax and the dealer's profit margin. GHI's cost (\$150,000) is the manufacturer's cost ~~which that~~ does not yet include retail items missing from the dealer cost, plus items such as profit margin normally added in when the manufacturer sells the product to either the dealer or a retailer. In this case, the dealer cost is adjusted 125% ($\$250,000 / \$200,000$) and the manufacturer's cost is adjusted 167% ($\$250,000 / \$150,000$) to arrive at the proper trade level.

11

12

¹⁵³ Fixtures, and other real property, should be assessed at the appropriate state of production as discussed in AH 501, *Basic Appraisal* (January 2002), page 12.

1 As illustrated in Example 4.2, the trade level concept requires adjustments based on what a
 2 consumer at that level of consumption would pay. If another consumer of like property at that
 3 level of trade would be subject to a cost (i.e., sales tax), the full economic cost should include
 4 that cost component whether or not the cost was actually incurred. However, quantity discounts,
 5 as discussed on page 66, should be excluded from full economic cost. In *Xerox Corporation v.*
 6 *County of Orange*, (1977) 66 Cal.App.3d 746, 758¹⁵⁴ the California Court of Appeal indicated
 7 that "under the market value concept, where price is the basis of value, the sales tax and freight
 8 charges are elements of value." Consumer trade level includes sales tax, freight and installation
 9 charges and the property is valued in accordance with the comparative sales, cost or income
 10 method. The courts have also supported the trade level concept by allowing inclusion of a
 11 markup in value for interdivisional transfers of manufactured goods for purposes of delivery or
 12 to facilitate marketing.¹⁵⁵

13 Internal Revenue Code section 482 states that the Internal Revenue Service (IRS) may allocate or
 14 apportion income between two and/or more organizations, trades, or business (whether or not
 15 incorporated, whether or not organized in the United States, and whether or not affiliated) owned
 16 or controlled directly or indirectly by the same interests. For example, if a company has a
 17 product manufactured by its related offshore manufacturer, the product's cost to the U.S. entity
 18 for income tax purposes may include the cost to manufacture the equipment plus an additional
 19 element for profit. The standard cost plus intercompany profit is called the *transfer price*. If the
 20 transfer price is used to determine the book cost of self-manufactured equipment, then the book
 21 cost contains or includes a trade level adjustment. The transfer price may or may not be equal to
 22 purposes. An auditor-appraiser should recognize that a profit element is included in book cost
 23 and relate this cost to market value at the time of transfer to determine the appropriate trade level
 24 adjustment for assessment purposes.

25 The following table simplifies the application of the trade level principle:

¹⁵⁴ Decision supported in *County of San Diego v. Assessment Appeals Bd. No. 2* (1983) 140 Cal.App.3d 52, 56.

¹⁵⁵ *Beckman Instruments, Inc. v. County of Orange* (1975) 53 Cal.App.3d 767.

EXAMPLE 4.2 (CONTINUED)			
TRADE LEVEL			
	ABC Grading	Dozer Sales Lease to JKL	GHI Manufacturer
Manufacturer's Cost (Cost incurred to produce equipment, costs incurred to bring equipment to finished state)			\$150,000
+ Value Added as Moved to Next Trade Level (mark up to include profit to manufacturer)			<u>50,000</u>
Dealer's Cost		\$200,000	\$200,000
+ Value Added as Moved to Next Trade Level (mark up to include profit to dealer, sales tax, freight, installation, and other necessary charges)		50,000	50,000
Consumer Level Cost / Full Economic Cost	<u>\$250,000</u>	<u>\$250,000</u>	<u>\$250,000</u>

- 1
- 2 In practice, determination of a trade level adjustment may be more complex because of (1)
- 3 uniqueness of the equipment, (2) the infrequency of sales, and (3) the unavailability of facts
- 4 necessary to determine its marketability on the lien date. To simplify the process, keep in mind
- 5 the examples provided here and first determine how the property is actually held or used on the
- 6 lien date.
- 7 In gathering data to determine a proper trade level adjustment, the use of a property prior to and
- 8 after the lien date should be considered since it may influence how it is valued on the lien date.
- 9 For example, if a lessor of copy machines uses a copier prior to and/or after the lien date but
- 10 places the copier in its inventory on the lien date, that copier is properly classified as assessable
- 11 equipment at the consumer trade level.
- 12 Include all costs necessary and appropriate for the property's trade level, and make adjustments
- 13 for any discounts that may be appropriate.¹⁵⁶ For example, if the consumer is a company that
- 14 typically receives quantity discounts due to the amount of equipment purchased, it generally is
- 15 appropriate to reflect such a discount in the adjusted cost.¹⁵⁷ (see also *Discounts/Adjustments*). If
- 16 a lessor leases property in quantity to one lessee, it may be appropriate to consider a quantity
- 17 discount adjustment that a customer at the lessee's trade level would receive. For example, when
- 18 property is leased for a period of more than six months, the property should be valued at the fair
- 19 market value price that a customer at the same trade level as the lessee would pay for that

¹⁵⁶ See *Valid Cost Components* in this chapter for a discussion on full economic cost.

¹⁵⁷ See *Discount/Adjustments* in this chapter.

1 property. Under the concept of full economic cost, as described in Rule 10, subsection (b), such
 2 price would be adjusted for any appropriate quantity discount that a customer at that lessee's
 3 trade level would receive.

4 Following is an example of trade level adjustment incorporating quantity discounts:

EXAMPLE 4.3
TRADE LEVEL WITH QUANTITY DISCOUNT
<p><u>FACTS:</u></p> <ul style="list-style-type: none"> • Alpha Company purchases a computer for \$2,500 and uses it in its business. • Beta Company purchases 1,000 identical computers for \$2,100 per computer and uses them in its business. The price difference is from a quantity discount. • At the same time, Comp Sales, a computer dealer, purchases 1,000 identical computers for \$1,700 (dealer's cost with a quantity discount) and rents them on a one-year lease to Kappa Company. Kappa uses the computers in its business, in competition with Alpha and Beta. • Concurrently, the computer manufacturer (Sigma) withdraws 2,000 identical computers from inventory. The manufacturer's cost is \$1,500 per unit. Sigma uses the computers in its business, in competition with Alpha, Beta, and Kappa.

5

6 Logically, the cost per unit and the full economic cost of the piece of equipment to Alpha
 7 Company is \$2,500 per unit. The cost per unit and the full economic cost for each piece of
 8 equipment to Beta Company is \$2,100 per unit. It is important to recognize that trade level does
 9 not extinguish a quantity discount. The full economic cost for each piece of Comp Sales
 10 equipment should be \$2,100 per unit, since Beta Company and Comp Sales purchased the same
 11 quantity. The quantity discount allowed for Sigma (manufacturer) needs to be determined by the
 12 auditor-appraiser. The auditor-appraiser needs to examine the greatest quantity discount given by
 13 the manufacturer, and make an appraisal judgment to determine if a greater quantity discount is
 14 justified. The quantity discount allowed the manufacturer, when it is its own largest customer,
 15 should be at least as large as its largest external wholesale or retail customer.

EXAMPLE 4.3 (CONTINUED)				
TRADE LEVEL WITH QUANTITY DISCOUNT				
	Alpha	Beta	Comp Sales	Sigma
Manufacturer's Cost (Cost incurred to produce equipment, costs incurred to bring equipment to finished state)				\$1,500
+ Value Added as Moved to Next Trade Level (Mark up to include profit to manufacturer)				200
Dealer's Cost			\$1,700	1,700
+ Value Added as Moved to Next Trade Level (Mark up to include profit to dealer, sales tax, freight, installation, and other necessary charges)			400	400
Consumer Level Cost/Full Economic Cost	\$2,500	\$2,100	\$2,100	\$2,100 or some value less than \$2,100

1

2 A unique trade level problem arises when a manufacturer of equipment is also its own largest
3 consumer, and the manufacturer routinely awards significant purchase discounts to others. In
4 valuing such equipment used for internal consumption, Rule 10(e) mandates assessment at the
5 price for which this equipment could be purchased ~~for~~ from an outside supplier. Such purchases
6 would probably reflect at least the largest purchase discount awarded to any other consumer.
7 Additional adjustments should be made for differences in the self-constructed equipment and
8 equipment sold to the manufacturer's customers. Such discounts and/or appropriate retail selling
9 prices for internally used equipment can be determined through (1) analysis of sales transactions,
10 which reflect large customer discounts or (2) use of a gross margin mark up method. When
11 actual sales data are available, the first method is preferred.

12 Previous examples demonstrate the determination of trade level through analysis of sales
13 transactions. The second method of determining full economic cost when a trade level
14 adjustment is necessary is called the gross profit method. The audit-appraiser may use the
15 manufacturer's gross margins on United States sales to determine the trade level adjustment. This
16 method should be used with caution, and only when the manufacturer has actual sales at the
17 retail level.

18

19

20

EXAMPLE 4.4	
TRADE LEVEL ADJUSTMENT USING GROSS PROFIT METHOD	
Total Sales to End Users Only (Net of value added <u>by</u> retailers and original equipment manufacturers)	\$10,000,000
Cost of Goods Sold (Net of marketing and administrative costs if not included in book costs)	7,500,000
Gross Profit	2,500,000
Gross Profit Percentage	33.33%
Trade Level Adjustment (1 + Gross Profit Percentage)	1.3333
Full Economic Cost with Added Trade Level ($\$1,500 \times 1.333 = \$2,000$)	\$ 2,000

1

2 To determine appropriate adjustments, information should be gathered from available sources
 3 (which may include review of accounting records to determine normal profit margin added at
 4 each level, review of cost guides, and gathering of information from equipment dealers). This
 5 information should be evaluated and determined to be appropriate prior to use. For example,
 6 when using the gross profit method, total sales should include all sales at the appropriate level;
 7 and the trade level adjustment should result in the property's full economic cost at the user's
 8 level. For any given situation, information gathering relevant to cost and evaluation of this
 9 information is an important part of the process and value estimate.

10 Caution must be exercised when the gross margin mark up method is used. The gross margin
 11 should reflect only those sales to end-users. If the manufacturer only sells at the wholesale level
 12 of trade, use of the gross margin method to extract a trade level factor will not bring the costs to
 13 the retail trade level. Further analysis of sales or other data will be required to determine an
 14 appropriate increment to add to achieve the retail, or end user level.

15 Sales to value-added retailers (VARs) and to original equipment manufacturers (OEMs) are not
 16 sales to end-users. Financial data pertaining to the sales to VARs, or OEMs ~~value-added retailers~~
 17 ~~or original equipment manufacturers~~ should be extracted from the "total sales revenue" and the
 18 "cost of goods sold" to isolate those sales at the retail level. Caution should be exercised when
 19 using income statements and annual reports; because they reflect combined sales and cost of
 20 goods sold data, i.e., sales to all customers, both wholesale and retail, are consolidated for
 21 reporting purposes.

22 The auditor-appraiser should analyze the underlying sales records to isolate revenue, discounts,
 23 and cost of goods sold data to end users only. Sales journals of actual invoices and purchase
 24 contracts will provide relevant information concerning the appropriate quantity discounts to be
 25 reflected in the final trade level factor.

26

1 The auditor-appraiser's analysis should include an analysis of the booked costs of the self-
 2 manufactured assets, as well as the components of the cost of goods sold. These costs should
 3 include comparable components of cost if the gross profit method is being used. If they are not
 4 comparable the trade level factor applied will not reflect the retail level. For example, booked
 5 costs may include material, labor, and some overhead costs, while "cost of goods sold" usually
 6 includes material, labor, overhead, marketing and administrative costs. The "cost of goods sold"
 7 amount in the financial statements must be adjusted to remove marketing and administrative
 8 costs prior to calculation of the trade level factor.

9 During the analysis of the booked costs of the self-manufactured assets, the auditor-appraiser
 10 should review these costs for the inclusion of sales tax on materials. Some manufacturers pay the
 11 sales tax on materials and include them ~~it~~ in the standard, or booked costs. An adjustment should
 12 be made to recognize ~~this~~ these added costs in the final calculation of a trade level factor.

13 Only sales within the United States should be considered when calculating a trade level factor
 14 from the assessee's financial records. The mark-up on exported products may vary considerably
 15 from the mark up on the sale of domestic products.

16 If the manufacturer is diversified and sells a wide range of products and services, caution should
 17 be exercised to isolate revenue and costs from the sale of products that are comparable to the
 18 self-manufactured assets that are being appraised.

19 While the trade level principle is most frequently relevant when assessing leased and self-
 20 constructed equipment, it is also important regarding other property where book cost is not
 21 indicative of costs generally incurred by the market, considering the location and use of the
 22 property. However, caution must be exercised when applying the trade level principle. Consider
 23 the rental of the bulldozer by Dozer Sales to JKL Grading Company in Example 4.2. If the rental
 24 had been for less than six months (short-term lease) instead of the one-year lease specified in the
 25 example, Rule 10(c) directs that the bulldozer shall be assessed at Dozer's acquisition value
 26 (\$200,000 dealer cost with sales tax added) instead of the \$250,000 consumer-level cost. The
 27 lessor would then be considered the consumer pursuant to subdivision (c) of Rule 10.

28 Trade level is an important concept in the assessment valuation process. The Business Property
 29 Statement requires that assessees report costs at the proper trade level.⁴⁵⁸ During the course of an
 30 audit the auditor-appraiser should verify that the assessee compiled and reported at the proper
 31 trade level, and that all necessary and appropriate adjustments have been made.

32 **Depreciation of Machinery & Equipment**

33 *Depreciation*, for appraisal purposes, is a loss in value from any cause. It is the difference
 34 between the value of a hypothetical new, similar property and the current value of the subject
 35 property; the total measure of the reduced value at a particular point in time. In other words, it is
 36 a by-product of the value estimate.

⁴⁵⁸ ~~Rule 10.~~

1 For appraisal purposes, depreciation occurs in two different ways. First, and probably most
 2 important, the remaining economic life of a property may decline. Instead of yielding benefits for
 3 ten years as when new, a property may now have only eight years remaining service. Second,
 4 there may be a reduction in net benefits from the property. Fewer benefits may be provided, or
 5 the same benefits are provided at a higher cost (thus, fewer net benefits are provided). Thus, a
 6 decline in the remaining life or the efficiency of property causes depreciation.

7 The appraiser's definition and use of depreciation ~~is~~are fundamentally different from the
 8 accountant's definition and use of depreciation, as discussed earlier regarding value. The
 9 accountant uses depreciation to amortize a property's cost over the life of the property. Each year
 10 the accountant estimates depreciation, based on a preselected life, to recover the cost of the
 11 equipment in the most beneficial legal manner for GAAP and/or income tax purposes.

12 These definitional differences are represented mathematically below:

13 *Replacement Cost New - Depreciation = Current Market Value (Appraiser)*

14
 15 *Reproduction Cost New - Depreciation = Current Market Value (Appraiser)*

16
 17 *Capitalized Cost - Depreciation = Book Value (Accountant)*

18
 19 The appraiser should recognize that depreciation from reproduction cost new is different from
 20 depreciation from replacement cost new when these costs are different. In situations where
 21 equipment has undergone minimal changes in technology, reproduction cost and replacement
 22 cost are likely to be similar. The appraiser cannot use the accountant's depreciation estimate
 23 when valuing an asset because he or she must determine an estimate of depreciation ~~which~~ that
 24 directly relates to the actual loss in value the property has incurred. Accountants are not
 25 concerned with representing market value at any point in time, but are concerned only with
 26 writing off the cost incurred to purchase the asset. If book value (capitalized cost – depreciation
 27 = book value) has any relation to market value, it is only coincidental. Rather than using
 28 depreciation computed for accounting purposes as an estimate, appraisers should use methods of
 29 estimating depreciation that represent the loss in value a property has suffered.

30 Although depreciation may be, and most often is, estimated in a lump sum, it is important to be
 31 aware of each type of depreciation in order to determine (1) if all necessary adjustments have
 32 been made and (2) that there are no duplicate allowances for any one type. Each type of
 33 depreciation: physical deterioration, functional obsolescence, and external obsolescence, is
 34 defined and discussed below.

35 **Types of Depreciation Defined**

36 A property may suffer from one or more forms of depreciation. That is, a single piece of
 37 equipment may contain elements of physical deterioration as well as both functional and external
 38 obsolescence. In some cases, calculation methodologies may be used to separately estimate the
 39 amount of depreciation attributable to each cause. In many situations, however, it may be

1 impossible to categorize the amount of depreciation attributable to each cause. Regardless of
 2 whether total depreciation is calculated as a whole or as a sum of parts, recognizing and
 3 identifying the types of depreciation applicable to a property may aid in estimating total
 4 depreciation to arrive at value.

5 ***Physical Deterioration***

6 *Physical deterioration* is the loss in value which may be the result of wear and tear either from
 7 use or exposure to various elements. This type of depreciation is expected on most equipment.
 8 Virtually all properties deteriorate as they age, and it is not abnormal unless equipment is put to
 9 excessive use or misused. Good maintenance will slow the process, while lack of maintenance
 10 and overuse will increase physical deterioration.

11 Most physical deterioration can be corrected. However, the relationship between the costs
 12 involved and the economic benefit derived determines whether it is economically feasible to
 13 correct or repair physical deterioration. An element of physical deterioration is considered
 14 *curable* when the cost to correct the deficiency is less than the economic benefit resulting
 15 therefrom. When the cost to correct the deficiency is greater than the resulting economic benefit,
 16 the element of physical deterioration is considered *incurable*.

17 ***Functional Obsolescence***

18 *Functional obsolescence* is the loss of value in a property caused by the design of the property
 19 itself. When the capacity of a property to perform the function for which it was intended
 20 declines, functional obsolescence is present. Functional obsolescence may include such things as
 21 changes in taste in the marketplace, changes in equipment design, materials, or process, or poor
 22 initial design.

23 Changing technology commonly creates functional obsolescence for machinery and equipment,
 24 and some functional obsolescence can be or should be considered normal to varying degrees
 25 (depending upon the industry and equipment type). Older machines and sometimes newer
 26 machines or entire lines of equipment, even though still in use, may be made obsolete by new
 27 technologies and manufacturing processes and the market value may be reduced because of
 28 functional obsolescence.

29 Functional obsolescence may be less tangible or visible than physical deterioration, but it may be
 30 more significant. However, it may be curable. An element of functional obsolescence is
 31 considered *curable* when the cost to correct the deficiency is less than the resulting economic
 32 benefit. When the cost to correct the deficiency is greater than the resulting economic benefit, the
 33 element of functional obsolescence is considered *incurable*.

34 ***External Obsolescence***

35 External obsolescence, also known as economic obsolescence, is a loss in value resulting from
 36 adverse factors external to the property that decrease the desirability of the property. This type of
 37 depreciation may include the loss of value due to: inflation, high interest rates, legislation,
 38 environmental factors, reduced demand for the product, increased competition, changes in raw

1 material supplies, and increasing costs of raw material, labor or utilities without a corresponding
2 price increase of the product.

3 Loss in value attributable to external obsolescence is usually beyond the owner's control and is
4 mostly atypical depreciation. It can, however, be normal in industries where markets have shown
5 long-term, sustained, and predictable shifts, such as the market for semiconductor and other
6 high-technology equipment. It can be identified by studying the overall market conditions for a
7 property. For example, if the output of a machine is superseded in the marketplace by output of a
8 different material (i.e., fiberglass for metal or plastic for wood), and the market no longer
9 absorbs the superseded output, then the machinery has suffered external obsolescence.

10 **Methods of Estimating Depreciation and Value**

11 There are several methods of estimating depreciation and value for appraisal and assessment
12 purposes. Appraisers may need to use one or more of these methods while determining
13 depreciation from all causes. Again, the appraiser's methods are not the same as the accountant's
14 methods because an accountant uses depreciation to recover cost over a preselected useful life of
15 the property as determined by GAAP and/or federal and state income tax laws while an appraiser
16 uses depreciation to estimate market value.¹⁵⁹

17 ***Market Method***

18 The Market Method of calculating value factors (and/or developing depreciation tables) relies on
19 market data with adjustments made for relevant property characteristics incorporated (see
20 Appendix C-H). It is a method of estimating a property's total depreciation directly without
21 utilizing indirect engineering economics calculations. The Market Method is the preferred
22 method when reliable data¹⁶⁰ are available because it captures all forms of depreciation,
23 including both external and functional obsolescence.

24 Using a variation of this methodology, an analyst and/or appraiser may gather market data for
25 identical or similar property to compare the used price of an asset to the original new price of
26 that same asset. The difference is the analyst and/or appraiser's estimate of percent good (used
27 price / new price = percent good factor or value factor)¹⁶¹ at the age it was at the time of sale.
28 The estimates are reduced to a table of value factors (similar to a depreciation table and/or the
29 percent good tables published by the Board) and arrayed on a scattergram. A best-fit curve,
30 passing through the entire mass of points, estimates average value factors at each age and the
31 average decline in value per year. (It is usually set to 100 percent at age 0 in order to correspond
32 with the assumption that a new asset is purchased at its market value when new.)

¹⁵⁹ Assessors tend to utilize equipment index factors and percent good factors published by the Board for the majority of appraisals concerning machinery and equipment, and fixtures. However, different methods of estimating depreciation and value may be appropriate.

¹⁶⁰ See AH 501, *Basic Appraisal*, Chapter 6, under the discussion of the cost approach for information regarding data collection and analysis.

¹⁶¹ Using the market method, a combined factor may be estimated similar to the result of multiplying the index factor and the percent good factor used from AH 581 tables discussed in this chapter.

1 The Board used a similar market methodology to calculate the computer valuation schedules
 2 from market data. (These tables are provided in the annual update of AH 581, *Equipment Index*
 3 *and Percent Good Factors*.) The Board also recommends this method in AH 501, *Basic*
 4 *Appraisal*, as applied to real property.¹⁶² When reliable, accurate, and representative data are
 5 available regarding machinery and equipment, and fixtures, use of this approach (or a modified
 6 version) is the preferred method.

7 ***Equipment Index Factors and Percent Good Factors***

8 The valuation of personal property and business fixtures for assessment purposes most often
 9 involves the use of a mass appraisal method. The property statement is organized to facilitate the
 10 use of such a method, specifically equipment index and percent good factors. Property (normally
 11 equipment) is valued based on information reported on property statements. Each piece of
 12 equipment is not identified and valued separately, but rather, the equipment is valued as a group
 13 based on the type of business and the classification of the property.¹⁶³ The first step in the
 14 calculation process is to "trend" the historical cost of the property to an estimated reproduction or
 15 replacement cost new (cost x index factor). This trending is accomplished using an equipment
 16 index factor. The next step is to multiply the trended historical/original cost by a percent good
 17 factor to estimate the market value of the property, reproduction or replacement cost new less
 18 normal depreciation.

19 As explained in AH 581, *Equipment and Fixtures Index, and Percent Good and Valuation*
 20 *Factors*, and AH 582, *Explanation of the Derivation of Equipment Percent Good Factors*,
 21 equipment index factors and percent good factors are computed and published by the Board
 22 annually for use in estimating reproduction cost new and equipment value, respectively. The
 23 tables provided in AH 581 are based upon data for different types of property. Percent good
 24 factors in AH 581 use the present worth relationship principle. These factors also assume a
 25 constant rate of net income decline. If a rate of income decline different from that assumed in the
 26 tables occurs and can be demonstrated, a recomputation should be made by adjusting the income
 27 adjustment factor. This in turn will alter the percent good factors to be used. A discussion of the
 28 factors, the equipment index factor and the percent good factor, is included here in a general
 29 context. This discussion is not meant to represent a study of the topic, but rather an overview to
 30 facilitate the application of the factors. For more information, refer to AH 581 and AH 582.

31 **Equipment Index Factors**

32 Equipment index factors are developed for use in mass appraisals and are generally reliable and
 33 practical for converting historical or original cost to estimates of reproduction cost new or
 34 replacement cost new for mass appraisal purposes. Index factors are used to adjust a property's
 35 original cost for price level changes since the property was acquired. The index factors
 36 recommended by the Board, updated and distributed annually, include three separate index factor
 37 tables: Table 1, Commercial Equipment, Table 2, Industrial Equipment, and Table 3,

¹⁶² AH 501, Chapter 6, under the heading "Measurement of Accrued Depreciation."

¹⁶³ An exception is Form AH 571-F (Agricultural Property Statement). Each piece is listed separately on this form. See Chapter 7 for a complete discussion of property statements.

1 Agricultural and Construction Equipment. The tables rely on indexes published by the U.S.
 2 Government Bureau of Labor Statistics (BLS) and on information published by Marshall &
 3 Swift Publication Company.

4 The indexes published by the BLS and Marshall & Swift are intended to track price changes for
 5 an identical product sold under identical terms over time, such that the indexes approximate an
 6 estimate of reproduction cost new. Thus, when the original cost of property is multiplied by the
 7 Board's index factor for the year of acquisition, the product typically approximates current
 8 reproduction cost new.

9 Reproduction cost is the cost to replace an existing property with an identical property, a replica.
 10 Replacement cost is the cost to replace an existing property with a property of equivalent utility.
 11 The significance of the difference between these two types of the cost approach arises when
 12 property has experienced significant functional obsolescence. Functional obsolescence is the loss
 13 of value in a property caused by the design of the property itself. In cases where the property has
 14 experienced significant functional obsolescence, the original piece of equipment would not be
 15 replaced by an identical substitute. The buyer would instead look for the best way to perform the
 16 same functions. In either case, replacement cost or reproduction cost, the cost of equipment
 17 should be adjusted for depreciation to arrive at an estimate of market value.

18 As indicated earlier, the index factors provided by the Board include three separate index factor
 19 tables – commercial equipment index factors, industrial machinery and equipment index factors,
 20 and agricultural and construction equipment index factors. Prior to 2002, the commercial
 21 equipment index factors (Table 1) were presented in AH 581 as 12 separate classes of equipment
 22 and the industrial equipment index factors (Table 2) were presented as ~~6~~ six separate groups of
 23 industries. Beginning with the January 1, 2002 lien date, the commercial equipment index factors
 24 were averaged into one table and the industrial equipment index factors were averaged into one
 25 table. Averaging of the multiple categories of equipment index factors continues to produce
 26 results within an acceptable band of value. In addition, the averaging provides administrative
 27 benefits to assessors when assessing business property. The index factors in AH 581 are intended
 28 to be used to provide a time-efficient method of making reasonable estimates of reproduction
 29 cost for typical properties; the factors are a tool for estimating fair market value.

30 Price Changes

31 Price changes are usually an increasing factor (inflation). During those periods of time when the
 32 cost of raw material and/or labor actually declines, however, price changes may be a decreasing
 33 factor (deflation). Price changes are measured from a base year, in which a beginning index
 34 number is typically set at 100. If raw materials, labor and other costs rise, the index will probably
 35 increase. In a period when the costs of the factors of production decline, the index may decrease.

36 Effects of Technological Progress

37 If technological progress has occurred since the acquisition date of an asset, the cost of
 38 producing a functionally superior but physically similar asset may now be lower. Consequently,

1 the current replacement cost new of previously existing assets will probably decline. High
 2 technology equipment, for example, typically suffers greater than normal functional
 3 obsolescence due to technological progress.

4 In situations where equipment has undergone minimal changes in technology, reproduction cost
 5 and replacement cost are likely to be similar. In industries where equipment is undergoing rapid
 6 changes in technology, further adjustments are likely to be needed. Board staff has identified a
 7 few industries where equipment has experienced rapid changes in technology. AH 581 includes
 8 separate tables for the of valuation of ~~nonproduction computers and related equipment, semi-~~
 9 ~~conductor semiconductor manufacturing equipment and fixtures, and biopharmaceutical industry~~
 10 ~~equipment and fixtures.~~ factors for specific types of equipment.¹⁶⁴ Indications of changes in
 11 technology may include increased capacity of new equipment, changes in equipment design,
 12 material, or process, or lower costs for new equipment. The effects of technological advance may
 13 include the increased capacity of new equipment, changes in equipment design, materials and
 14 processes, and lower costs for new equipment. Forces that may cause obsolescence include
 15 changes in taste in the marketplace and regulatory requirements.

16 Assesseees may present evidence to the assessor to support their estimation of market value when
 17 they believe that application of the index factors does not produce results within an acceptable
 18 band of value. Evidence presented to the assessor should be reviewed and considered. (Evidence
 19 presented to the assessor at the time that the business property statement is filed allows the
 20 assessor time to review and consider the evidence prior to the closing of the assessment roll).
 21 The evidence may be presented in the form of an independent appraisal, a market study, price
 22 lists for new equipment, and/or data from used equipment price guides.

23 An independent appraisal is an appraisal conducted by an unrelated firm that specializes in the
 24 valuation of personal property and fixtures. The appraisal typically includes a listing of all of the
 25 property included in the valuation. The appraisal may include itemized valuations of each piece
 26 of equipment or a total value estimate. The format presented must clearly identify the appraisal
 27 approach and may vary depending on the appraisal approach (i.e., cost, comparative sales, and
 28 income) utilized by the appraiser.

29 The evidence may also be presented in the format of a market study. An example of a market
 30 study is described as the Market Method presented earlier in this chapter and in Appendix C H.
 31 The Market Method is any method of calculating value factors (and/or developing depreciation

¹⁶⁴ ~~In years 1997, 1998, and 1999 valuation tables for computer related and semi-conductor manufacturing equipment were distributed via *Letters To Assessors*. Beginning in year 2000, the valuation tables were included in AH 581. The "interim" biopharmaceutical industry valuation table, effective January 1, 1999, was distributed via LTA No. 99/54; this table is now also included in AH 581. Index factors for state assessed properties are available upon request. The valuation factors resulted from valuation factor studies chapter 5 of AH 581 provides an overview of the valuation factor study process as provided in section 401.20. The nonproduction computer valuation factors table was approved by the Board in April 2009 and is effective as of the January 1, 2010 lien date. The semiconductor manufacturing equipment and fixtures table was approved by the Board in October 2008 and became effective on January 1, 2009. The biopharmaceutical industry equipment and fixtures valuation factors table was approved by the Board in July 2008 and became effective on January 1, 2009.~~

1 tables), which relies on market data, with adjustments made for relevant property characteristics
 2 incorporated in the data. Data used for the market study should include recent market sales that
 3 meet all conditions of an arms-length transaction. Data from bankruptcy and/or liquidation sales
 4 would not provide indications of market value.

5 Price lists for new equipment and price guides for used equipment are other sources that may be
 6 used to value personal property. When reliable evidence of current replacement costs is available
 7 in a viable format, it is more appropriate to use market-indicated costs rather than trended
 8 historical costs. Price lists and used equipment price guides provide market-indicated costs. If
 9 price lists for new equipment are utilized, adjustments may be necessary if the equipment being
 10 valued is no longer available in the market. In addition, depending on the technological advances
 11 in some industries, the price lists for new equipment may not provide any benefit. With regard to
 12 used equipment price guides, if no market exists for used equipment in a particular industry, such
 13 guides may not be a useful alternative.

14 The methods mentioned above are provided as examples of methods that may be utilized to
 15 determine fair market value when it is necessary to test whether the application of index factors
 16 and percent good factors in AH 581 provide an acceptable value indicator. Other methods may
 17 be presented depending on the type of data available.

18 Some ~~areas~~ questions the assessor should consider when reviewing evidence presented include
 19 the following:

- 20 • Are causes of rapid change of technology apparent in the industry?
- 21 • Does the appraisal utilized by the assessee to estimate fair market value include appropriate
 22 adjustments?
- 23 • Are the data provided by the property owner verifiable?
- 24 • ~~Were~~ Did the assessee apply or interpret the data applied/interpreted correctly?

25 **Percent Good Factors**

26 In a mass appraisal program, percent good factors are frequently used in estimating depreciation.
 27 Percent good, as a percentage, is the complement of depreciation. For example, if total
 28 depreciation is 20 percent, then percent good is 80 percent. The percent good concept is used in
 29 the appraisal process for two reasons: (1) it focuses the appraisal on the benefits remaining or the
 30 economic life remaining in the property rather than the benefits used; and (2) it saves one
 31 arithmetical operation when estimating market value.

32 Percent good factors are provided by the Board in AH 581, *Equipment Index and Percent Good*
 33 *Factors*,¹⁶⁵ for use in valuing personal property and fixtures. In general, an average service
 34 life¹⁶⁶ estimate is needed in order to utilize the table. In mass appraisal situations, estimating life

¹⁶⁵ AH 582 discusses derivation of the percent good factors included in AH 581.

¹⁶⁶ The average life term of a group of items

1 for each piece of equipment is not practical; therefore, service life is not generally estimated on
 2 an individual basis. (It may occur in practice, however, when the assessee files an appeal, when
 3 an audit is conducted, or when equipment is self-constructed.) Average service life can be
 4 estimated by an appraiser based on a mortality study of individual acquisitions and retirements
 5 (see Appendix D F), historical usage of property, useful life expectancy as reflected by the
 6 applicable industry, or other information as available. When an item is not new, the tables may
 7 be applicable based on the item's *remaining economic life*¹⁶⁷ since the remaining economic life is
 8 usually greater than the original average service life minus age. This occurs because in any group
 9 of equipment, some items "die" prematurely, so the life of the remaining items would generally
 10 exceed the average service life.

11 Any percent good table or depreciation schedule, including those published by the Board, should
 12 be used only as a guide in the estimation of value. They may reflect more or less depreciation
 13 than the actual market indicates. If equipment has experienced abnormal, excessive, or even less-
 14 than-expected depreciation, the percent good factors may not be reliable. In this case, a percent
 15 good factor could be used in combination with another method of depreciation calculation, or it
 16 may be necessary to use another approach to value altogether. This is also true if the equipment
 17 is unique, if limited cost information is available, or if age or expected life estimates cannot be
 18 accurately determined. There may be instances when an appraiser should verify reproduction or
 19 replacement cost new less depreciation by other approaches before accepting a mass-appraisal
 20 indicator such as the indicator developed from an AH 581 table as the best indicator.

21 The Board publishes separate percent good factors in AH 581 for equipment acquired new or
 22 used for agricultural mobile and construction mobile equipment. The assessor should not average
 23 these separate factors unless it cannot be determined from taxpayer-supplied information
 24 whether the equipment was acquired new or used. Further, if the assessor sets a minimum
 25 percent good for equipment depreciation tables, there the assessor must be able to provide
 26 supportable evidence for the use of the minimum percent good.¹⁶⁸

27 ***Sampling***

28 Indexes published in AH 581 are based on government price indexes derived by market
 29 sampling. When necessary, and resources are available, the assessor may conduct similar such
 30 studies to derive his or her own indexes.

31 In order to promote uniformity in appraisal practices and values throughout the state, the Board
 32 issues information and data relating to commercial and industrial property. This information
 33 includes, but is not limited to, appropriate index factors and percent good factors. Most counties
 34 do not have the staff to conduct independent and statistically sound sampling procedures to
 35 develop their own valuation factors. Moreover, when counties develop and use different
 36 valuation factors for property, value inequities may result between counties for the same type of
 37 property.

¹⁶⁷ The expected remaining life of the property on the appraisal date.

¹⁶⁸ Section 401.16.

1 Most notably, where the equipment index and percent good factors provided by the Board and
 2 other approaches to value and methods of estimating depreciation are not good indicators of
 3 value, an assessor may wish to use some type of sampling methodology to develop his or her
 4 own factors. To use sampling, assessors and auditors must develop and use recognized methods
 5 that will be accepted with confidence by the Board and assessees. In developing a sample plan,
 6 technique, and program, an interested reader should consult a textbook on statistics for
 7 information on the theory and application of sampling. For an example, see the Board's *Sales and*
 8 *Use Tax Audit Manual*, Chapter 13: *Statistical Sampling*.

9 ***Straight-Line or Age-Life Method***

10 Under ~~this approach~~ the straight-line or age-life method, depreciation is estimated by dividing
 11 the actual or effective age of the property by the estimated economic life. The straight-line or
 12 age-life method is based on the relationship between physical age and estimated economic life.
 13 Physical life, or age, is the time the equipment has existed. Economic life of a property
 14 represents the period of time during which the property has value.

15 Although straight-line depreciation may have little or no bearing on market value, effective age
 16 should be recognized whenever data reasonably indicates that effective age is different than
 17 actual age. *Effective age* is the "age indicated by the condition and utility of a structure"¹⁶⁹ (or
 18 property). Because there may be a large variation in the condition of property having the same
 19 age, the effective age (as opposed to the actual age) is the best indicator of the market's
 20 perception of age.

21 This approach does not reflect the relationship between the present worth of the future earnings
 22 of the property versus the present worth of future earnings of a new replacement property. It
 23 ignores the principle that money has a time value (income earned in the near future has a greater
 24 value than the same amount of income to be earned in the distant future). Thus it tends to
 25 understate the economic value of older property that is producing a current income comparable
 26 to the current income that would be produced by a new replacement. Conversely, this method
 27 does not reflect additional depreciation that should be recognized if the existing property benefits
 28 are *less* than the benefits that would be earned by a new replacement.

29 ***Cost to Cure Technique***

30 This technique may be used to measure physical deterioration and curable functional
 31 obsolescence. It requires the appraiser to estimate the cost to cure items of physical deterioration
 32 and functional obsolescence that are in fact curable. However the cost to cure technique cannot
 33 measure incurable functional obsolescence or external obsolescence.

34 ***Production Output or Service Hours Method***

35 The Production Output Method is based on the assumption that an asset is acquired for
 36 production, and it depreciates in relation to the number of units produced. To use this method of
 37 calculation, an estimate of total ultimate output is required. (The estimate can be in production

¹⁶⁹ Appraisal Institute, *The Dictionary of Real Estate Appraisal*, s.v. "effective age."

1 units or service hours.) Full economic cost divided by the estimate of total ultimate output gives
 2 the depreciation charge for each unit of output. Like the straight-line method, this method
 3 ignores the economic value of future earnings and thus understates the value of a property if net
 4 operating income is comparable to a new replacement property, and overstates the value to the
 5 extent net operating income is less than a new replacement property.

6 *Utilization Adjustment*

7 A utilization adjustment to a Replacement Cost Less Normal Depreciation (RCLND) estimate
 8 may be appropriate when equipment is significantly underutilized, that is, it may be appropriate
 9 when property is not used at design or expected capacity. This condition of underutilization may
 10 exist because of functional obsolescence, external obsolescence, or a combination of both, but
 11 usually originates ~~with~~ from external forces. These external forces diminish the demand for use
 12 of the property which results in the existence of property with capacity that would not be
 13 replaced. The condition may also occur due to errors in initial planning. The adjustment is
 14 analogous to an abnormally high vacancy factor used to calculate net operating income for use in
 15 the capitalized income approach to value.

16 Utilization adjustments may be made when there is excess capacity that is beyond the control of
 17 a prudent operator that is recognized by the market. Generally, the amount of obsolescence is a
 18 function of the difference between the replacement cost new of the existing property versus the
 19 replacement cost new of a property with a capacity that is adequate for the foreseen
 20 requirements. However, operation at below design capacity will not always translate to an
 21 equivalent percentage amount of obsolescence (i.e., operating at 75 percent of design capacity
 22 may only equate to a 10 percent increase in obsolescence). An explanation of this seeming
 23 incongruity is demonstrated in pipeline valuation. Much of the cost of constructing a pipeline is
 24 the same regardless of the design capacity because installation charges do not vary
 25 proportionally to the diameter of the pipe. Cost is much the same regardless of the design
 26 capacity. Consequently, a pipeline with a physical utilization of 90 percent of design capacity is
 27 considered to be at 100 percent of economic utilization because the replacement cost new of a
 28 pipeline with the lower design capacity would cost essentially the same as the replacement cost
 29 new of the existing capacity.

30 To make a utilization adjustment when appropriate, for excess capacity affecting value,
 31 information should be gathered and an appropriate means for estimating the adjustment should
 32 be determined. The Board's ~~Valuation~~ State-Assessed Properties Division, for example, has a
 33 formula for reducing the RCLND of pipelines that are clearly oversized for the foreseeable
 34 future. The calculation begins with knowledge of the level of the foreseeable physical utilization
 35 of a pipeline segment (the "load" factor) which is expressed as a percentage amount. This "load"
 36 factor is converted to a "utility" factor which is also expressed as a percentage amount; this
 37 calculation is non-linear. The utility factor represents the ratio of needed capacity to design
 38 capacity and it is applied to an RCLND estimate to reach an estimate of Replacement Cost Less
 39 Depreciation (RCLD). In similar fashion, the American Society of Appraisers utilizes a

1 calculation which captures loss in value due to underutilization. The appraiser must use care in
2 applying this methodology.¹⁷⁰

3 As mentioned above, this type of adjustment is not appropriate for all or even most types of
4 properties (or equipment). Even when a property operates significantly below design capacity,
5 there may be no under-utilization and a utilization adjustment would not be appropriate.
6 However, when evidence reasonably demonstrates that replacement property would have a lower
7 capacity, a utilization adjustment may be appropriate. A study of the facts pertaining to that
8 particular property is necessary to determine how to arrive at any appropriate adjustment.

9 Following are some suggested items, but not a complete list, to consider if there is a question of
10 excess capacity.

- 11 • Is full capacity ever needed or expected?
- 12 • Does the definition of capacity take into consideration down time for repairs and
13 maintenance?
- 14 • Does the capacity reflect intended product mix? (Different product mixes may create
15 different capacities. A finer product may take longer to mill than a coarser product, for
16 example.)
- 17 • What is the normal utilization for users of similar equipment? (What utilization do
18 purchasers of new similar equipment anticipate? What is the property owner's definition
19 of capacity?)
- 20 • How does the current and future expected utilization compare with the utilization when
21 new?
- 22 • What is the cause of the excess capacity? (External obsolescence is a valid reason;
23 normal seasonal or even daily variations do not constitute excess capacity.)
- 24 • Could a larger capacity machine have been installed to take advantage of off-peak utility
25 rates?
- 26 • Is the problem industry-wide or is it the individual owner? (An industry-wide excess
27 capacity is indicative of external obsolescence; individual excess capacity may be a
28 business enterprise problem that should not be reflected in the value of the property.)
- 29 • Is there evidence that the equipment would be replaced with substitute equipment of
30 lower capacity?

31 **Limitations of the Cost Approach**

32 An appraiser cannot assume that the cost approach, or any approach, automatically provides the
33 best indicator of value. All available information must be analyzed to determine the best

¹⁷⁰ American Society of Appraisers, *Appraising Machinery and Equipment*, McGraw-Hill (1989) p. 104-105.

1 indicator of value. When available or possible, it is best to compare the estimated value to actual
2 market value of similar property to verify accuracy of results.

3 The cost approach, like other approaches to value, is not valid unless it is made as of a specific
4 date. The fluctuating purchasing power of money, together with changes in the efficiency of
5 labor and changing techniques of production, and other economic factors cause costs and
6 depreciation to vary over time. It is therefore essential to specify that costs are as of a certain
7 date (i.e., the appraisal date) in order for the principle of substitution to be meaningful. The more
8 current the costs, the newer the property, the more reliable and valid the cost approach to value
9 will be.

10 The cost approach is also limited by the accuracy of the information used. If the cost and
11 depreciation estimates are skewed or otherwise unrepresentative of the property, the resulting
12 value will not be an appropriate representation of the property's market value.

13 ***Summary of the Cost Approach: Example***

14 The following example illustrates the valuation of a piece of equipment using the cost approach
15 method of valuation. Keep in mind, however, when the cost approach is applied to personal
16 property and fixtures it is normally applied to groups of equipment and fixtures (rather than on a
17 piece by piece basis) and such detailed information may not be available. The example illustrates
18 an application of the approach and is used to summarize the discussion in the text. It is not
19 controlling in all situations.

EXAMPLE 4.5
USE OF THE COST APPROACH

Company C acquired a bookbinding machine in 2009~~6~~. Details of the acquisition are as follows:

- Invoice cost (including sales tax) \$40,000~~2~~
- A 1 percent discount was allowed because payment was made in cash within 30 days.
- Company C's transportation cost of \$1,200 was paid to deliver the machine to the factory~~2~~
- Cost of installation was \$2,430. This included labor, materials, including a raised flooring to accommodate the new machine.
- The engineer spent 2/3 of her time during July on trial runs of the new machine. Her monthly salary is \$9,000 per month.
- An allowance of \$5,500 was granted by the supplier because the machine proved to be of less than standard performance.
- One year extended service warranty included in purchase cost, retail value \$500. One-year supplies (exempt as inventory) included in purchase cost, retail value \$500.

NO MAJOR TECHNOLOGICAL CHANGES HAVE BEEN MADE TO THIS TYPE OF PROPERTY SINCE ACQUISITION. WHAT IS THE MACHINE'S ASSESSABLE VALUE ON THE 2002~~9~~ LIEN DATE?

A. Computation of Full Economic Cost:

Invoice Cost	\$40,000
Less: Discount	(400)
Rebate/Allowance	(5,500)
Non-property items (<u>warranty/supplies</u>)	(1,000)
Add: Transportation Cost	1,200
Installation Costs	2,430
Machinery Testing Cost (\$9,000 salary x 2/3)	<u>6,000</u>
Full Economic Cost	<u>\$42,730</u>

B. Computation of Value

Using the Board's index factors and percent good factors, the auditor-appraiser determined that the equipment falls into Table 2: Industrial Machinery and Equipment Index Factors with an estimated economic life of 15 years. From the tables, the index factor is 1.04~~8~~ and the percent good factor is .90~~86~~. Using this information, the full cash value (assessable value) is estimated:

$$\$432,730 \times 1.04~~8~~ \times .90~~86~~ =$$

\$39,68875

0

C. Computation of value using known current Replacement Cost New

If the current replacement cost new of a comparable machine (including sales tax, freight, installation, etc.) is known, that RCN should be used rather than the index factored original cost in the calculation of value.

1 **COMPARATIVE SALES APPROACH**

2 The comparative sales approach may be defined as any approach that uses direct evidence of the
3 market's opinion of value of a property. It is based upon the principle of substitution, that is, the
4 fair market value of an item is closely and directly related to sales price (under the conditions of
5 fair market value) of comparable, competitive properties. Thus, this method presumes that the
6 value of a property will approximate the selling prices, listings, offers, the opinions of owners
7 and appraisers, and appraisals of competitive substitutes. Ideally, however, value is estimated
8 based not only on an opinion of value (such as list price), but measured by actual purchases of
9 comparable properties.

10 Sale prices of comparable properties provide an indication of what the market is willing to pay
11 for that type of property at that time. For personal property, value guides and price schedules
12 which reflect the going market price for comparable equipment and which estimate the current
13 value of specific types of equipment can be used as the basis for determining market value of
14 similar equipment. Adjustments should be made when the condition of the subject property is
15 above or below average. Additional elements of value seldom reflected in sales comparison
16 value guides are sales tax, freight, discounts, and other costs unique to specific equipment. These
17 costs must be added to (or subtracted from) the sales price of equipment where appropriate to
18 arrive at full cash value for property tax purposes.¹⁷¹

19 The comparative sales approach is limited in its application to personal property and business
20 fixtures, and is used less often than is the cost approach to value, because (1) most types of
21 personal property and business fixtures are resold infrequently (limited sales data are available),
22 (2) sales data, when available, are generally limited by comparability, and (3) in many cases,
23 personal property and business fixtures are not sold without affecting other property (whether
24 real or personal property). This approach is, however, applicable to personal property and
25 business fixtures that are frequently exchanged in the market when their exchange does not affect
26 other items, such as agricultural and construction equipment, boats, and airplanes. Sales
27 comparables would usually not be good indicators of value for other types of property that
28 require extensive testing or considerable installation costs.

29 **Sources of Information**

30 The appraiser may utilize valuation guides in making the appraisal estimate when sufficient
31 information regarding the make, model, etc., of the equipment is reported on the property
32 statement, or otherwise available (such as through audit), and when such guides are available.
33 When using the comparative sales approach to value real property, numerous sources of data are
34 available. When valuing personal property and/or fixtures, this is not always the case. ~~The~~
35 ~~following table~~ AH 581 includes a short list of valuation guides available for use in valuing
36 personal property. Other available publications, which may be helpful, are listed in *Appraising*
37 *Machinery and Equipment*.¹⁷²

¹⁷¹ *Xerox Corp. v Orange County* (1977) 66 Cal.App.3d 746.

¹⁷² American Society of Appraisers, *Appraising Machinery and Equipment*, pages 53-57.

TABLE 4C
SOURCES OF INFORMATION

Equipment Type	Name of Publication	Phone Number
Agricultural Equipment	<i>National Farm Tractor and Implement Blue Book</i>	800-654-6776
Agricultural Equipment	<i>Official Guide—Tractors and Farm Equipment</i>	707-678-8859
Construction Equipment	<i>Green Guide for Construction Equipment</i>	800-669-3282
Vessels	<i>BUC Used Boat Price Guide</i>	800-327-6929
Vessels	<i>N.A.D.A. Appraisal Guides</i>	800-966-6232
Vessels	<i>National Boat Book Official Used Marine Valuation</i>	800-654-6776
Aircraft	<i>Aircraft Bluebook Price Digest</i>	800-654-6776
Aircraft	<i>Vref Aircraft Value Reference</i>	800-773-8733

- 1 When reliable comparables are available, whether from sales in the market, value guides, or
- 2 other sources, the comparative sales approach may be preferable to other value approaches.
- 3 Following is an example where such sales are available and value is determined using the
- 4 comparative sales approach as discussed in this section.

EXAMPLE 4.6
USE OF THE COMPARATIVE SALES APPROACH

John Jetski purchased a new ~~1990~~ 2005 Bayliner boat (~~Classic Runabout, Model 192cu~~) with a ~~110 HP mercury engine and trailer in 1990~~ for ~~\$19,200~~ \$15,000. On the ~~2002~~ 2009 lien date, this boat was located in the county and was assessable.

The following information was available to and gathered by the appraiser:

- The assessee is planning to sell the boat to his brother next month for ~~\$3,000~~ \$1,000 because he is moving out of state.
- A similar boat (with trailer) was seen advertised in the local newspaper for ~~\$15,000~~ \$9,000.
- Research in two separate value guides found a value range from ~~\$6,500~~ \$9,200 to \$14,010 ~~\$8,000~~ for this particular boat in average condition.
- An inspection of the boat and a conversation with the assessee found the boat to be in average condition for its age.

The assessee argues that the boat's value is ~~\$3,000~~ \$1,000.

USING THE COMPARATIVE SALES APPROACH TO VALUE, WHAT IS THE ESTIMATED TAXABLE VALUE OF THIS VESSEL?

The estimated taxable value of the boat is between ~~\$9,200 to \$14,010~~ \$6,500—\$8,000 using two separate used-boat value guides. The assessee's estimate of value, ~~\$3,000~~ \$1,000, does not represent market because it is not an arm's length transaction, has not occurred under normal circumstances, and is not a "sale" (the sale has not occurred yet). The appraiser in this case estimates the value at \$12,000 ~~\$7,500~~, which includes sales tax.

1

2 **INCOME APPROACH**

3 The income approach to value includes any method of converting an anticipated income stream
4 into a present value estimate. This approach can be considered as an approach to value when the
5 subject property meets three assumptions:

- 6 1. Value is a function of income (i.e., the property is purchased for the income it will
7 produce).
- 8 2. Value depends upon the quality and quantity of the income stream (i.e., the investor
9 demands a return of and on his/her investment in the property).
- 10 3. Future income is less valuable than present income (i.e., the value of the property is the
11 sum of the present worth of its anticipated/future net benefits).

1 When any of these do not correspond to the reality of the property, the income approach to value
2 should not be given great weight as an indicator of the property's current market value.

3 The income approach has limited application to personal property and fixtures because it is often
4 extremely difficult to attribute an income stream directly to individual items of personal property
5 and fixtures. However, the income approach can be applied to leased personal property or other
6 personal property to which an income stream can be attributed. The approach can also be used to
7 estimate personal property as a residual amount. For example, the value of an entire
8 manufacturing plant can be estimated using the income approach, with the value of the
9 constituent personal property then estimated as a residual by subtracting out the (presumably)
10 known values of any real property and other assets.

11 A general discussion and explanation of the income approach to value is included in AH 501,
12 *Basic Appraisal*, and the income approach chapter of AH 502, *Advanced Appraisal*. These
13 sections will not be repeated here. Below is a short discussion of how, and when, the approach
14 can be applied to personal property. When using this technique, refer to the above mentioned
15 sections for additional in-depth discussion of the income approach.

16 There are several aspects of appraising personal property that may differ from those encountered
17 in the valuation of real property. These include:

- 18 • Verification that the income is truly attributable to the property. In many cases, the
19 "rental" or "lease" income is significantly influenced by business activity, personal
20 services, sales or services directly related to the rented property (the rental amount could
21 be artificially high or artificially low), or other non-property factors. In such cases, the
22 income approach is unlikely to measure the value of the personal property unless the
23 income attributable to the property can be isolated.
- 24 • Caution in the selection of the remaining economic life. Since personal property usually
25 has a much shorter economic life than real property, an error in the estimate of remaining
26 economic life will have a much greater impact than it will for real property.
- 27 • Difficulty in finding market evidence for capitalization rates for personal property as
28 compared to real property.

29 Despite the problems, where income(s), capitalization rates, and economic life estimates are
30 available and reliable, the income approach is equally valid for personal property as it is for real
31 property.

32 The income approach is often most applicable in the case of leased personal property because an
33 income stream can often be directly attributable to leased personal property. Much of the
34 following discussion is in the context of leased personal property. As discussed below, other
35 issues arise in an appraisal of leased personal property under the income approach.

36 The components that make up the value of personal property are the costs of manufacturing the
37 item, transportation of the item, installation of the item, and profit markups. Additionally, a sales

1 tax or a use tax component must be added. The components of the value of personal property
 2 may be borne by either the lessor or the lessee. Payment of expenses by the lessee does not
 3 diminish the value of the personal property. The terms of the lease agreement or rental contract
 4 should be carefully analyzed to insure that all costs are included in the valuation process. When
 5 the costs of transportation or installation are paid by the lessee, the economic income may ~~have~~
 6 need to be adjusted to include a charge for these expenditures in the valuation process, or the
 7 costs may be added as a lump sum to the capitalized earning ability of the income stream.
 8 However it is done, all property expenditures must have been properly identified and included in
 9 the value of the (leased) equipment.

10 Maintenance of the property, on the other hand, which may be considered a cost pursuant to
 11 ~~make up part of the lease, cost but~~ is not a component of value. For instance, if the lessor is
 12 charging the lessee for maintenance under the lease contract, the auditor-appraiser must deduct a
 13 maintenance charge from the income stream. One method to estimate this charge is to make an
 14 estimate of service time, and then relate this time to prevailing labor rates, as shown below:¹⁷³

EXAMPLE 4.7
ADJUSTING INCOME FOR MAINTENANCE CHARGES
A machine requires 3 hours of service each month at a rate of \$95 per hour: A monthly cost of \$285 ($\$95 \times 3 = \285)
If the monthly rental is \$1500: Then, the maintenance is 19% of gross income ($\$285 / \$1,500 = .19$, or 19%)
Gross annual income is then \$18,000 ($\$1,500 \times 12 = \$18,000$), annual expenses are \$3,420 ($\$285 \times 12 =$ $\$3,420$), and the net annual income is \$14,580 ($\$18,000 - \$3,420 = \$14,580$)

15

16 **Processing the Income Stream**

17 The steps for processing the rental income stream for personal property are the same steps that
 18 are used for processing real property income. The steps are as follows:

	Potential Gross Income (PGI)
(less)	<u>Vacancy and Collection Losses (V & C)</u>
	Effective Gross Income (EGI)
(less)	<u>Operating Expenses</u>
	Net Income Before Recapture and Property Taxes (NIBR&T)
(less)	<u>Property Taxes</u>
	Net Income Before Recapture (NIBR)

¹⁷³ Estimates and percentages for service time, rates, costs, and maintenance expenses estimates and percentages may be obtained from various sources in the marketplace (for instance, the lessor may be able to supply the actual service time for the preceding year), and this could serve as a guide when reconstructing the operating statement.

(less) Allowance for Recapture
 Net Income (Yield Income)

1

2 As with real property, it is the *anticipated* income stream of personal property that is processed
 3 when deriving income multipliers and rates. In the valuation of personal property, the income
 4 stream cannot be processed below NIBR&T.¹⁷⁴

5 **Vacancy (Idle Time) and Collection Losses**

6 Personal property that is held for lease or sale by a retailer or wholesaler on the lien date may be
 7 exempt from taxation. Because these items are exempt for the entire year, it can be argued that it
 8 is improper to allow for vacancy (idle time) and collection losses. However, it is also reasonable
 9 to take the position that an item may be out on lease on the lien date (and therefore taxable) but
 10 returned to the retailer or wholesaler prior to the expiration of the lease period. Consequently, the
 11 retailer or wholesaler may very well suffer a loss of income because of vacancy (idle time) or
 12 collection loss. An allowance made for vacancy (idle time) and collection loss should be based
 13 on the actions of the market place.

14 **Expenses**

15 As with real property, all lessor-borne expenses that are necessary to maintain the equipment's
 16 income stream should be deducted as an operating expense. If the expenses are paid by the
 17 lessee, they are not deductible from the income stream. Maintenance expense is a good example.
 18 If the lessee pays the maintenance charges, the lessor will generally charge a lesser rent and the
 19 expenses are not allowed. If the lessor is responsible for maintenance, the rents will reflect this
 20 expense. An adjustment will be necessary similar to that shown in Example 4.7.

21 Particular care must be given to analyzing expenses. They may have been paid by either the
 22 lessor or the lessee, and therefore included on either or both books. The lessor's books may show
 23 an expense for maintenance. If the lessee has purchased a maintenance contract from the lessor,
 24 the price of the contract must be added to the rental fees before processing the income stream. If
 25 this is not done, then the expenses for maintaining the item are not deducted as an expense.

26 **Valuation Methodology**

27 Both direct and yield capitalization methods can be used to value machinery and equipment.
 28 Yield capitalization is often used. In the case of leased equipment, for example, the income to be
 29 capitalized can be divided into two segments (1) the lease, or rental, payments (net of allowable
 30 expenses) over the term of the lease, estimated as the present value of an annuity; and (2) a
 31 reversionary payment representing the estimated market value of the property at the end of the
 32 lease, estimated as the present value of a single payment. Thus:

33
$$\text{Value of property} = \text{present value of an annuity} + \text{present value of the reversion}$$

¹⁷⁴ When calculating NIBR&T for business property, status, category and trade level of the property are important factors to consider.

EXAMPLE 4.8 (CONTINUED)
USING THE INCOME APPROACH TO VALUE PERSONAL PROPERTY

WHAT IS THE ESTIMATED TAXABLE VALUE OF THE MACHINES?

	<u>Per Machine</u>	<u>Total (50 Machines)</u>
A. VALUATION OF THE RENTAL INCOME		
Market Potential Gross Income	\$2,700	\$135,000
Less: Vacancy & Collection Loss	<u>0</u>	<u>0</u>
Effective Gross Income	\$2,700	\$135,000
Expenses: (Maintenance \$500 + Insurance \$ 200)	<u>(700)</u>	<u>(35,000)</u>
Net Income Before Recapture & Taxes (NIBR&T)	<u>\$2,000</u>	<u>\$ 100,000</u>
 NIBR&T x PW1PP (2.88409)	 \$5,768	 \$288,409
B. VALUATION OF THE SALVAGE VALUE		
Salvage Price	\$500	\$25,000
PW \$1 (13.5% Yield + 1% ETR) ¹⁷⁵	<u>0.581806</u>	<u>0.581806</u>
Present Value of Salvage Income	\$291	\$14,545
C. TOTAL PROPERTY VALUE		
Present Value of Rental Income	\$5,768	\$288,409
Present Value of Salvage Income	<u>291</u>	<u>14,545</u>
TOTAL VALUE	<u>\$6,059</u>	<u>\$302,954</u>

1

2 **Summary of the Income Approach**

3 The income approach can be applied to leased equipment or other personal property appraisal
4 units that independently produce income because it converts expected rental income to a present
5 value estimate, but it is normally not applicable to most types of personal property. Personal
6 property, in general, is not purchased to independently produce income. It is often difficult to
7 assign or estimate an expected income to that individual property. The example above helps to
8 illustrate how the income approach to value can be used in the appraisal of personal property. In
9 practice, each situation is different and this should be taken into consideration by the auditor-
10 appraiser.

11

12

13

¹⁷⁵ Present worth of \$1 at 14.5% at 4 years, factor from compound interest table.

RECONCILIATION AND VALUE CONCLUSION

1

2 The final step in the appraisal process is to reconcile value indicators from the separate
3 approaches utilized into a final estimate of value, when more than one approach to value is
4 applied. Resolving the differences among the value indicators is called *reconciliation*. The result
5 of the reconciliation is the final value estimate.

6 In the reconciliation process, consideration should be given to any factors influencing value that
7 are either not reflected or only partially reflected, in the value indicators. The greatest weight
8 should be given to that approach or combination of approaches that best measures the type of
9 benefits the subject property yields. The reconciliation step should involve an analysis of: (1) the
10 relative appropriateness of the approaches applied; (2) the accuracy of the data collected and
11 calculations made in each approach; (3) the quantity of data available for each approach; and (4)
12 the consistency in the manner in which the approaches to value were applied.

13 For example, a cost estimate should be reviewed for the realism of the depreciation estimate and
14 whether it is supported by market data. If the sales comparison approach was used, a check
15 should be made to determine whether the value indicator was based on sufficient market data or
16 relies heavily upon only one sale. In reviewing the income approach, the appraiser should
17 reexamine the estimates of economic rent, economic life, expenses, and capitalization rate.
18 Alternative estimates should be considered. Additionally, the appraiser should avoid estimates
19 that are consistently optimistic or pessimistic.

20 Although containing an element of judgment, the analysis of value indicators should be based
21 upon indicators derived from objective data, plus general overall value influences (economic,
22 physical, political, and social factors). If a value indicator were perfect, it would already reflect
23 these value influences. However, in actual practice, any value indicator is usually far from
24 perfect. As indicated above, if the appraiser has adequate and reliable data, the greatest reliance
25 should be placed on that value indicator and approach ~~which~~ that best measures the type of
26 benefits the subject property is expected to yield.

CHAPTER 5: ASSESSMENT OF IMPROVEMENTS RELATED TO BUSINESS PROPERTY

Improvements related to business property include improvements reported on Schedule B of the Business Property Statement and other improvements owned by or made for a business. Many variables exist regarding the valuation of these improvements. Factors required to make a valid assessment—especially property classification, identification of assessee, and valuation—may be difficult to determine. Depending on the data source, the assessment can be processed by either the real property appraiser, the auditor-appraiser or both, on either the secured or unsecured roll, creating a situation that may result in duplicate or escape assessments. Assessment of improvements related to business property is, therefore, an important topic for discussion within this section of the Assessors' Handbook. The discussion is divided into five main sections: definitions of relevant terms, classification, appraisal, determination of assessee, and suggested procedures. It is directed to both real property appraisers and auditor-appraisers.

DEFINITIONS OF RELEVANT TERMS

The purpose of this section is to define and describe the following relevant terms: improvements, building improvements, landlord improvements, leasehold (or tenant) improvements, structure items, and fixtures as used in the context of this section.

IMPROVEMENTS

As defined in section 105, improvements include:

- (a) All buildings, structures, fixtures, and fences erected on or affixed to the land.
- (b) All fruit, nut bearing, or ornamental trees and vines, not of natural growth, and not exempt from taxation, except date palms under eight years of age.

Improvements within this statutory definition are reported, classified and subclassified on the Business Property Statement, Schedule B.¹⁷⁶ Examples of such improvements are provided in Rule 124(b)(2).

BUILDING IMPROVEMENTS

As used on the property statement, *building improvements* are all improvements to a structure. They may include improvements made by the landlord and improvements made by or for the tenant. They can be sub-classified as structure items and/or fixtures.

¹⁷⁶ No classification between structure items and fixtures is required for State assessed leasehold improvements.

1 LANDLORD IMPROVEMENTS

2 For purposes of this discussion, building improvements made by the real property owner are
3 referred to as *landlord improvements*. This term includes improvements paid for by the landlord
4 whether they benefit the landlord or the tenant. A landlord improvement is either structure item
5 or a fixture, as discussed below.

6 LEASEHOLD (OR TENANT) IMPROVEMENTS

7 For purposes of this discussion, the term *leasehold improvement* and *tenant improvement* are
8 used synonymously to mean all "improvements or additions to leased property that have been
9 made by the lessee."¹⁷⁷ Leasehold improvements include structure items as well as fixtures paid
10 for by the lessee.

11 For example, two tenants move into separate units,

- 12 • Tenant A moves into a shell and makes basic improvements (e.g., a drop ceiling, floor finish,
13 floor to ceiling partitions for an office) to finish the interior of the structure.
- 14 • Tenant B moves into a space ready for occupancy and only makes improvements designed
15 for a specific trade business, or profession (e.g., shelving attached to a wall or dressing rooms
16 in the case of retail apparel sales).

17 As the definitions below will indicate, Tenant A has made improvements classified as structure
18 items. Tenant B has made improvements classified as fixtures. However, in both cases, the
19 improvements made by the tenants are leasehold (or tenant) improvements.

20 STRUCTURE ITEMS

21 A *structure* may be defined as "an edifice or building; an improvement."¹⁷⁸ Structure items are
22 integral parts of the structure by nature. The Business Property Statement further describes
23 structure items:

24 An improvement will be classified as a structure when its primary use or purpose
25 is for housing or accommodation of personnel, personalty, or fixtures and has no
26 direct application to the process or function of the industry, trade, or profession.

27 Structure items are reported on the property statement on Schedule B, column 1, *Structure Items*.
28 A listing of items commonly reported and classified as structure items can be found in ~~Appendix~~
29 ~~A and also in Chapter 7 of AH 581, *Equipment Index and Percent Good Factors*.~~

¹⁷⁷ Appraisal Institute, *The Dictionary of Real Estate Appraisal*, s.v. "leasehold improvement."

¹⁷⁸ Appraisal Institute, *The Dictionary of Real Estate Appraisal*, s.v. "structure."

1 **FIXTURES**

2 Rule 122.5(a)(1) defines *fixtures*:¹⁷⁹

3 A fixture is an item of tangible property, the nature of which was originally
4 personalty, but which is classified as realty for property tax purposes because it is
5 physically or constructively annexed to realty with the intent that it remain
6 annexed indefinitely.

7 Rule 122.5(a)(2) sets forth three tests to determine what constitutes a fixture for property
8 tax purposes:

9 The manner of annexation, the adaptability of the item to the purpose for which
10 the realty is used, and the intent with which the annexation is made are important
11 elements in deciding whether an item has become a fixture or remains personal
12 property. Proper classification, as a fixture or as personal property, results from a
13 determination made by applying the criteria of this rule to the facts in each
14 case.¹⁸⁰

15 Fixtures are reported on the Business Property Statement, Schedule B, Column 2, *Fixtures Only*.
16 A listing of items commonly reported and classified as fixtures can be found in ~~Appendix A and~~
17 ~~also in Chapter 7 of AH 581, *Equipment Index and Percent Good Factors*~~. It is important to note,
18 however, that these items are fixtures only when they are *not* an integral part of the building, but
19 their "use or purpose directly applies to or augments the process or function of a trade, industry,
20 or profession."¹⁸¹

21 **Types of Fixtures**

22 **Trade Fixtures**

23 In the context of property tax, a *trade fixture* is merely a type of fixture that is "trade-related."
24 All fixtures, including trade fixtures, have received the same treatment by the courts. In the
25 interest of uniformity, neither the statutes nor the courts base the classification of fixtures on
26 whether they are trade-related. As expressed by the California Supreme eCourt in *Trabue*
27 *Pittman Corp., LTD. v. County of Los Angeles* (1946) 29 Cal.2d 385, 293:

28 To classify trade fixtures as real property is not to obliterate the distinction between
29 fixtures and trade fixtures for all purposes, nor to introduce an innovation into the law of
30 trade fixtures. It is well settled that for purposes of taxation the definitions of real
31 property in the revenue and taxation laws of the state control whether they conform to
32 definitions used for other purposes or not. . . . Section 104 of the Revenue and Taxation
33 Code declares that real estate shall include "improvements," and section 105 defines
34 improvements as "fixtures." No exception is made in the case of trade fixtures. According
35 to Burby, a trade fixture is merely a particular type of fixture, one for which the law
36 makes a special provision permitting its removal under certain circumstances by a lessee

¹⁷⁹ See also Chapter 2 of this manual.

¹⁸⁰ Intent is the primary test of classification. Rule 122.5(d)(1).

¹⁸¹ Rule 463(c).

1 from the lessor's real property to which it has been annexed. (See Burby Hornbook of the
2 Law of Real Property (1943) p.28.)

3
4 In a subsequent case deciding similar issues, the eCourt held:

5 It follows [from *Trabue Pittman* above] that the applicable statutes do not permit
6 of the division of trade fixtures into classes or of the distinctions contended for by
7 defendants, and on the contrary require all fixtures or trade fixtures to be taxed as
8 improvements.¹⁸²

- 9 • Additionally, "trade fixture," in section 469 and "fixture" in Rule 192(a) are used
10 synonymously when identifying the pool of taxpayers with largest assessments for audit
11 purposes in the determination of a mandatory audit. (Fixtures and personal property values
12 are components in the value criterion for identifying the pool of taxpayers with largest
13 assessments for audit purposes.) Thus, trade fixtures are merely a particular type of fixture
14 and must be evaluated under the three-part test in Rule 122.5.

15 **Fixed Machinery and Equipment**

16 *Fixed machinery and equipment* (FME) is another type of fixture. FME is equipment which is
17 physically or constructively annexed and intended to remain indefinitely with the realty. Rule
18 122.5(c) sets forth the standard for constructive annexation and some examples are provided in
19 subdivision (e). The concept of *constructive annexation* of equipment has long been recognized
20 by the courts. As stated by the California Court of Appeal:

21 In addressing the question of annexation, we initially observe that the common
22 law test of technical affixation of the article to the realty is no longer an absolute
23 prerequisite to "fixture" status." On the contrary, the modern trend of case law
24 underlines that fixtures include articles such as heavy machinery whose
25 permanent annexation is not manifested by the use of bolts, screws, and the like,
26 but which are of such weight that the mere retention in place of gravity is
27 sufficient to give them the character of permanency and therefore affixation to the
28 realty.¹⁸³

29 An assessee may erroneously report FME as personal property (i.e., machinery and equipment)
30 on Schedule A of the Business Property Statement. The assessee may report such property as
31 machinery and equipment because of its use/function as machinery or equipment. However, if
32 the property's weight or method of attachment and the intent as reasonably manifested by
33 outward appearance is that the property remain annexed indefinitely, then based on Rule
34 122.5(c), such equipment is actually FME, that is, a fixture. Often, the incorrect classification is
35 discovered by physical inspection.

¹⁸² *Simms v. County of Los Angeles* (1950) 35 Cal.2d 303.

¹⁸³ *Seatrains Terminals of Cal. V. County of Alameda* (1978) 83 Cal.App.3d 69, 75, quoting *M.P. Moller, Inc. v. Wilson* (1936) 8 Cal.2d 31, 37.

CLASSIFICATION

CLASSIFICATION ON THE PROPERTY STATEMENT

Schedule B (including the supplemental schedule) of the Business Property Statement requests information regarding building improvements (landlord and leasehold improvements) in relation to a specific property or business. It provides valuable information and may be used by both auditor-appraisers and real property appraisers. Items reported in Column 1 and Column 2 are structure items and fixtures, respectively, as defined earlier. Items reported in Column 3, *Land Improvements*, include such things as blacktop, curbs, and fences; and items reported in Column 4, *Land and Land Development*, include such things as fill and grading.

WHY CLASSIFICATION IS IMPORTANT

Property tax law requires that improvement value be shown separately from land value and personal property value on the assessment roll. However, there is no requirement that fixtures value be shown as a separate category of improvements.¹⁸⁴ Nonetheless, it is necessary for the appraiser to make the distinction between fixtures and other improvements prior to enrollment, because classification may affect the audit procedures and valuation of property.

It is important to properly classify fixtures separate from other improvement items for several reasons:

1. Fixtures are a separate appraisal unit when measuring declines in value (Rule 461(e)).¹⁸⁵
2. Fixtures are treated differently than other real property (i.e., structure items) for supplemental roll purposes.
3. Fixtures and personal property values are components in the value criterion for determination of a mandatory audit – identifying the pool of taxpayers with the largest assessments for audit purposes under section 469.

Other than these three areas, fixtures are subject to the same constitutional, statutory, and regulatory provisions affecting the valuation and assessment of other real property.

Fixtures are a Separate Appraisal Unit When Measuring Declines in Value

Proposition 8, amended article XIII A of the State Constitution to require the assessor to recognize declines in value (of real property) if market value on the lien date falls below the property's factored base year value. Section 51 requires that the assessor annually enroll the

¹⁸⁴ Section 602.

¹⁸⁵ However, there are as exceptions to the general rule that fixtures are a separate appraisal unit for declines in value. For example, rules 469(e)(2)(C), and 473(e)(4)(C), and 474(d) – in the context of mineral properties, and geothermal properties, and petroleum refinery properties, respectively – provide that for the purpose of declines in value, certain fixtures may be valued in an appraisal unit comprising land, improvements (other than fixtures), and reserves, rather than valued as a separate appraisal unit. In terms of mineral properties, "[e]ach leach pad, tailings facility, or settling pond shall be considered a separate appraisal unit for purposes of determining its taxable value on each lien date subsequent to the lien date upon which its initial base year value was determined." For refineries, land, improvements, fixtures and other fixed machinery are rebuttably presumed to constitute a single appraisal unit, except in disasters, where land is a separate appraisal unit (Rule 474(d)(2)).

1 lower of either (1) a property's base year value factored for inflation, or (2) its full, or market,
 2 value as of the lien date. Thus, declines in value under Proposition 8 are determined by
 3 comparing the current full value (i.e., current market value) of an appraisal unit to the factored
 4 base year value of the unit on the lien date.¹⁸⁶

5 Appraisal unit is defined in section 51(d) as the unit that (1) persons in the marketplace
 6 commonly buy and sell as a unit or (2) that is normally valued separately. Land and
 7 improvements, for example, are an appraisal unit because improvements are typically bought and
 8 sold with land. Fixtures not typically bought and sold separately in the market are also
 9 considered a separate appraisal unit under this section, because they are normally valued
 10 separately. Rule 461(e) provides that fixtures, and other machinery and equipment classified as
 11 improvements, are a separate appraisal unit when measuring a decline in value.¹⁸⁷

12 A special provision applies, however, to petroleum refining properties, as provided in Rule 474.
 13 For this special type of property, land, improvements, fixtures, and other fixed machinery and
 14 equipment are rebuttably presumed to constitute a single appraisal unit, except in disasters,
 15 where land is a separate appraisal unit. Evidence that can rebut this presumption includes the
 16 following:

- 17 • The elements of the property are not in common ownership or typically do not transfer in
 18 the marketplace as a single unit
- 19 • The fixtures and other fixed machinery and equipment are not functionally and physically
 20 integrated with the realty and do not operate together as one economic unit.¹⁸⁸

21 **Fixtures may be a Separate Appraisal Unit for Supplemental Roll Purposes**

22 Generally, all property that changes ownership or is newly constructed after the lien date is
 23 assessed as of the date of change in ownership or date of completion of new construction and is
 24 subject to supplemental assessment. An exception to this requirement applies to certain fixtures
 25 and certain taxable possessory interests. Section 75.5 removes from the definition of "property"
 26 subject to supplemental assessment, "fixtures ~~which~~ that are normally valued as a separate
 27 appraisal unit from a structure" and taxable possessory interests, as specified ~~early identified in~~
 28 ~~the section.~~ Section 75.5 states:

29 "Property" means and includes manufactured homes subject to taxation under Part
 30 13 (commencing with Section 5800) and real property, other than the following:

¹⁸⁶ See also Rule 461(e).

¹⁸⁷ See *County of Orange v. Orange County Assessment Appeals Bd.* (1993) 13 Cal.App.4th 524, where the appellate court held that under Rule 461(e), "the components of taxable property may be separated for valuation purposes," and that section 51, subdivision (e) "states, albeit ungrammatically, that an appraisal unit can be that which are [sic] normally valued separately. Taken as a whole, neither section 51 in general, nor subdivision (e) in particular, mandates appraisal of the property as a single unit."

¹⁸⁸ Rule 474(d)(3)(A)&(B).

1 ~~(a) Fixtures which are normally valued as a separate appraisal unit from a~~
 2 ~~structure.~~

3 ~~(b) Newly created taxable possessory interests, established by month-to-month~~
 4 ~~agreements in publicly owned real property, having a full cash value of fifty~~
 5 ~~thousand dollars (\$50,000) or less.~~

6 With regard to fixtures, this exclusion from supplemental assessment applies only to fixtures that
 7 are normally valued as a separate appraisal unit from the land and other improvements on which
 8 they are located. It does not apply to fixtures that are included with other property as part of a
 9 single appraisal unit that changes ownership or is newly constructed. If an entire property
 10 containing land, structures, and fixtures is valued as a single appraisal unit upon a change in
 11 ownership or new construction, the fixtures included in the unit are subject to supplemental
 12 assessment.¹⁸⁹

13 **Fixture Value Included in Value Criterion for Mandatory Audit Purposes**

14 The combined total value of personal property and fixtures determines whether ~~an audit is~~
 15 ~~mandatory~~ a taxpayer is within the pool of taxpayers with the largest assessments for audit
 16 purposes under Section 469; the value of structure items is not included in this determination.
 17 Section 469(a)-(b)(1), in part, states that:

18 Fifty percent of the audits required by subdivision (a) shall be performed on taxpayers
 19 selected from a pool of those taxpayers that have the largest assessments of locally
 20 assessable trade fixtures and business tangible personal property in the county.
 21

22 ~~In any case in which locally assessable trade fixtures¹⁹⁰ and business *tangible*~~
 23 ~~*personal property* owned, claimed, possessed, or controlled by a taxpayer~~
 24 ~~engaged in a profession, trade, or business has a full value of four hundred~~
 25 ~~thousand dollars (\$400,000) or more, the assessor shall audit the books and~~
 26 ~~records of that profession, trade, or business at least once every four years.¹⁹¹~~
 27 ~~(Emphasis added.)~~

28 Therefore, ~~C~~caution should be exercised to avoid misclassification. If fixtures are
 29 misclassified—notably, if fixtures are classified as structures or visa versa—the value criterion
 30 for ~~mandatory~~ audits under section 469 cannot be applied properly.

¹⁸⁹ See LTA No. 91/59; section 75.15 also addresses the supplemental assessment of fixtures.

¹⁹⁰ Fixtures and trade fixtures are synonymous terms in this context, as discussed earlier.

¹⁹¹ ~~The change in the threshold level for mandatory audits (from \$300,000 to \$400,000) was effective January 1, 2001.~~

1 APPRAISAL OF IMPROVEMENTS RELATED TO BUSINESS PROPERTY

2 GENERAL

3 In general, improvements related to business property (i.e., landlord improvements,
4 leasehold/tenant improvements, structure items, and fixtures) are valued, as is other real
5 property, in accordance with section 51. As previously discussed, section 51 requires county
6 assessors to value taxable real property at the lesser of its factored base year or its full cash value
7 as defined in section 110.¹⁹²

8 In accordance with section 110.1, a property's base year value is its fair market value as of either
9 the 1975 lien date or the date the property was newly constructed, or underwent a change in
10 ownership after the 1975 lien date. Base year value is generally estimated using one or more of
11 the generally accepted and authorized approaches to value discussed in Rule 3 (i.e., the
12 comparative sales approach, the cost approach, or the income approach). The base year value can
13 be adjusted for the effects of inflation up to a maximum of 2 two percent per year based on the
14 California Consumer Price Index. For example, an improvement with a 2001-2002 base year
15 value of \$100,000 (and a 2002 inflation factor of 2 two percent) has an adjusted base year value
16 of \$102,000 in year 2002-2003.

$$17 \quad \text{Base Year Value} \times \text{Inflation Factor} = \text{Indexed Base Year Value}$$

$$18 \quad \$100,000 \times 1.02 = \$102,000$$

19 The full cash value on the lien date is the property's current market value. This value is also
20 estimated by one or more approaches to value allowed by Rule 3. If the current market value of a
21 property is below its factored base year value, the property is temporarily reassessed to reflect
22 the lower value, that is, the property's current market value or its full cash value on the lien date
23 (section 51(a)). Properties valued under Proposition 8 (Rule 461(e)) guidelines are reviewed
24 annually. In some future year, if and when the property's market value exceeds its factored base
25 year value, the factored base year value is restored to the assessment roll. Assume that the
26 improvement mentioned above, with a factored base year value of \$102,000, has a current
27 market value of \$95,000. Since the market value (\$95,000) on the 2002-2003 lien date is less
28 than the indexed based year value (\$102,000), the market value is enrolled until such time that
29 the market value exceeds the factored base year value.

30 The valuation of structure items is normally conducted by the real property appraiser since he or
31 she has the market data, cost manuals, and requisite experience to properly value all real
32 property. In certain circumstances, however, the auditor-appraiser may be required to value this
33 property. In other circumstances, the real property appraiser may be required to value fixtures
34 when they are commonly bought and sold in the marketplace with the land and improvements
35 and are so integrated with the realty such that the highest and best use of the property depends on
36 the valuation of the appraisal unit as a whole.

¹⁹² Fixtures, although real property, are often valued in a manner similar to personal property.

1 Fixtures are normally valued and assessed by the auditor-appraiser. Since fixtures are property
 2 that directly apply to or augment the process or function of a trade, industry, or profession, it
 3 follows that fixtures should be valued by the same appraiser (i.e., the auditor-appraiser) valuing
 4 other business property.

5 In most cases concerning fixtures, the lower value is the full cash value on the lien date. This is
 6 the current market value of the property estimated by the auditor-appraiser using an appropriate
 7 approach to value (the cost approach, the comparative sales approach, or the income approach).

8 When determining the taxable value of new building improvements (i.e., landlord or tenant
 9 improvements), the appraiser should ensure that the value of these improvements is not already
 10 included in the existing assessment. For example, if an office building changes ownership and is
 11 valued using the comparative sales and/or income approach, the value indicator and resulting
 12 assessment on the secured roll *may* include some or all of the value of the building
 13 improvements. Such improvements should not then be doubly assessed on the unsecured roll.

14 **SOME VALUATION ISSUES**

15 In valuing improvements related to business property (i.e., landlord and leasehold (tenant)
 16 improvements, both structure items and fixtures), careful consideration should be given to new
 17 construction, leasehold improvements abandoned on the lien date, and fixtures ~~which~~ that have
 18 declined in value. Several issues and questions arise and should be addressed regarding these
 19 types of improvements. The following discussion addresses these issues.

20 **New Construction**

21 Property tax law governing the valuation of new construction is primarily contained in sections
 22 70 through 74.67 and Rules 463 and 463.5. Also, AH 502, Chapter 6 discusses the subject of
 23 new construction; ~~and that it also includes a discussion is generally applicable to~~ regarding new
 24 construction involving improvements related to business property.

25 Rule 463(b) defines new construction to include: (1) "Any substantial addition to land or
 26 improvements, including fixtures..."; (2) "Any substantial physical alteration of land which
 27 constitutes a major rehabilitation of the land or results in a change in the way the property is
 28 used"; (3) "Any physical alteration of any improvement which converts the improvement or any
 29 portion thereof to the substantial equivalent of a new structure or portion thereof or changes the
 30 way in which the portion of the structure that had been altered is used..."; or (4) "Any substantial
 31 physical rehabilitation, renovation or modernization of any fixture which converts it to the
 32 substantial equivalent of a new fixture or any substitution of a new fixture."

33 Rule 463(b)(4) excludes construction or reconstruction performed for "the purpose of normal
 34 maintenance and repair" from the definitions. Underground storage tanks that must be improved
 35 or replaced after September 7, 1999 to comply with federal, state, and local regulations shall not

1 be considered new construction. These tanks shall be considered to be replaced for normal
2 maintenance and repair.¹⁹³

3 In the context of fixtures, rehabilitation, renovation, or modernization of a fixture that converts
4 the fixture to the substantial equivalent of new is new construction. Rule 463(b)(5), relating to
5 fixtures, provides that "substantial equivalency shall be ascertained by comparing the productive
6 capacity, normally expressed in units per hour, of the rehabilitated fixture to its original
7 productive capacity." Repair to a fixture does not qualify as the substantial equivalent of new.¹⁹⁴
8 Normal or routine maintenance in order to continue the use of function of the unit (i.e., a new
9 roller to replace the old one in a printing press) is also not considered new construction.¹⁹⁵

10 Landlord and leasehold (tenant) improvements, both structure items and fixtures, are frequently
11 renovated, rehabilitated, or modernized. This is often done in order to provide an interior or
12 exterior "facelift" for the space. Existing improvements may be removed and new improvements
13 added, even before the useful life of the existing improvements is over. If such construction
14 activity converts the existing improvements to substantially equivalent to new or is the
15 installation of a new fixture or the replacement of an existing fixture, such activity is new
16 construction.

17 When new construction of landlord and/or leasehold improvements occurs, relevant information
18 may be received by the assessor from different sources. Information may originate from (1) the
19 Business Property Statement (Schedule B) as reported by the assessee, (2) building permits, (3)
20 county health permits required for some types of construction or (4) a lease agreement. The
21 Business Property Statement is received by the business property division, and building permits
22 are received by the real property division. An assessee may report information on the property
23 statement that has also been provided to the real property appraiser in the form of a permit (and
24 perhaps a follow-up construction activity questionnaire submitted by the assessee). Since
25 information is received by both divisions, the landlord and/or leasehold improvements may be
26 assessed by both divisions (or may escape assessment) if a system of effective coordination is
27 not in place. Methods for ensuring such coordination are discussed later in this chapter and in
28 Appendix A B.

29 After the information regarding construction activity is received, improvements should be
30 classified as a structure item or fixture.¹⁹⁶ The descriptions of additions and deletions should be
31 reviewed by both an auditor-appraiser and real property appraiser and valued appropriately. The
32 appraiser should examine the data received to determine whether any demolition costs have been
33 excluded, whether some elements of reported cost reflect normal maintenance and hence not new
34 construction, and whether, and to what extent, the new construction adds value.

¹⁹³ Section 70(e).

¹⁹⁴ Rule 463(b)(4).

¹⁹⁵ Rule 463(b)(4).

¹⁹⁶ See *Why Classification is Important*, which is discussed earlier in this section.

- 1 The following example illustrates a fixture qualifying as new construction because it is an
- 2 addition since the last lien date.

EXAMPLE 5.1						
VALUATION OF NEW CONSTRUCTION (FIXTURES)						
<p>On February 1, 20012008, an assessee purchased and installed a new walk-in refrigerator (not an integral part of the building). The total installed cost of the refrigerator was \$15,000 \$10,000. At acquisition, it had an estimated <i>average service life</i> of 12 years. The inflation factor for the current year is 2%.</p> <p style="text-align: center;">What is the assessed value on the 2002 2009 lien date, January 1, 2002 2009?</p>						
	<u>Cost</u>	<u>Index Factor</u>	<u>Percent Good Factor</u> ¹⁹⁷	<u>Fair Market Value</u>	<u>Inflation Factor</u>	<u>Indexed Value</u>
Total 2001 2008 Cost	\$10,000 \$15,000	100	.93	\$9,300 \$13,950		
Total 2001 2008 Cost	\$10,000 \$15,000				1.02	\$10,200 \$15,300
Enrolled Value				\$9,300 \$13,950		
What is the supplemental assessment value?						
<p>No supplemental assessment applies to this fixture. The fixture is a separate appraisal unit, and is not part of a larger appraisal unit; therefore, the property is not subject to supplemental assessment.</p>						

- 3
- 4 **Valuation of Abandoned Leasehold Improvements**
- 5 Improvements installed by a tenant, but left at a vacant rental space are called abandoned
- 6 leasehold improvements. The real property appraiser and/or auditor-appraiser may encounter
- 7 difficulties when assessing this property. For example, to whom are the structure items and
- 8 fixtures assessed, and what is their value? No two cases will be the same. Facts related to each
- 9 scenario will differ and appraisal must be based on those facts.
- 10 Following is an example of one possible scenario involving abandoned leasehold improvements.

¹⁹⁷ Percent good factor from "Table 4: Machinery and Equipment Percent Good Factors," 12 year life, AH 581, January ~~2009~~2002.

EXAMPLE 5.2
ABANDONED LEASEHOLD IMPROVEMENTS

- A retail business moves into a new indoor mall in ~~2006~~, 2000. The mall space is leased to the tenant as a shell. It is the tenant's responsibility, and expense, to finish the space to his or her specifications. The retail business spends ~~\$40,000~~ \$20,000 to install leasehold improvements. The leasehold improvements, improvements paid for by the lessee, include structure items (dropped ceiling, finished walls, lighting fixtures, and carpet) and fixtures (burglar alarm system, and permanent partitions-less than floor to ceiling).
- After two years at this location, the retail business moves out of the space to another mall. The leasehold improvements installed two years earlier are abandoned and the space is left vacant on the lien date, January 1, ~~2002~~-2009.
- Because the tenant has abandoned the improvements and the leased space in the scenario above, any improvements left behind revert to the owner of the mall; therefore, the mall owner is the assessee. The structure items and fixtures are assessable to the mall owner on the lien date.
- The improvements may continue to have value because, in theory, another tenant using the same space and improvements may not be required to spend the same amount of time and money in order to utilize the space for his or her needs. The value, on the other hand, may be less than indicated by the cost approach, since a future tenant may have different needs than the original tenant. Professional judgment is needed to determine whether the abandoned improvements have the same value, lower value, or no value.
-

1
2 **Valuation of Fixtures Under Decline in Value**
3 Measuring declines in value can be simple when only one appraisal unit is involved. Fixtures, for
4 example, as a separate appraisal unit are valued at current market value on the lien date and at
5 the indexed base year value, and the lower value is enrolled. However, measuring declines in
6 values may become more difficult in a total property appraisal because more than one appraisal
7 unit is involved. When a decline in value(s) of such property occurs, the first part of Rule 461(e)
8 is extremely important and must be applied.

9 Declines in value will be determined by comparing the current lien date full value
10 of the *appraisal unit* to the indexed base year full value of the same unit for the
11 current lien date. (Emphasis added.)

12 In other words, each appraisal unit must be considered separately. The following example
13 illustrates how declines in value and appraisal units should be treated under Rule 461(e).

EXAMPLE 5.3			
TOTAL PROPERTY APPRAISAL UNDER DECLINE IN VALUE			
	Market Value on the Lien Date (Prop 8 Value)	Factored Base Year Value (Prop 13 Value)	Total Property Value (Assessed Value)
Appraisal Unit 1			
Land	\$515,000	\$100,000	
Building	<u>60,000</u>	<u>85,000</u>	
Unit 1 Value	<u>\$575,000</u>	<u>\$185,000</u>	\$185,000
Appraisal Unit 2			
Fixtures	<u>40,000</u>	<u>52,000</u>	
Unit 2 Value	<u>\$ 40,000</u>	<u>\$ 52,000</u>	\$ 40,000
Total Property Value (Unit 1 + Unit 2)			<u>\$225,000</u>
<p>As indicated in the above example, the proper unit values are "Appraisal Unit 1" (land and building) value of \$185,000 and the "Appraisal Unit 2" (fixtures) value of \$40,000. The correct total value of this property is \$225,000. The appraisal units must be defined properly when applying Rule 461(e) and recognizing declines in value. If the appraisal units are not defined properly, the assessed value of the property would be erroneous and not in compliance with property tax law.</p>			

1

2

DETERMINATION OF ASSESSEE

3 When the owner of a business is also the owner of the land and building, there is no question as
 4 to the proper assessee of the improvements related to business property (i.e., the landlord or
 5 tenant improvements). In this case, taxable property is assessed to one account on the secured
 6 roll. In the case where the owner of the real property (other than fixtures) does not own the
 7 business, however, other possibilities arise. Improvements related to business property may be
 8 constructed and paid for by either the landlord (landlord improvements) or the tenant (leasehold
 9 improvements) and in either case are assessable to either party.

10 When new construction of landlord or tenant improvements occurs, the added value of the new
 11 construction is typically assessed to the party who paid for the improvements. A tenant in a
 12 shopping center, for example, is typically assessed on the unsecured roll for leasehold
 13 improvements—structure items and fixtures—since they are constructed at the tenant's expense.
 14 Such construction is generally reported on the Business Property Statement. On the other hand,
 15 the landlord is typically assessed on the secured roll for landlord improvements since they are
 16 constructed at the building owner's expense. (Such new construction is usually discovered by a
 17 building permit.)

18 As a general rule, whether short-term or extended-term leases, if improvements are constructed on
 19 leased land, and the ground lease provides that the lessee has the right to remove the improvements at
 20 the end of the lease term per Civil Code section 1013, the "owner" of the improvements is presumed
 21 to be the ground lessee. On the other hand, if the lease states that the ground lessor retains ownership

1 of the improvements at the end of the lease term (and the ground lessee has no right of removal), the
2 "owner" of the improvements is the ground lessor."

3 However, the above procedure is not a legal requirement. Section 405 allows the assessor to
4 assess property to "the persons owning, claiming, possessing, or controlling it on the lien date."
5 In the case of landlord improvements and leasehold improvements, the courts have interpreted
6 this to mean either the lessor or lessee may be the assessee, even if the improvements have been
7 paid for by the opposite party.¹⁹⁸

8 **COORDINATION IN THE ASSESSMENT OF LANDLORD IMPROVEMENTS AND** 9 **LEASEHOLD IMPROVEMENTS**

10 Close cooperation between auditor-appraisers and real property appraisers is essential when
11 valuing and assessing landlord and leasehold improvements, because special difficulties arise
12 concerning the uniform assessment and proper enrollment of this type of property. Record
13 management for accurate tracking of base year values and ownership of this type of property
14 may be complex and tedious but extremely important in order to ensure correct valuation and
15 assessment. As discussed earlier, information regarding this type of property is received from
16 various sources and may be submitted to either auditor-appraisers and/or real property
17 appraisers. The value may be enrolled on either the secured roll or the unsecured roll, and the
18 assessee may be either the landlord or the tenant.

19 Internal procedures in assessors' offices should be designed to ensure that all landlord
20 improvements and leasehold improvements are (1) valued on and at the appropriate date and
21 amount, (2) not assessed on multiple accounts, (3) assessed on the proper roll (i.e., secured or
22 unsecured), and (4) assessed to the proper assessee. The means by which this coordination is
23 accomplished may differ from county to county, but general guidelines for coordination should
24 be maintained in all assessment programs.

25 **ESTABLISH A COMPREHENSIVE SET OF WRITTEN PROCEDURES REGARDING** 26 **ASSESSMENT OF LANDLORD AND LEASEHOLD IMPROVEMENTS**

27 A comprehensive set of written procedures that describes how to systematically identify and
28 assess landlord and leasehold improvements can help promote uniform assessment. As noted
29 above, the assessment of landlord and leasehold improvements requires record management for
30 proper tracking of base year values and ownership. Written procedures clarify each staff
31 member's responsibilities in the valuation process for this type of property, making appraisal and
32 record management easier to maintain.

¹⁹⁸ *Valley Fair Fashions, Inc. v. Valley Fair* (1966) 245 Cal.App.2d 614, *Tele-Vue Systems, Inc. v. Contra Costa County* (1972) 25 Cal.App.3d 340, and *Ventura County v. Channel Islands State Bank* (1967) 251 Cal.App.2d 240.

1 **CLEARLY IDENTIFY LANDLORD AND LEASEHOLD IMPROVEMENTS ON APPRAISAL**
2 **RECORDS**

3 Proper notes on appraisal records concerning the establishment of value ~~is an~~ are important ~~step~~
4 in the appraisal process. Appraisal notes should include information regarding the existence of
5 landlord and leasehold improvements, a description of the improvements, and the basis for
6 valuation. If the improvements involve more than one account, the appraisal records should
7 indicate in what manner the improvements are assessed (i.e., to whom, secured or unsecured roll,
8 and assessor's parcel number or business property account number). This information will not
9 only assist appraisers and auditor-appraisers who may work on the subject parcel or related
10 business account(s) in the future, but will also help to avoid duplicate or escape assessments.

11 **COORDINATION OF LANDLORD AND LEASEHOLD IMPROVEMENT APPRAISAL**

12 Appendix A ~~B~~ describes and suggests one method of coordinating the appraisal of landlord and
13 leasehold improvements that is used in some assessors' offices. It is not the only proper method.
14 An example is included as illustration. The example starts with the source documents and goes
15 through several steps including classification, determination of assessee, valuation and
16 enrollment of value.

CHAPTER 6: SPECIAL ISSUES

VALUATION OF OTHER TYPES OF PERSONAL PROPERTY

LEASED EQUIPMENT

Valuation and assessment of leased equipment can be one of the more difficult tasks an auditor-appraiser encounters.¹⁹⁹ Many impediments are generated by a lack of complete, up-to-date information. Other problems are based on the nature of the property. Leased equipment is usually easily movable, and it may change ownership (or possession) and situs frequently. This can make it difficult to analyze the factors (assessability, assessee, situs, description, and classification) necessary to make an appropriate opinion of value and a valid assessment.

Assessability

Assessability of leased equipment, or equipment intended for lease, is the first consideration an appraiser encounters. As discussed in Chapter 1, personal property leased on the lien date is assessable unless exempt. However, personal property held for lease on the lien date is inventory. Leased equipment, or property intended for lease, is assessable when:²⁰⁰

- property is actually leased or rented on the lien date.
- property is being used by the owner for purposes not directly associated with the prospective sale or lease of that property.
- property has been used by the owner prior to the lien date, even though "held for lease" on the lien date.
- property is intended to be used by the lessor after being leased (or during intervals between leases), even though "held for lease" on the lien date.

Assessee

A person who owns, claims, possesses, or controls property on the lien date is the assessee of that property.²⁰¹ This is either the lessor or the lessee. Under section 405, the assessor may assess leased property to either, or both, whether or not there is a private agreement between the parties to the lease. Section 405 specifically states, in part:

(b) The assessor may assess all taxable property in his county on the unsecured roll jointly to both the lessee and lessor of such property.

(c) Notices of assessment and tax bills relating to jointly assessed property on the unsecured roll shall be mailed to both the lessee and the lessor at their latest addresses known to the assessor.

¹⁹⁹ Leased equipment reported to the ~~State Board of Equalization~~ Board by public utility companies is assessed at the state level. However, the Board may delegate to a local assessor the duty to assess a property used but not owned by a state assessee on which the taxes are to be paid by a local assessee.

²⁰⁰ See Rule 133(b), *Business Inventory Exemption, Exclusions*.

²⁰¹ Section 405(a).

1 However broad this statute, the courts and most counties have reasonably construed the
 2 language.²⁰² That is, property is generally *not* assessed jointly although the assessor has that
 3 option pursuant to section 405. Property under a true lease is usually assessed only to the lessor
 4 and property under conditional sales contract only to the lessee. Exceptions to this rule mainly
 5 occur when the lessor requests to be assessed to ensure the taxes are paid or one of the parties to
 6 the lease is an exempt entity.

7 Capital leases are analogous to conditional sales contracts. Lessees under such leases are the
 8 beneficial owners of the properties leased, as they gain possession, use, and control of the leased
 9 properties and the leases include bargain purchase options at the end of the lease terms. For
 10 property tax purposes, including the annual reporting obligation specified in section 441, the
 11 lessee is the responsible party under a capital lease.

12 **Leasing with Exempt Entities**

13 ***Banks and Financials***

14 Tangible personal property owned by banks and financial corporations (commonly referred to as
 15 financial institutions or financials) is exempt from property taxation by the in-lieu tax provisions
 16 under article XIII, section 27 of the California Constitution, and sections 23154, and 23181
 17 through 23183 of the Revenue and Taxation Code, improvements or fixtures are assessable
 18 however. These businesses pay an in-lieu "franchise tax on net income" instead. A listing of
 19 banks and financials qualified under these sections is maintained by the Franchise Tax Board
 20 with confidential copies distributed to assessors annually by the Board of Equalization.²⁰³ The
 21 in-lieu exemption does not apply to banks and financial corporations whose principal activity
 22 consists of leasing tangible personal property (see section 23183(b)). Generally, such
 23 corporations are not shown on the list. Any questions in this regard should be directed to the
 24 Franchise Tax Board.

25 If a lessor bank or financial institution is shown in the listing of banks and financials, the leased
 26 property is assessable to the lessee (unless the lessee is also exempt from property taxation)
 27 pursuant to section 235. Section 235 states:

28 For purposes of this division, the lessee of tangible personal property owned by a
 29 bank or financial corporation shall be conclusively presumed the owner of that
 30 property.

²⁰² 61 Ops.Cal.Atty.Gen. 472, 475 (1978).

²⁰³ As of year 2000, state chartered credit unions are exempt from paying the bank and corporate in-lieu franchise tax (section 23701y). Therefore, state chartered credit unions no longer appear on the *Confidential List of Banks and Financial Corporations*. Assessors need to independently evaluate, on a case by case basis, whether these entities qualify as a financial corporation for assessment purposes. The personal property of those qualifying as financial corporations remains exempt from property tax. Generally, state-chartered credit unions are (1) not subject to the bank and corporation in-lieu tax, (2) subject to real property tax, and (3) not subject to personal property tax. Federally-chartered credit unions are (1) not subject to the bank and corporation in-lieu tax, (2) subject to real property tax, and (3) subject to personal property tax.

1 However, where personal property is leased to an exempt bank or financial, it is assessable to the
 2 owner/lessor (unless the owner/lessor is also exempt from property taxation). The owner/lessor
 3 holds title to the property and does not benefit from the lessee's in-lieu exemption.

4 ***Insurance Companies***

5 Personal property owned by insurance companies is exempt from property taxation, regardless of
 6 how the property is used by that insurance company, pursuant to article XIII, section 28, of the
 7 California Constitution.²⁰⁴ Property leased to insurance companies, rather than owned by them,
 8 however, remains assessable to the lessor (unless the lessor is also exempt from property
 9 taxation). The Department of Insurance maintains a listing of, and periodically issues a
 10 publication containing the names of insurance companies authorized to do business in California.
 11 Assessors should utilize the publications in the administration of this exemption. In the event that
 12 a taxpayer/insurance company seeks exemption of its personal property under article XIII,
 13 section 28 but it has not been recognized by the Department of Insurance as an insurance
 14 company qualified to do business in California, the burden is on the taxpayer/insurance company
 15 to establish to the Department of Insurance that it is an insurance company qualified to do
 16 business in California, such that it is so recognized by the Department and included in its listings
 17 and publications.

18 ***Government Entities***

19 Property leased to or from a federal, state (California), or local governmental (county, city,
 20 district in California) entity is not taxable to that entity, although the property may remain
 21 taxable to another party. It is not taxable to the governmental entity because:

- 22 • The federal government is immune from taxation pursuant to the United States Constitution.
 23 It is a "governing constitutional principle that the properties, functions, and instrumentalities
 24 of the federal government are immune from taxation by state and local governments."²⁰⁵
- 25 • The California Constitution, article XIII, sections 3 and 5 expressly exempt from taxation all
 26 property owned by the state or local governments, except as provided in section 11(a) of the
 27 California Constitution, article XIII (which applies only to land and improvements outside
 28 the boundaries of the local government).

29 **Personal Property**

30 Personal property owned by the government is immune (federal) or exempt (state or local) from
 31 all taxation, as discussed above, and it is not subject to being a possessory interest as is with real
 32 property (with one exception).²⁰⁶ "[T]he Legislature has not provided for the taxation of limited

²⁰⁴ *Mutual Life Insurance of New York v. City of Los Angeles* (1990) 50 Cal.3d 402 overturned *Massachusetts Mutual Life Ins. Co. v. City and County of San Francisco* (1982) 129 Cal.App.3d 876

²⁰⁵ *TRW Space & Defense Sector v. County of Los Angeles* (1996) 50 Cal.App.4th 1703, 1710.

²⁰⁶ See section 201.5.

1 interests in tangible personal property. It has not defined personal property as including a right
 2 to its possession as it has real property."²⁰⁷

3 Under a "lease to ownership plan" or direct financing lease, privately owned personal property
 4 leased to the government is immune from taxation if the government is considered the owner of
 5 the property (government has exclusive management, responsibility and control of the property).
 6 However, Pprivately owned personal property leased to and held by the government is not
 7 immune (federal) or exempt (state or local) where title remains with the lessor. In such cases, the
 8 property is taxable to the owner/lessor, even if its situs is located on government-owned land.
 9 (The exceptions are Congressional grants of immunity for the privately held personal property of
 10 Indians located on Indian reservations and personal property located on federal enclaves.) In the
 11 former circumstance, business equipment leased to a tribe and used on a reservation is not
 12 assessable to the tribe. The state is preempted by federal law from imposing such a tax on Indian
 13 lessees; but, if taxing the equipment would not impose a burden on federally regulated tribal
 14 activity, the equipment may be assessed to the non-Indian lessor

15 Frequently, in cases where federal immunity or state/local exemption is claimed regarding leases
 16 of property with the government, the question is who "owns" the property? In one case, for
 17 example, a court found that title to tools, equipment, and material owned by the federal
 18 government but used by a private contractor doing government construction remained with the
 19 government and were, therefore, immune from taxation.²⁰⁸ In another case, a court found that
 20 title to personal property consisting of materials and inventory used by a private contractor doing
 21 government construction never vested in the government, even though the government fully
 22 reimbursed the costs to the contractor. The nature of the property involved was mere overhead,
 23 "the common staples of any ongoing business; the contractor was the owner."²⁰⁹ In a subsequent
 24 case, however, a court found that title to overhead property vested in the government, pursuant to
 25 the terms of the contract, and was not assessable to the contractor.²¹⁰

26 Where the question of ownership is not clear, proper analysis of the lease agreements and other
 27 sales or financing documents is important. In establishing ownership for tax assessment
 28 purposes, the assessor should determine who holds the *essential indicia of ownership*.²¹¹

29 A title clause standing alone is not conclusive of ownership for tax purposes when
 30 it appears that the taxpayer retains the *essential indicia of ownership*. . .
 31 Accordingly, it is necessary to examine the terms of the contracts to determine

²⁰⁷*General Dynamics Corp. v. County of Los Angeles* (1958) 51 Cal.2d 59, 64-65. An exception is set forth in section 201.5 for personal property owned by or for the California Pollution Control Financing Authority.

²⁰⁸*General Dynamics Corp. v. County of Los Angeles* (1958) 51 Cal.2d 59, *supra*.

²⁰⁹*TRW Space & Defense Sector v. County of Los Angeles* (1996) 50 Cal.App.4th 1703, 1718.

²¹⁰*Hughes Aircraft Co. v. County of Orange* (2002) 96 Cal.App.4th 540.

²¹¹*Mayhew Tech Center Phase II v. County of Sacramento* (1992) 4 Cal.App.4th 497, 505, *citing General Dynamics Corp., supra*, 51 Cal.2d at 67.

1 whether plaintiffs retained rights in the property inconsistent with its ownership
2 by the United States for tax purposes.²¹² (*Italics added.*)

3 Several factors have been identified by the court(s) under the *essential indicia of ownership* test
4 as evidence that the government holds title. The tests can be applied when the government is
5 either the lessor or the lessee and title is not physically held by the government. When the
6 government is a lessee, for example, *essential indicia of ownership* may be apparent if:

- 7 1. Title automatically passes to the government (lessee) at the end of the lease term (the title
8 clause of the lease agreement);
- 9 2. The property itself is used as security for any unpaid lease payments (in the event of
10 default, the lessor would sell the property to pay off the debt and the remainder would go
11 to the government);
- 12 3. The government (lessee) has full authority to alter the property at will;
- 13 4. The government (lessee) is required to maintain the property.

14 Again, no one factor standing alone is indicative of *essential indicia of ownership*, or proper
15 owner for assessment purposes. The ultimate decision must be made upon consideration of all
16 the facts.

17 **Fixtures (and Other Real Property)**

18 Fixtures owned by the federal government and leased to a private party are immune (federal) or
19 exempt (state or local) from property taxation, to the same extent as other real property. Fixtures
20 are not assessable to the government owning the property, but the *possessory interest* in the
21 fixtures is assessable to the lessee as any other type of real property leased from the government.
22 The assessment is on the entire interest of the lessee. It is a *possessory interest* in real
23 property.²¹³ A possessory interest within an area in which the United States has exclusive
24 jurisdiction (so-called "federal enclaves") is excluded from the meaning of "taxable possessory
25 interest" and is immune from taxation.

26 Thus, determination of ownership becomes less of an issue; the property is either assessable as
27 an improvement or a possessory interest value. If, however, ownership does become an issue, it
28 should be determined based on the *essential indicia of ownership* as discussed earlier.

29 **Summary of Lease Situations with a Governmental Agency as Either Lessor or** 30 **Lessee**

31 The following table summarizes the discussion regarding the assessability of leased property
32 wherein the federal, state, or a local government agency is either the lessor or lessee. The table is

²¹² *General Dynamics Corp. v. County of Los Angeles supra.* (1958) 51 Cal.2d 59 at 67.

²¹³ Section 107(a).

- 1 not controlling in all situations and, again, *essential indicia of ownership* (referred to as *owner*
- 2 *(title with)* in the table) should be determined based on all facts.

1

TABLE 6A ASSESSABILITY OF LEASES INVOLVING GOVERNMENT				
LESSOR	LESSEE	OWNER (TITLE WITH)	TYPE OF PROPERTY	ASSESSEE
Private Party	Government	Lessor	Personal Property	Private Party
Private Party	Government	Lessee	Personal Property	No assessment (Immune or Exempt)
Private Party	Government	Lessor	Fixtures (and other real property)	Private Party
Private Party	Government	Lessee	Fixtures (and other real property)	Private Party (Possessory Interest)
Government	Private Party	Lessor	Personal Property	No assessment (Immune or Exempt)
Government	Private Party	Lessee	Personal Property	Private Party
Government	Private Party	Lessor	Fixtures (and other real property)	Private Party (Possessory Interest)
Government	Private Party	Lessee	Fixtures (and other real property)	Private Party

2

3 *Other Exempt Entities or Institutions*

4 Property leased to other exempt entities and institutions may be eligible for exemption, but each
5 situation must be considered individually. In some cases, the property may be automatically
6 exempted; in others, claim forms must be filed in order for the applicable exemption or reduction
7 to be granted. For example, a lessor who leases equipment to public libraries, museums, schools,
8 community colleges, state colleges, and the University of California is not automatically exempt
9 from taxation on the property. The lessor may file a claim for exemption if (1) the leased
10 equipment is "used exclusively" by an aforementioned entity as lessee and (2) it is demonstrated
11 that the benefit of the exemption has inured to the lessee institution. A lessor's exemption claim
12 should only be filed when the lease has been adjusted for taxes and the public entity has already
13 received the benefit of the reduction. Where the lessor does not claim the exemption, the lessee
14 must file a claim in order to receive the refund of tax that the lessor has paid to the county.

15 A discussion of exemptions is located in Assessors' Handbook Section 267, *Welfare, Church and*
16 *Religious Exemptions*. Reference to code sections governing exemptions (sections 202 et. seq.,
17 203, 214 et seq.) is also necessary to determine whether equipment leased to qualifying entities is
18 deemed eligible for exemption or if a claim must be filed.

1 **Situs**

2 Physical situs of leased equipment may change frequently, as previously discussed in Chapter 3.
3 Determination of tax situs for this type of property is generally governed by Rule 204 and
4 section 623.

5 Prior to January 1, 1996, Rule 204, *Leased ~~Equipment~~Property*, was the sole authority governing
6 situs determination. It required a determination of a *precise* situs for each piece of leased
7 equipment (a time-consuming process in many cases). However, section 623 has made *precise*
8 situs of leased equipment less important by allowing a single assessment for leased personal
9 property assessed to the same assessee:

10 The assessor *may* place a single assessment on the roll for all leased personal
11 property in the county that is assessed with respect to the same taxpayer. Any
12 property assessed pursuant to this section shall, in the absence of evidence
13 establishing otherwise, be deemed to be located at the taxpayer's primary place of
14 business within the county. (Italics added.)

15 **Description: Types of Leases**

16 A lease is generally defined as any contract that gives rise to a lessor and lessee relationship in
17 real or personal property. There are many different types of leases and lease situations. To
18 properly determine property tax reporting and assessment questions, it is important to define and
19 consider each type of lease, and the terms associated with them: short-term leases, extended-term
20 leases, true leases, and financing leases or conditional sales contracts.

21 **Short-Term Leases**

22 Leases or rentals of property on a daily, weekly, or other short-term basis (defined as a period of
23 six months or less) are *short-term leases*. The property is assessable to the lessor at the lessor's
24 principal location, regardless of actual location or control on the lien date.²¹⁴ The lessor is
25 considered the owner, and value is estimated by reference to the owner's cost of the property.²¹⁵

26 **Extended-Term Leases**

27 An *extended-term lease* (commonly referred to as a *long-term lease*) is any lease whose duration
28 is more than six months, or for an unspecified period. In many cases, property leased under this
29 type of lease eventually becomes property of the lessee. For example, a lessee leases a computer
30 for five years. At the end of the five-year lease period, the lessee has the option to buy the
31 computer for \$1. Essentially, from the start of the lease, the lessee is the owner of the equipment
32 whether or not title has actually passed. During the lease term the assessor may assess this
33 equipment to either the lessor or the lessee, and situs for assessment purposes is generally the
34 actual location of the leased equipment, subject to the provisions of section 623 as discussed
35 above.

²¹⁴ Rule 204(a).

²¹⁵ See trade level discussion in Chapter 4.

1 Extended-term leases, business property leased for a term of more than six months or for an
 2 extended (even though unspecified) period, must be valued as if in the hands of the lessee, after
 3 all costs of production, including marketing costs, profit, sales tax, freight, and installation costs
 4 have been added. The lessee is considered the consumer of the property, and the property is
 5 therefore valued at the consumer trade level. In the example, the lessee may record a \$1 buy-out
 6 cost on his or her books. The actual value for assessment purposes should be based on the total
 7 acquisition cost at the inception of the lease (if the cost approach is utilized) or the present value
 8 of the lease payments made during the lease (if the income approach is utilized).

9 **True Leases**

10 *True leases*, whether short-term or extended-term as defined earlier, are agreements under which
 11 an owner gives up possession and use of his/her property for valuable consideration and for a
 12 definite term and at the end of the term, the owner has the absolute right to retake, control, or
 13 convey the property. It is an agreement under which there is no intention of transferring
 14 ownership. At termination of the lease, the property will be returned to the lessor.

15 **Conditional Sales Contracts or Financing Leases**

16 *Conditional sales contracts* or financing leases (agreements) are purchases rather than true
 17 leases. They can be short-term or extended-term agreements whereby the seller (vendor) accepts
 18 periodic payments for the purchase price while retaining title to the property for security
 19 purposes. Possession of the property transfers to the buyer (vendee) without full legal title until
 20 payment of the purchase price or a predetermined date occurs.²¹⁶

21 These contracts provide possession, use and control to the buyer. The buyer or lessee is the
 22 beneficial owner of the property, and therefore becomes the assessee, regardless of whether or
 23 not ~~they~~ he or she holds title.

24 ***Differentiating Between a True Lease and a Conditional Sales Contract***

25 It is often difficult to distinguish between a true lease and a conditional sales contract, and no
 26 precise formula has been devised for separating the two types of contractual arrangements.²¹⁷ An
 27 agreement identifying itself as a lease may, in actuality, be a conditional sales contract and vice-
 28 versa. Proper distinction is of prime importance because assessability, exempt status, appropriate
 29 assessee, and value depend on this distinction.

30 According to the Uniform Commercial Code, in determining whether an instrument is a lease or
 31 a sales contract, the contract form is not as important as the intent of the parties. Following are
 32 some issues related to the lease contract that will help determine the intent of the parties of the
 33 contract. In any contract, some of the issues may be indicative of a true lease while others may
 34 be indicative of a conditional sales contract. The intent of the parties should be determined by the
 35 express terms of the contract. Some terms such as liability for insurance, taxes, and other

²¹⁶ Miller & Starr, *California Real Estate*, (2d.ed.) "Specific Real Estate Contracts", section §2:42.

²¹⁷ 61 Ops.Cal.Atty.Gen. 472 (1978).

1 expenses may not establish ownership. These terms are, therefore, not considered in the table
 2 below.

TABLE 6B			
ISSUES TO REVIEW WHEN VERIFYING LEASE TYPE			
(TRUE LEASE V. CONDITIONAL SALES CONTRACT)			
Issue		True Lease	Conditional Sale
Lease Period	<ul style="list-style-type: none"> • Lease period is approximately the same as the anticipated life of the property. • Lease is for a fixed period with a nominal option payment (i.e., \$1) required to transfer title. • Lease is cancelable on a monthly or annual basis. • Optional purchase clause is at market value. 	 X X	 X X
Rent	<ul style="list-style-type: none"> • Present value of contractual rental payments is equal to or greater than the current purchase price. • Present value of contractual rental payments is considerably less than the purchase price. 	 X	 X
Ownership Terms	<ul style="list-style-type: none"> • The contract contains specific provisions retaining ownership with the lessor. • The contract transfers all ownership responsibility, with the exception of title, to the lessee. 	 X	 X
Accounting Treatment by Lessor or Lessee (FASB 13)	<ul style="list-style-type: none"> • Lessor is treating the property as a depreciating asset. • Lessor is treating the property as a note, contract, or account receivable. • Lessee is treating the property as a depreciating asset 	 X	 X X

3

4 As mentioned earlier, like any factual determination, analysis of any one item cannot determine
 5 lease type. All evidence must be weighed. Reliance on any one factor may lead an appraiser to
 6 the wrong conclusion. For instance, treatment (by either the lessor or the lessee) for financial
 7 accounting purposes can be misleading.

8 **Statement of Financial Accounting Standards No. 13 (FASB 13)**

9 Accounting for leases can be a controversial area of financial accounting. Many lessees structure
 10 their lease agreements to avoid capitalization for financial accounting purposes or to improve
 11 their financial position. The Statement of Financial Accounting Standards No. 13 (FASB 13) was

1 developed to govern accounting for leases. This standard, FASB 13, provides lessees and lessors
 2 with established criteria for classifying leases and also requires reporting and disclosure of leases
 3 on financial statements based on the classification made by the lessor and/or the lessee. Thus,
 4 when an audit is conducted, or taxpayer's records are reviewed, leased equipment can be
 5 identified. The nature of the leasing arrangement and activities must be disclosed regardless of
 6 the lease type.

7 Recognition of these requirements for classifying and reporting leases for financial accounting
 8 purposes under FASB 13 is useful in that a substantial amount of information about the property
 9 may be discerned. However, such information does not necessarily determine property tax
 10 classification, assessability, or value. Accounting records alone are not conclusive, although they
 11 may greatly assist the auditor-appraiser in gathering and evaluating all the facts. A lease, for
 12 example, does not necessarily need to be capitalized for it to be assessed to the lessee.
 13 Possession, claim, or control in itself may determine the assessee (section 405(a)).

14 **Valuation of Leased Equipment**

15 When valuing leased equipment, all three approaches to value should be considered: the
 16 replacement or reproduction cost approach, the comparative sales approach, and the income
 17 approach. Each approach, when appropriate, should be applied as discussed in Chapter 4 of this
 18 section.

19 Regardless of which approach(es) is used, leased property must be valued at the proper trade
 20 level. The proper trade level depends on the term of the lease. Under extended-term leases (more
 21 than six months), the lessee is considered to be the consumer of the equipment and thus is
 22 assessable at that level, the consumer trade level. The appraiser should determine the selling
 23 price new of the equipment to consumers, plus sales tax and delivery and installation costs; then
 24 adjust for depreciation. In short-term leases or rentals (six months or less), the lessor is
 25 considered to be the consumer of the equipment, and the value is determined at the lessor's trade
 26 level.

27 **SUPPLIES**

28 Supplies are classified as personal property.²¹⁸ The historical cost of supplies on hand as of the
 29 lien date is reportable by the assessee on the Business Property Statement.

30 Normally, the value of supplies can be based on cost information and/or physical examination of
 31 supplies on hand. The cost approach is an appropriate approach to value because of the relatively
 32 short economic life of the property. Current purchase price often reflects value. In some cases it
 33 is necessary to adjust the purchase price or recorded cost to include supplies not included in the
 34 assessee's books, to adjust for trade level or discounts, or to reflect general price level changes.
 35 These adjustments usually are addressed primarily as a result of an audit.²¹⁹

²¹⁸ See discussion of supplies in Chapter 2 for determination of items included in assessable supplies.

²¹⁹ ~~See discussion of auditing for assessment purposes in Chapter 8.~~

1 It is important, when utilizing the cost approach and the assessee's accounting records, to ensure
 2 that inventory is not misclassified or reported as supplies. Supplies should not be confused with
 3 inventory. Supplies are items used in the ordinary course of business but not incorporated into
 4 the product sold or held for lease. Inventory, on the other hand, are products held for sale or
 5 lease, which include items incorporated into the product or transferred with the product when
 6 sold. An in-depth discussion of this topic is included in Chapter 2, *Classification*, of this section.

7 The cost and value of assessable supplies may be estimated by the percentage of annual
 8 purchases method. This method summarizes total yearly supplies purchased, and estimates the
 9 supplies turnover rate based on frequency and quantities of supplies purchased during the year.
 10 Total annual supplies purchased divided by this supplies turnover rate (Total Annual Supplies /
 11 Turnover Rate = Estimated Supplies on Hand) generally results in a reasonable estimate of the
 12 value of the supplies on the lien date. The reasonableness of this estimate can often be verified
 13 during the physical inspection of the business when an audit is conducted. Caution should be
 14 used if supplies are seasonal when using the percentage of annual purchases method.

15 **CONSTRUCTION IN PROGRESS**

16 Construction in progress (CIP) is also an item required to be reported on the Business Property
 17 Statement. CIP is assessable at full cash value on the lien date.²²⁰ The income and sales
 18 comparison approaches are of limited use because property under construction is typically not
 19 producing any income, and it is difficult to find comparable sales of partially completed projects.
 20 For this reason, the cost approach is nearly always used to value this type of property. Costs
 21 incurred as of the lien date represent total costs, including preliminary direct and indirect costs
 22 such as planning and engineering charges. These costs may or may not represent actual market
 23 value on the lien date. Ultimately, the value should be based on what the property in its partially-
 24 constructed condition would bring in the market place involving a willing buyer and seller. The
 25 seller would attempt to recover all costs if the equipment under construction was sold in a
 26 partially constructed state.

27 The instructions on the Business Property Statement request an attachment of an itemized listing
 28 of costs for construction in progress for improvements to land, machinery, equipment, furniture,
 29 buildings or other improvements, or leasehold improvements. Reported CIP may include both
 30 real property and personal property items that may be hard to distinguish depending on the stage
 31 of completion. Reported costs may also include direct and indirect costs that were discussed
 32 earlier in Chapter 4, *Valuation of Personal Property*, which may or may not influence value.
 33 Review of the costs included in CIP is important to determine assessability, classification, and
 34 contribution to value. Coordination between the real property appraiser and the auditor-appraiser
 35 is equally important to correctly classify building and leasehold improvements, and to avoid
 36 duplicate and escaped assessments (see Chapter 5 for more information on this topic).

²²⁰ Construction in progress regarding personal property is assessable only when actual construction has begun by the lien date. If actual construction has not yet begun, any costs incurred (i.e., engineering fees) are exempt from taxation for the entire year.

1 **COMPUTER AND RELATED EQUIPMENT**

2 Non-production computers and related equipment must be reported separately from other types
3 of personal property on the Business Property Statements. Effective January 1, 2010, the Board
4 adopted a valuation table and classification guidelines pertaining to the assessment of non-
5 production computers.

6 ~~This equipment includes non-production computers (excluding computer-operated machinery~~
7 ~~and equipment), monitors, printers, scanners, disk drives, and cables. These items have relatively~~
8 ~~short lives, and are influenced by rapidly changing technology and user needs. Non-production~~
9 ~~computers consist of: (1) general purpose computers; (2) general purpose computer peripherals;~~
10 ~~and (3) local area network (LAN) devices. General purpose computers contain a central~~
11 ~~processing unit and memory (be it volatile, fixed, on chips, on a disk, or a diskette), and run a~~
12 ~~stored program (software). General purpose computers can be programmed to do different kinds~~
13 ~~of tasks, rather than special purpose computers that are limited by design to a specific task.~~
14 ~~General purpose computers consist of mainframes, servers and microcomputers (desktops and~~
15 ~~laptops). General purpose computer peripherals consist of the auxiliary equipment which is~~
16 ~~designed to be placed under the control of a general purpose computer. General purpose~~
17 ~~computer peripherals include equipment such as monitors, keyboards, mice, docking stations,~~
18 ~~printers, scanners, disk drives, tape drives, modems, wireless cards and web cameras. LAN~~
19 ~~devices are used to connect two or more general purpose computers, to store data and to facilitate~~
20 ~~data traffic in a network. LANs are usually contained in a single building (but equipment which~~
21 ~~is part of a LAN is not excluded merely because it is also part of a wide area network). LAN~~
22 ~~devices include equipment such as routers, computer network switches, hubs, virus protection~~
23 ~~equipment, and storage devices. Non-production computers do not include telecommunication~~
24 ~~equipment or lines (wire, fiber or other) used to connect LANs, computers embedded in~~
25 ~~machinery, and equipment or computers specifically designed for use in any other application~~
26 ~~directly related to manufacturing.~~

27 Production computers (computer operated machinery and equipment or computers embedded in
28 machinery) are not reported, considered, or valued with non-production computer equipment on
29 Schedule A, Column 5, *Computers*. They are valued as other types of machinery and equipment
30 specific to an industry, and are normally reported on Schedule A, Column 1, *Machinery and*
31 *Equipment for Industry, Profession, or Trade*. When computerized equipment is encountered, a
32 special study of the equipment and the industry it serves may be required to determine the
33 appropriate valuation method.

34 **General Valuation**

35 ~~Valuation of non-production computers and related equipment has become increasingly difficult,~~
36 ~~yet important, due to rapid changes in technology and changing needs of users. Because of~~
37 ~~typically shorter lives, rapid depreciation, and little salvage value in many circumstances, the~~
38 ~~Board has provided three separate valuation tables to aid the appraiser using the cost approach to~~
39 ~~value. These tables segregate computers by original cost, and apply different factors based on~~
40 ~~past value trends. As with most equipment, these factors are not appropriate for all computers. In~~

1 some cases, other approaches to value will be more appropriate. Sound appraisal judgment is
 2 necessary to determine the appropriateness of applying the factors to specific computers and
 3 estimating the accuracy of the resulting value.

4 **Storage Media for Computer Programs**

5 Section 995 provides that storage media for computer programs are to be valued as if there were
 6 no computer programs on such media except basic operational programs. Otherwise, computer
 7 programs shall not be valued for purposes of property taxation. Section 995.2 defines the terms
 8 "basic operational program" and "processing program." Rule 152 explains how to properly
 9 determine the classification of computer software.²²¹

10 ***Basic Operational Programs***

11 Basic operational programs are those programs that are "fundamental and necessary to the
 12 functioning of a computer."²²² They are, according to section 995.2:

13 . . . that part of an operating system including supervisors, monitors, executives
 14 and control or master programs that consist of the control program elements of
 15 that system.

16 A *basic operational program* is a control program, as defined in section 995.2, ~~that~~ which is
 17 included in the sale or lease price of the computer equipment. The assessable value of storage
 18 media containing basic operational programs includes the value of the storage media *and* the
 19 value of the program embedded on it. The basic operational programs in personal computers and
 20 mainframe computers are the basic input output system (BIOS) and licensed internal code (LIC
 21 or microcode).

22 Often, computer equipment is purchased or leased at a single price. When the price is not
 23 segregated, or not able to be segregated, between taxable and nontaxable property and programs,
 24 the total purchase price may be used as an indicator of taxable value.²²³ Pursuant to Rule 152(f),
 25 when an assessee can identify and segregate the costs (and supply information to support such
 26 separation) the value must be adjusted appropriately.

27 The assessee is determined by the ownership and control of the storage media. The value of the
 28 storage media is assessable to "the person owning, claiming, possessing, or controlling the
 29 storage media on the lien date."²²⁴ Storage media shall not be assessed to the owner of the
 30 copyright of the computer program embodied or stored on the media unless the owner of the
 31 copyright also owns, claims, possesses, or controls the storage media on the lien date. If the

²²¹ This rule was amended in 1996 and subsequently challenged in court; however, the court found that the Board's 1996 amendment to Rule 152 properly clarified what constitutes a computer's basic operational program, as opposed to other, separate programs, was a legitimate exercise of the Board's rulemaking authority, and was consistent with the Legislature's intent to exempt basic computer programs from taxation. *Hahn v. State Bd. of Equalization* (1999) 73 Cal.App. 4th 985.

²²² Section 995.2

²²³ Rule 152(e).

²²⁴ Section 405(a).

1 licensee of a basic operational program owns the storage media on which a program is stored,
 2 then the licensee is the assessee. If the storage media is leased, then the assessor has the option of
 3 making the assessment to the owner (lessor), the lessee, or to both according to section 405(b).

4 ***Processing Programs***

5 A processing program is a program used to develop and implement the specific applications that
 6 the computer is to perform. It consists of:

7 . . . language translators, including but not limited to, assemblers and compilers;
 8 service programs, including, but not limited to, data set utilities, sort/merge
 9 utilities, and emulators; data management systems, also known as generalized
 10 file-processing software, and application programs including but not limited to
 11 payroll, inventory control and production control. Also excluded from the term
 12 "basic operational program" are programs or parts of programs developed for or
 13 by a user if they were developed solely for the solution of an individual
 14 operational problem of the user.²²⁵

15 Its operation is possible only through the facilities provided by the basic operational program (or
 16 control program). By itself, however, a processing program is not fundamental and necessary to
 17 the functioning of a computer.

18 Only the storage media for processing programs are assessable and they are valued as if there
 19 were no computer programs on them. This value is assessable to "the persons owning, claiming,
 20 possessing, or controlling it on the lien date."²²⁶

21 **BIOPHARMACEUTICAL INDUSTRY EQUIPMENT AND FIXTURES**

22 Effective January 1, 2009, the Board adopted a valuation table and classification guidelines
 23 pertaining to the assessment of specific property owned and/or used by the biopharmaceutical
 24 industry. The valuation table and classification guidelines can be found in AH 581, Table 9.
 25 "Biopharmaceutical Industry Equipment and Fixtures" consist of equipment and fixtures utilized
 26 in connection with, or in support of, research and/or manufacturing activities that use organisms,
 27 or materials derived from organisms, their cellular, subcellular, or molecular components, to
 28 discover and/or provide products for human or animal therapeutics, diagnostics, and/or vaccines.
 29 For mass appraisal purposes, these factors contained in the table are intended to be applied
 30 directly to the historical costs of property for each category.²²⁷

31 **SEMICONDUCTOR MANUFACTURING EQUIPMENT AND FIXTURES**

32 Effective January 1, 2009, the Board adopted a valuation table and classification guidelines
 33 pertaining to the assessment of semiconductor manufacturing equipment and fixtures found in
 34 AH 581. Similar to the nonproduction computer valuation factors and the biopharmaceutical

²²⁵ Section 995.2.

²²⁶ Section 405(a).

²²⁷ See AH 581 for classification guidelines.

1 industry equipment and fixtures valuation factors, the semiconductor manufacturing equipment
 2 and fixture valuation factors are intended to be applied directly to historical costs. ~~One~~ The factor
 3 is applied to the acquisition cost to determine the replacement cost new less normal depreciation.
 4 Semiconductor manufacturing equipment consists of (1) manufacturing equipment used in a
 5 clean room for the fabrication of semiconductor chips; (2) test equipment used in the
 6 manufacturing and research and development environment and to test semiconductor
 7 manufacturing equipment; and (3) fixtures in place to support a semiconductor fabrication
 8 facility. This definition is not limited by the size of a semiconductor facility or the technology of
 9 the chips produced.²²⁸

10 SPECIAL CONSIDERATIONS

11 IDLE, UNUSED, OR OBSOLETE EQUIPMENT

12 Idle, unused, or obsolete equipment has value, even if only salvage or scrap value.²²⁹ Therefore,
 13 the auditor-appraiser must estimate value and assess this type of equipment. Idle, unused, or
 14 obsolete equipment may need to be valued separately from in-use, active equipment of a similar
 15 type.

16 First, an auditor-appraiser must consider all the reasons why equipment is idle on the lien date.
 17 This may or may not influence value for assessment purposes. For example, consider a printing
 18 press no longer in use because it was replaced by a newer model. The old press is stored in the
 19 office break room because there is no other place to put it until sold, donated, or otherwise
 20 disposed of. The older model has value although not in productive use and the value can be
 21 computed in the same manner as a similar piece of equipment that is in productive use. On the
 22 other hand, consider a second example of a printing press no longer in use because it needs
 23 repair. Assume the part needed to repair the press is no longer manufactured; there is no way to
 24 repair the part or the printing press; and it would not interface with modern equipment in use if it
 25 were repaired. This printing press has value, but the value may only be the salvage value of the
 26 property, or the value of the tangible materials since the printing press in essence is unusable or
 27 obsolete. As illustrated here, to value idle, unused, or obsolete equipment, an appraiser must
 28 determine the reason(s) for non-use. It influences value and the resulting assessment.

29 EQUIPMENT PURCHASED USED

30 Valuation of equipment purchased used is peculiar in that the equipment index and percent good
 31 factors, normally utilized by the assessor in mass appraisal, may or may not produce results
 32 reflective of market value. This may be due to differences between total economic life and
 33 remaining economic life, and between historical cost (cost to the original owner) and acquisition
 34 cost (cost to current owner). The equipment index factors provided by the Board (in AH 581)
 35 include separate tables for new and used agricultural and construction equipment, but does not

²²⁸ See AH 581 for classification guidelines.

²²⁹ This discussion could also be applied to the valuation of equipment that is abandoned in place, and back up equipment.

1 include separate tables (new and used) for other types of equipment. An appraiser should take
 2 care to determine how the results of applying factors, both trending and estimation of
 3 depreciation, relate to the actual market value of equipment purchased used. If the results are not
 4 indicative of market value, another method of estimating depreciation, as discussed in Chapter 4,
 5 or another valuation approach should be utilized.

6 Another method of estimating cost and implementing the equipment index factors and percent
 7 good factors, used infrequently but one which may have validity in certain situations, is reverse
 8 trending. Where application of table factors does not accurately represent market value, index
 9 factors can be applied (to acquisition cost) in a reverse sense in order to estimate the historical
 10 cost (cost to the original owner). Then, the appraiser can apply traditional methodology to
 11 estimate value. In order to utilize this approach, an auditor-appraiser should be assured that the
 12 results are indicative of market value on the lien date.

13 Reverse trending is a method of recognizing, and removing from the final valuation conclusion,
 14 assets that are still recorded on the assessee's books, but no longer exist, and have been replaced.
 15 This method is particularly useful for hotel/motel or retail businesses, where periodic
 16 refurbishing occurs, but layers of prior costs are still recorded on the books of the property
 17 owner.

18 ***Steps in the Reverse Trending Process***

- 19 1. Verify that in fact the books and records, and reported costs, appear to lack periodic updating
 20 for disposed assets. Such an inference can be drawn when the original reported costs for each
 21 initial acquisition year indicate little or no change from lien date to lien date.
- 22 2. Verify that costs of new replacements have actually been reported. Assessee's do not always
 23 report replacement costs.
- 24 3. Determine year original asset(s) acquired. If original acquisition year unknown, remove the
 25 estimated original cost from the earliest year, and then the next earliest year, etc., until all of
 26 the cost is deleted.
- 27 4. Find appropriate price index factor(s) for the original asset's acquisition years.
- 28 5. Divide the new replacement cost(s) by the price index factor(s) determined in step 4.
- 29 6. Subtract the cost(s) determined in step 5 from the total cost(s) reported for the original assets'
 30 acquisition years.

1

EXAMPLE 6.1
REVERSE TRENDING

An assessee owns a machine shop and the start-up costs in ~~1987~~ 1992 for all equipment was \$535,981. Over the years the assessee has consistently reported \$535,981 as ~~1987~~ 1992 acquisition costs.

The original acquisition in ~~1987~~ 1992 included the cost of a Bridgeport Mill, but the assessee does not know how much it cost in ~~1987~~ 1992, and does not have any other records to substantiate its cost. In ~~2008~~ 2001 the assessee replaced the old Bridgeport Mill with a new one that cost \$81,763, including sales tax, freight, and installation.

For mass appraisal purposes, Use the following method to estimate the original cost to be deducted from the total recorded 1987 acquisition costs:

- From the AH 581, *Equipment Index and Percent Good Factors*, January ~~2009~~ 2002, Industrial Machinery and Equipment Table, the ~~1987~~ 1992 price index factor is 137 ~~134~~.
- Divide the new replacement cost, \$81,763 by 1.37 ~~1.34~~; the result is an estimated base cost for a Bridgeport Mill in ~~1987~~ 1992 of ~~\$61,017~~ \$ 59,681.
- Subtract ~~\$61,017~~ \$ 59,681 from the reported ~~1987~~ 1992 acquisition costs of \$535,981.

EXAMPLE 6.2
REVERSE TRENDING

- A hotel owner expended \$3,203,102 in ~~2004~~ 2008 for the refurbishment of 150 rooms in a 500-room complex.
- Although some costs have been deleted from the records over time, the property owner has not deducted any original costs relative to the 150 refurbished rooms.

To estimate the cost adjustment, index the earliest historical costs, and begin deleting costs, until an amount equivalent to the current dollar expenditure is removed. (The commercial equipment index factors are taken from AH 581, January ~~2009~~ 2002.)

Begin with the audited fixed asset machinery and equipment costs (column titled F/A Cost), and adjust the indexed ~~2009~~ 2002 lien date assessable historical costs as shown on the following table.

2

1

EXAMPLE 6.2 (CONTINUED)					
REVERSE TRENDING					
Year	F/A Cost	Index Factor	Restated in 2002 2009 \$s	Cost to Remove	Full Economic Cost
2001 <u>2008</u>	\$ 3,203,102				\$ 3,203,102
2000 <u>2007</u>	123,784				123,784
1999 <u>2006</u>	56,223				56,223
1998 <u>2005</u>	72,358				72,358
1997 <u>2004</u>	1,225,488				1,225,488
1996 <u>2003</u>	2,789,321				2,789,321
1995 <u>2002</u>	698,354				698,354
1994 <u>2001</u>	3,579,684				3,579,684
1993 <u>2000</u>	7,899,642	<u>114</u> <u>129</u>	\$ 9,005,592 <u>\$10,190,538</u>	\$ 414,823 <u>\$104,177</u>	*7,535,762 <u>*7,818,884</u>
1992 <u>1999</u>	467,892	<u>116</u> <u>131</u>	—542,755 <u>612,939</u>	<u>542,755</u> <u>612,939</u>	
1991 <u>1998</u>	1,325,879	<u>118</u> <u>131</u>	—1,564,537 <u>1,736,901</u>	<u>1,564,537</u> <u>1,736,901</u>	
1990 <u>1997</u>	567,489	<u>120</u> <u>132</u>	—680,987 <u>749,085</u>	<u>680,987</u> <u>749,085</u>	
Total	\$22,009,216			\$ 3,203,102	\$ 19,233,133
*2002\$ 9,005,592 — 414,823 = 8,590,769 1993\$ 8,590,769 / 1.14 = 7,535,762 *Year 2000: \$10,190,538 – 104,177 = \$10,086,361 \$10,086,361 / 1.29 = *7,818,884					

2

3 VEHICLES

4 Vehicles subject to license by the Department of Motor Vehicles (DMV) for on road use *are not*
 5 subject to property tax assessment. The license fee imposed is in lieu of all property taxes levied
 6 for State and local purposes. However, vehicles exempt from DMV registration and license fee
 7 *are* subject to assessment by the assessor. Theyse vehicles are considered "implements of
 8 husbandry" or "special vehicles" and are specifically exempted from DMV registration under
 9 Vehicle Code Sections 4000-40203.

1 "Implements of husbandry" include, but are not limited to, any tool, machine, equipment,
 2 appliance, device or apparatus used in the conduct of agricultural operations, except where such
 3 implements are intended for sale in the ordinary course of business, and any additional items
 4 defined by the Vehicle Code.²³⁰ "Special vehicles" include steel-wheeled, track-laying, and
 5 rubber-tired equipment, and other vehicles ~~which~~ that are not subject to the license fees by DMV
 6 and are subject to assessment pursuant to section 994.²³¹ Also exempt from registration is special
 7 equipment, "special construction equipment" and "special mobile equipment"; as defined by the
 8 Vehicle Code. Section 565 of the Vehicle Code, states:

9 "Special construction equipment" is:

10 (a) Any vehicle used primarily off the highways for construction purposes and
 11 which moves only occasionally over the highways and which because of the
 12 length, height, width, or unladen weight may not move over the public highways
 13 unladen without the permit specified in Section 35780.

14 (b) Any vehicle which is designed and used primarily either for grading of
 15 highways, paving of highways, earth moving, and other construction work on
 16 highways, or for construction or maintenance work on railroad rights-of-way, and
 17 which is not designed or used primarily for the transportation of persons or
 18 property and which is only incidentally operated or moved over the highway. It
 19 includes, but is not limited to, road and railroad construction and maintenance
 20 machinery so designed and used such as portable air compressors, air drills,
 21 asphalt spreaders, bituminous mixers, bucket loaders, tracktype tractors, crawler
 22 tractors, ditchers, leveling graders, finishing machines, motor graders, paving
 23 mixers, road rollers, scarifiers, earth moving scrapers and carryalls, lighting
 24 plants, welders, pumps, water wagons, power shovels and draglines, speed
 25 swings, skip loaders, weed mowers, self-propelled and tractor-drawn earth
 26 moving equipment and machinery, including dump trucks and tractor-dump trailer
 27 combinations which either (1) are in excess of 96 inches in width or (2) which,
 28 because of their length, height or unladen weight, may not be moved on a public
 29 highway without the permit specified in Section 35780 of this [Vehicle] code and
 30 which are not operated laden except within the boundaries of the job construction
 31 site, and other similar types of construction equipment.²³²

²³⁰ Section 411.

²³¹ ~~Section 994.~~

²³² "Special construction equipment" does not include a vehicle originally designed for the transportation of persons or property to which machinery has been attached (unless specifically designated in section 565 of the Vehicle Code) or dump trucks originally designed to comply with the size and weight provisions of the Vehicle Code. (Section 570 of the Vehicle Code.)

1 "Special mobile equipment" is defined as "a vehicle, not self-propelled, not designed or used
2 primarily for the transportation of persons or property, and only incidentally operated or moved
3 over a highway, excepting implements of husbandry."²³³

4 All of these are subject to assessment by the assessor because they are exempt from license fees
5 by DMV, except by one-trip or special permit. Although identification plates may be found on
6 these vehicles, they are not evidence that the vehicle is registered and the DMV license fee paid.
7 Vehicles bearing these identification plates are exempt from registration and should be
8 assessed.²³⁴ The value should be determined using the same standards and guides used to value
9 other types of personal property according to section 413. However, in some cases, the assessee
10 of such property may be allowed to deduct from the amount of property tax any fee paid on such
11 vehicle (i.e., temporary licenses or special permits including a fee for property tax).²³⁵ For
12 example, if a permit costing \$20 (paid for prior to the lien date for the calendar year in which the
13 lien date occurs) included \$5 for a registration or service fee and \$15 for an in-lieu property tax,
14 it may be appropriate for the total property tax dollar amount as determined by the tax collector
15 (based on the assessor's estimated value) to be reduced by the amount of the in-lieu property tax
16 paid (\$15).

17 Certain other vehicles used for non-business personal use may be subject to property tax. Such
18 items as tractors, backhoes, forklifts, golf carts, even riding lawnmowers, do not qualify for
19 exemption under section 224 because that section specifically excludes vehicles from the
20 definition of personal effects, household furnishings, and pets. These types of unlicensed
21 vehicles are subject to property taxation, although they are often of such a low value and that
22 they may be exempted under a county's low value ordinance exempting low valued personal
23 property.²³⁶ Other types of vehicles , however, that must be registered with DMV the
24 Department of Motor Vehicles (such as snowmobiles, dune buggies, all-terrain vehicles, off-road
25 motorcycles) and are exempted by Vehicle Code section 38230 from property taxation.²³⁷

26 Under section 10751, vehicles subject to registration under the Vehicle Code pay the a vehicle
27 license fee in lieu of property taxes. New equipment permanently mounted on such vehicles must
28 be reported to the Department of Motor Vehicles and the value of the equipment added to the
29 license fee base of the vehicle. This code section precludes the imposition of local property
30 taxation of these types of vehicles. Note that such This equipment is not assessable regardless of
31 whether it is actually registered with DMV. Other types of property, sometimes used in the
32 ordinary course of business, that may be required to be registered by DMV include truck
33 mounted equipment and relocatable offices. Equipment that is permanently attached to a licensed
34 vehicle is not subject to local property taxation because it is considered part of the vehicle. When
35 this equipment is attached to the vehicle the assessee is required to notify DMV so that the value

²³³ Section 575 of the Vehicle Code.

²³⁴ Identification plates are obtained from DMV for a minimal fee, similar to the fee paid to register a vessel with a CF number.

²³⁵ Section 994(b).

²³⁶ See Revenue and Taxation Code Section 155.20.

²³⁷ Vehicle code section 38230.

1 of the vehicle can be adjusted. (However, it is not assessable regardless of whether it is actually
2 registered with DMV.)

3 Similarly owners of relocatable offices, usually utilized by construction companies, may register
4 the trailer with DMV.²³⁸ These trailers are classified as commercial coaches by DMV, and the
5 license can be verified with the yearly DMV (or HCD, ~~the Department of Housing and~~
6 ~~Community Development~~) registration. Since the assessee pays an annual "in-lieu fee" for these
7 trailers to DMV, they are not subject to local property taxation. Commercial trailers may also be
8 exempt from property taxation if issued permanent identification plates in California under
9 Vehicle Code section 5014.1, or licensed as a foreign commercial vehicle to a nonresident owner
10 pursuant to section 6852 of that the Vehicle eCode.

11 **EXPENSED EQUIPMENT**

12 Equipment expensed by an assessee for accounting purposes is assessable personal property as is
13 any personal property used in the ordinary course of business. Expensed equipment may include
14 any type of equipment from small hand tools such as a screwdriver to large machinery. Expensed
15 equipment should be reported on the property statement yearly until disposed, but may go
16 unreported. In the course of an audit, an auditor-appraiser should investigate to determine
17 reporting, classification, and assessment of these items. When discovered, all valuation and
18 assessment procedures are the same as those used for similar types of property.

19 **CONTAINERS**

20 Compressed gas cylinders, beer barrels, and steel drums are examples of types of containers that
21 are typically returned for refill and reuse.²³⁹ A deposit may be required, but there is generally no
22 intention by the buyer to sell the containers but only the product contained within that container.
23 The value of such items is most often determined using the cost approach (cost less
24 depreciation). In some cases, a trade level adjustment may be appropriate. However, the value
25 shall not be less than the deposit or similar charge paid by the buyer.²⁴⁰

26 **LIQUEFIED PETROLEUM GAS TANKS**

27 To promote assessment uniformity of liquefied petroleum gas tanks (commonly referred to as
28 *propane tanks*), Rule 153 was adopted regulating the assessment and valuation of liquefied
29 petroleum gas tanks. Rule 153 defines *liquefied petroleum gas tanks (LPG tanks)*, includes
30 guidelines to determine if the property is leased or rented, identifies the ultimate consumer of the
31 tanks, and describes valuation procedures. An LPG tank is defined as:

²³⁸ The relocatable office may be registered with either DMV, or HCD (Department of Housing and Community Development), in which it is not assessable, or it may be assessable by the assessor similar to mobile homes. See Vehicle Code section 4010 and *Mobilease Corp v. County of Orange* (1974) 42 Cal.App.3d 461, where the court held that relocatable office trailers leased to various companies and registered with DMV were not subject to property tax.

²³⁹ See Chapter 2 for discussion of situs of containers.

²⁴⁰ Section 996.

1 ...a tank used as a means of storage, delivery, or transfer of liquefied petroleum
2 gas products. The term also includes related equipment, apparatus, gauges and
3 meters, attached to or installed on the tank.²⁴¹

4 The LPG tank ~~defined is~~ shall be considered leased or rented "if the purchaser of the liquefied
5 petroleum gas is required to pay: (1) sales or use tax measured by the purchase price or a
6 separately stated lease or rental price of tank, or (2) installation fees or charges, maintenance fees
7 or charges, rent, or any other separately stated periodic charge on the LPG tank."²⁴² The
8 ultimate consumer of the tank is determined based on the length of the lease²⁴³ or, if not leased
9 or rented, the ultimate consumer of the property is considered to be the owner of the tank. Once
10 the ultimate consumer is defined, the assessor can value the tank accordingly.

11 **OAK BARRELS**

12 Oak barrels are often used in the manufacturing of wine or brandy. This property may be
13 assessable; however, in many cases oak barrels qualify as business inventory. Rule 133(a)(2)(B)
14 states, in part, that "business inventories" include:

15 New and used oak barrels used in the manufacturing process that physically
16 incorporate the flavor- and aroma-enhancing chemical compounds of the oak into
17 wine or brandy to be sold, when used for this purpose. However, an oak barrel is
18 no longer business inventory once it loses the ability to impart the chemical
19 compounds that enhance the flavor and aroma of the wine or brandy. An "oak
20 barrel" used in the manufacturing process is defined as having a capacity of 212
21 gallons or less. Oak barrels not used in the manufacturing process but held for
22 sale in the ordinary course of business are also considered business inventory.

23 When oak barrels qualify as business inventory as indicated by Rule 133, the property is exempt
24 from taxation.

25 **ANIMALS AND MIGRATORY LIVESTOCK**

26 Animals and migration livestock, where classified as personal property and not exempt as
27 business inventory, pets, or otherwise, are assessable at full cash value on the lien date in the
28 county where they have established situs. Taxable animals include those used in riding stables,
29 pack station operations, or rodeos, stallions or broodmares held for breeding, and registered or
30 show horses even when located on premises which belong to a person other than the property
31 owner. Animals involved in the production of food and fiber, such as dairy cattle and bulls, beef
32 cattle and bulls, draft animals, swine, sheep, and poultry, and animals held for sale or lease on
33 the lien date are exempt from taxation as business inventory.

²⁴¹ Rule 153(a).

²⁴² Rule 153(ab).

²⁴³ A lessee or renter is the ultimate consumer of the tank if the property is leased or rented for an extended period over six months (Rule 153(c) (1)). The owner of the LPG tank is the ultimate consumer of the tank if the property is leased or rented for six months or less (Rule 153(c)(2)).

1 Determining location, or situs, of animals and migratory livestock may be difficult due to the
 2 constant movement of the "property." ~~¶~~ This type of property often moves from city to city,
 3 county to county, or even state to state. The rules of situs apply. In the case of livestock, location
 4 may include more than one county; livestock may graze on land that is on the county line, or the
 5 livestock may be physically moved from field to field between counties.²⁴⁴ Where this occurs in
 6 significant proportions, section 990 allows for proration by the assessors' concerned. Section 990
 7 states:

8 Where migratory livestock are ranged in two or more counties during the year, the
 9 assessors of the counties interested may meet and prorate the number of stock to
 10 be assessed in each county, taking into consideration the time such stock ranged
 11 in each county.

12 Racehorses are also taxable as personal property. However, valuation is not required. Unlike
 13 other types of property, the owner computes and reports the tax due based on section 5722. The
 14 statement is then filed directly with the tax collector.²⁴⁵ See Chapter 7, *Property Statements*, for
 15 more information on the assessment of racehorses.

16 **SPECIAL VALUE ALLOWANCES**

17 **Works of Art**

18 The value of a work of art still owned by the artist who created it that has never been sold nor
 19 exhibited for profit, for assessment purposes, is the "full value of the materials which constitute
 20 the work of art."²⁴⁶ Works of art, antiques, and other decorations used in conjunction with a
 21 business and not otherwise exempt, should be assessed at their full cash value.

22 **Motion Pictures**²⁴⁷

23 The value of motion pictures (including the negatives, prints, and videocassettes), for property
 24 tax assessment purposes, is "the full value of only the tangible materials upon which such motion
 25 pictures are recorded."²⁴⁸ Section 988(a) states, in part, that:

26 . . . Such full value does not include the value of, or any value based upon, any
 27 intangible rights, such as the copyright or the right to reproduce, copy, exhibit or
 28 otherwise exploit motion pictures or the negatives or prints thereof.

29 **Business Records**

²⁴⁴ For other types of animals, situs should be determined based on the situs rules discussed in Chapter 3, *Situs*.

²⁴⁵ The assessor, however, must mail Board prescribed forms to owners of racehorses although the assessee file the statements with the tax collector (Rule 1045(a)(2)). The assessor must also audit the records of any racehorse owner who had a gross tax liability that exceeds \$2,000 for each of four consecutive years pursuant to Rule 1045(a)(3).

²⁴⁶ Section 986.

²⁴⁷ For a case discussing the Assessment of motion picture negatives, see *Michael Todd Co. v. County of Los Angeles* (1962) 57 Cal.2d 684.

²⁴⁸ ~~Rule 153(a).~~Section 988(a).

1 The assessment of business records (records of persons engaged in a business or profession) is
 2 governed by section 997. The value of this property, for assessment purposes, is "the cash value
 3 only of the tangible material upon which, or in which, such records are recorded, maintained, or
 4 stored"²⁴⁹ (section 997(a)). Similar to motion pictures, the value must be "determined without
 5 inclusion of or consideration of the intangible value of the information or data so recorded,
 6 maintained or stored, nor the intangible right to utilize such information or data."²⁵⁰

7 **ONE-WAY PAGING COMPANIES**

8 For the 1996 lien date and thereafter, one-way paging service companies utilizing facilities that
 9 are licensed by the Federal Communications Commission (FCC) are assessable by the county
 10 assessors. This is due to deregulation of the industry that prompted amendment to section 234 of
 11 the Public Utilities Code.²⁵¹ Previous to 1996 and this deregulation, these companies were
 12 assessed by the State Board of Equalization. Assessors now have jurisdiction over the one-way
 13 paging companies; while the Board continues to have assessment jurisdiction over the radio
 14 telephone companies regulated by the California Public Utilities Commission (CPUC).²⁵²

15 Most often, equipment owned by these companies is valued using the cost approach
 16 (Reproduction Cost New Less Depreciation – RCNLD). It is important to have a general
 17 knowledge of the equipment to be valued in order to apply appropriate equipment index and
 18 percent good factors. Following is a listing of equipment normally applicable and assessable to
 19 one-way paging companies. This equipment should be reported on the Business Property
 20 Statement when applicable, to the county, and should be looked for when conducting audits of
 21 these types of accounts.

22 **Control and Message Center Equipment**

- 23 • Radio-telephone control consoles
- 24 • Equipment and wiring
- 25 • Interconnect equipment, and associated apparatus used in receiving, forwarding, and
- 26 terminating calls and messages and for other control purposes
- 27 • Monitoring and measurement equipment installed for regular control purposes.

28 **Fixed Station Equipment**

- 29 • Transmitters
- 30 • Receivers
- 31 • Antennas

²⁴⁹ ~~Rule 153(a)~~ Section 997(a).

²⁵⁰ ~~Rule 153(a)~~ Section 997(a).

²⁵¹ A telephone corporation (company) does not include any one-way paging service utilizing facilities that are licensed by the Federal Communications Commission, including but not limited to, narrow-band personal communications services described in Section 24.100, Part 24 of Title 47 of the Code of Federal Regulations in effect on June 13, 1995.

²⁵² The Board's ~~Valuation~~ State-Assessed Properties Division maintains a list of state assessed companies.

- 1 • Associated equipment and wiring used in base station and repeater operations
- 2 • Microwave facilities
- 3 • Other equipment used for control of base station operations

4 **Mobile Equipment for One-Way Radio Service, Signaling, or Paging**

- 5 • Receivers
- 6 • Decoders
- 7 • Mobile antennas
- 8 • Associated apparatus that is mounted in vehicles or is hand portable (Note: mobile units
- 9 in stock may be subject to the business inventory exemption.)

10 **Shop and Test Equipment**²⁵³

- 11 • Instruments
- 12 • Tools
- 13 • Other equipment located in offices, shops, or vehicles and used in testing, maintaining,
- 14 and constructing a radio-telephone plant.

15 **BIOPHARMACEUTICAL INDUSTRY EQUIPMENT AND FIXTURES**

16 ~~Effective January 1, 1999, the Board adopted guidelines pertaining to the assessment of specific~~
 17 ~~property owned and/or used by the biopharmaceutical industry.~~²⁵⁴ ~~The biopharmaceutical~~
 18 ~~industry is defined as:~~

19 ~~Firms engaged in research and/or manufacturing activities that use organisms, or~~
 20 ~~materials derived from organisms, and their cellular subcellular and molecular~~
 21 ~~components to discover and/or provide products for human or animal therapeutics~~
 22 ~~and diagnostics. Biopharmaceutical activities make use of living organisms to~~
 23 ~~develop and/or produce commercial products, as opposed to conventional~~
 24 ~~pharmaceutical activities, that make use of chemical compounds to develop~~
 25 ~~and/or produce commercial products. Firms engaging in agriculture, animal~~
 26 ~~husbandry, and pharmaceutical delivery in the area of research and/or~~
 27 ~~manufacturing are specifically excluded.~~

28 ~~The guidelines adopted by the Board include direction regarding reporting of equipment and~~
 29 ~~fixtures on property statements (i.e., Form 571-L), a sample listing of equipment covered by the~~
 30 ~~guidelines, and a suggested valuation table for use in mass appraisals of reported equipment.~~
 31 ~~When appraising property owned and/or used by a biopharmaceutical company, reference to~~
 32 ~~LTA 99/54 for specific information is helpful.~~

²⁵³ Note that in many cases, paging companies charge small tools and instruments or other equipment costing \$50 or less directly to operating expense at the time of purchase.

²⁵⁴ LTA 99/54.

1 **POSSESSORY INTERESTS**

2 As discussed earlier regarding leases with governmental entities, except for property not exempt
 3 pursuant to section 201.5 (California Pollution Control Financing Authority), the Legislature has
 4 not defined "taxable possessory interest" as applicable to personal property.²⁵⁵ With the
 5 exception of the air pollution control provision, there is no possessory interest in personal
 6 property. Possessory interest is applicable to real property, including property that was formerly
 7 personal property but is now classified as fixtures.²⁵⁶ The value of the taxable *possessory interest*
 8 is based on the value of the right to possess or use publicly-owned real property.

9 When an auditor-appraiser encounters leased real property (structure items or fixtures) owned by
 10 an exempt public entity, the real property division should be consulted to determine whether a
 11 taxable possessory interest exists. The value of this interest is assessable to the lessee on the
 12 same basis or percentage of value as other property under section 107.1.

13 **PAWN SHOPS**

14 Property in possession of a pawnbroker, for sale or held for sale by the pawnbroker, is not
 15 assessable to him or her.²⁵⁷ This is exempt inventory to him/her whether or not the property is
 16 owned by him/her unless used in the ordinary course of business.

17 **VALUATION OF AIRCRAFT AND VESSELS**

18 Valuation of aircraft and vessels is unique. Unlike other personal property, this property is
 19 normally valued using the comparative sales approach. Sales of similar types of property are
 20 usually the best indicators of value. Valuation of both aircraft and vessels is discussed in-depth in
 21 separate Assessors' Handbook sections.

22 **BANKRUPTCY**

23 Bankruptcy is a legal process under federal law with the most common provisions being:

- 24 • Chapter 7 – A complete cessation of business and almost complete liquidation of assets of
 25 the petitioner to provide for the satisfaction of creditor claims. Certain assets may be
 26 allowed exemption from liquidation.
- 27 • Chapter 11 – Allows a reorganization of a business to promote and facilitate a
 28 rehabilitation or restructuring of its finances in order to continue operations and avoid
 29 liquidation. The filing of a Chapter 11 petition automatically institutes a stay of debt
 30 collections and lien enforcement while a reorganization plan is negotiated with creditors
 31 based on the future earning capacity of the business. The stay on the bankruptcy estate
 32 ~~are~~ is terminated when the plan is confirmed by the court.

²⁵⁵ *General Dynamics Corp. v. County of Los Angeles* (1958) 51 Cal.2d 59. ~~Section 201.5~~

²⁵⁶ Section 107.

²⁵⁷ Section 989.

- 1 • Chapter 13 – Allows individual debtors the opportunity to develop a new repayment
2 program for financial obligations. Debtors receive protection from creditors' collections
3 while their debt adjustment plan is being developed. Once the plan is approved by the
4 court, the bankruptcy estate terminates and the plan is executed.

5 Each type of bankruptcy provides a measure of protection to the petitioner by prohibiting legal
6 action by creditors against the petitioner. In the case of petitions under both Chapter 11 and
7 Chapter 13, the petitioner usually retains possession and control of the assets.

8 **ASSESSEE OF A BUSINESS IN BANKRUPTCY PROTECTION**

9 Although the filing of a petition for bankruptcy under Chapters 7, 11, or 13 creates a separate
10 and distinct estate, the estate of the bankrupt, the beneficial use of the bankrupt's assets is not
11 transferred upon the creation of the estate. Therefore, the assets do not undergo a reappraisable
12 change in ownership upon the creation of the estate.

13 Property in an estate should be enrolled, whether the assessment is a on the regular one roll or is
14 a result of an escape assessment, in the name of the estate or in the name of the beneficiary who
15 will receive the particular property. If the property has been distributed, the assessment; (regular
16 or escape), should be in the name of the beneficiary only since the executor's/administrator's
17 liability to pay taxes ceases once the estate is distributed.

18 Frequently, the State Board of Equalization discovers information concerning bankruptcy filings
19 in conjunction with the Policy, Planning, and Standards Division's Legal Entity Ownership
20 Program (LEOP). This information is forwarded to the county assessors upon discovery.

21 **SPECIAL VALUATION ISSUES SURROUNDING BANKRUPT ENTITIES**

22 Once a bankruptcy petition is filed, the federal bankruptcy court assumes jurisdiction, and can
23 determine the assessed value of property under certain circumstances. Since taxes take
24 precedence over some other claims, interested parties may seek to have the court reduce the
25 assessed value, thus affecting the related taxes that are due. In this manner, other unsecured
26 creditors will receive a larger share of the funds available.

27 Sales of assets from a bankruptcy estate should not necessarily be considered valid indicators of
28 market value under the definition of ~~Revenue and Taxation Code~~ section 110. The buyer of
29 property from a bankrupt's estate has the ability to take advantage of the exigencies of the seller.
30 Frequently, the trustee's desire to liquidate the assets in an abbreviated period of time further
31 impinges on the concept of "open market transaction."

32 A write-down of the assets after a discharge in bankruptcy to net book value, or some other
33 amount, should also be carefully reviewed. The newly recorded amounts may not represent
34 historical costs, or fair market value, as defined for property tax purposes.

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CHAPTER 7: PROPERTY STATEMENTS

Property statements are declarations of assessable property signed under penalty of perjury. The property statements filed by assesseees are used by assessors to gather information and ultimately determine the assessable value of property.²⁵⁸

The property statement shall show all information as of 12:01 a.m. on the lien date.²⁵⁹

Except as otherwise specifically provided, all tax liens attach annually as of 12:01 a.m. on the first day of January preceding the fiscal year for which the taxes are levied.²⁶⁰

The statement shall show "all taxable property owned, claimed, possessed, controlled, or managed by the person filing it and required to be reported thereon."²⁶¹ The property statement shall also show the situs of the property,²⁶² and a description of the property in the detail required.²⁶³

In compliance with section 451, the information on a property statement filed by assesseees is confidential information. This section reads:

All information requested by the assessor or furnished in the property statement shall be held secret by the assessor. The statement is not a public document and is not open to inspection, except as provided in Section 408.

In general, property statements are similar from county to county. All property statements are prescribed by the Board as set forth under Rule 171, which reads, in part:

Except as specifically authorized by the board with respect to heading, name and address of the taxpayer, location of the property, assessor's use columns, and the like, the assessor shall not change, add to, or delete the specific wording of property statement forms or mineral production report forms prescribed by the board or change the sequence of the questions, but ~~he~~ the assessor may otherwise arrange the content and alter the size and design of a property statement or mineral production report form to meet the needs of his office procedures and facilities.

²⁵⁸ There are several types of property statements based on type of property: business property, agricultural property, apartments, vessels, aircraft, etc. Most of these property statements are prescribed by the Board. For state assessed properties, property statements are governed by Part 2, Chapter 4, Article 5 commencing with section 826 through 834.

²⁵⁹ Section 448.

²⁶⁰ Section 2192.

²⁶¹ Section 442.

²⁶² Section 443.

²⁶³ Section 445.

1 Each year, the Board prescribes the property statements that are available for use by assessors for
 2 the forthcoming assessment year. The assessor is required to notify the Board of the forms
 3 (including exemption claim forms, which are also prescribed by the Board) that will be
 4 reproduced using the Board's template, the forms that will not be used, and forms originated by
 5 the Board that may have been rearranged by the assessor. Rearranged forms must be submitted to
 6 the Board for approval. A checklist provided by the Board accompanies a copy of the forms and
 7 instructions submitted to the Board by the assessor.

8 Assessors commonly develop their own forms to supplement the use of property statements.
 9 Such forms or questionnaires may be used in lieu of property statements unless the assessee is
 10 required by law to file a property statement. For example, section 441(a) requires that every
 11 person who owns taxable personal property (other than a manufactured home) in the county that
 12 costs \$100,000 or more must file a property statement. For smaller accounts, the assessor may
 13 require the person to file a property statement or may use a questionnaire instead. The key
 14 difference between property statements (which must be prescribed by the Board) and
 15 questionnaires (developed by the county assessor) is that the assessee is subject to a 10 percent
 16 penalty for failure to file a property statement timely,²⁶⁴ but the assessor cannot impose a penalty
 17 for failure to respond to a questionnaire. ~~The only exception is that in the case of general aircraft,~~
 18 ~~section 5365 provides that the assessor may ask the owner to file a statement (not Board-~~
 19 ~~prescribed) setting forth the make, model, and year of manufacture of the aircraft, and section~~
 20 ~~5367 provides for a 10 percent penalty for failure to file the statement timely.~~

21 The assessor may request any person within his county to file a property statement.²⁶⁵ It is,
 22 however, much more efficient to request a statement only from those actually owning,
 23 possessing, or controlling personal property. An assessor, therefore, should have a program to (1)
 24 discover assessable personal property, (2) obtain declarations (or property statements) and (3)
 25 process these statements once filed. This chapter will discuss each of these aspects.

26 **DISCOVERING ASSESSABLE PERSONAL PROPERTY**

27 The business climate is ever changing with businesses opening, closing, transferring, and
 28 changing locations constantly. (Other types of personal property, vessels and aircraft for
 29 example, also exist in ever changing environments.) Therefore, the assessment roll regarding
 30 personal property and fixtures must be continually updated. Developing a program for
 31 discovering information regarding taxable personal property and fixtures, and for verifying new
 32 and existing information, is the best assurance that the assessment roll is complete, accurate, and
 33 valid.

34 Discovery methods may differ from county to county. These methods may involve procedures
 35 tracking property transfers, city and county business permits, sales tax permits, business

²⁶⁴ Section 463.

²⁶⁵ Section 453.

1 questionnaires, telephone and reverse telephone directories, newspapers, BOE Forms 600B and
 2 600R, FAA (Federal Aviation Association), California Race Horse Association, and Department
 3 of Motor Vehicle (DMV) records. It may also include conducting a field canvass and field
 4 checks. Due to budgetary and time constraints, an assessor may use any or all of these methods
 5 depending upon what works best and is most cost effective in that particular county.

6 **PROPERTY TRANSFERS**

7 If a business or property transfer is processed through escrow, a statement of bulk sale or tax
 8 clearance from the county tax collector may be required. These statements contain helpful
 9 information regarding the existing business and ownership in addition to information regarding
 10 the buyer. If a sale does not go through escrow, information regarding the sale may be provided
 11 by the seller. In some situations, to prevent future tax liability, sellers notify the assessor when
 12 their business is sold. Whether obtained from the tax collector, the seller, the buyer or another
 13 source, the information regarding the sale of a business can be used to update the assessor's
 14 inventory of assessees who may have taxable personal property or fixtures in the county.

15 **BUSINESS PERMITS**

16 If a business operates (or is planning to operate) within city or county limits, the owner may be
 17 required to apply for a business permit. The application normally requests, in addition to other
 18 information, the business name, owner's name, business location, and phone number. Therefore,
 19 business permit records can provide a valuable source of information to the assessor for property
 20 tax purposes. Some cities and counties have monthly summaries of new businesses that they
 21 make available to the assessor. (It is in the city's best interest to aid the county assessor since a
 22 portion of collected tax dollars are allocated to them.) In fact, section 72 requires county and
 23 city building departments to furnish the assessor with copies of building permits and certificates
 24 of occupancy.

25 **SALES TAX PERMITS**

26 On a monthly basis, the Board of Equalization prepares sales tax permit registration information
 27 for counties.²⁶⁶ This information includes owner and business names, D.B.A. (Doing Business
 28 As), address, type of business, and other information pertinent for a business acquiring or
 29 updating a sales or use tax permit in the county. The information can be used to update and/or
 30 verify business information. In respect to the type of business, the classification code provides a
 31 description of the business. A listing of the classification codes is ~~included in Appendix C for~~
 32 ~~reference purposes.~~ provided in Publication 28, *Tax Information for City and County*
 33 *Officials.*²⁶⁷

²⁶⁶ In the past, this information has been supplied on 3" x 5" cards, but is now also available on computer disc. (To receive the information on computer disc, call the ~~State Board of Equalization's~~ Board's Local Revenue Allocation Section at 916-324-1321-3000.)

²⁶⁷ This publication is a Sales and Use Tax publication and is available on the Board's website (www.boe.ca.gov).

1 **BUSINESS QUESTIONNAIRES**

2 Business questionnaires can be a low-cost, yet valuable tool, for following up on other source
3 documents and public records. If data received from other sources do not provide all information
4 required to initiate a new account, or verify information on an existing account, a questionnaire
5 specifically designed by an assessor's business division to request pertinent information may
6 save the time of the field visit (field check).

7 **TELEPHONE DIRECTORY AND REVERSE TELEPHONE DIRECTORY**

8 A telephone directory or a reverse telephone directory, especially if published near the lien date,
9 can be a useful resource for discovery of businesses. Basic information found here can be used to
10 send business questionnaires or arrange field checks in order to gather enough data to establish
11 or update business accounts.

12 **NEWSPAPERS**

13 Useful information concerning business formations, dissolutions, transfers and other changes are
14 found in newspapers. Items referring to newly established businesses or closings are helpful to
15 update the assessment roll. In addition, items regarding new products, or acquisition of a new
16 subsidiary are helpful when establishing an audit list or preparing for an audit.

17 **VALUATION FORMS 600B AND 600R**

18 Forms 600B and 600R are forms sent from the Valuation State-Assessed Properties Division of
19 the State Board of Equalization to the county assessors. These forms include lists of equipment
20 leased by State-assessed companies that should be locally assessed. State-assessed companies,
21 such as public utilities, are assessed by the Board, but the Board may delegate to county
22 assessors the duty to assess property used but not owned by the state assessee.²⁶⁸

23 **DEPARTMENT OF MOTOR VEHICLES (DMV)**

24 The Department of Motor Vehicles (DMV) is a good source for verifying information regarding
25 vessels, special vehicles, or other licensable equipment. Based on the vehicle license number
26 (i.e., CF number for a boat), DMV can provide information such as owner's name, mailing
27 address, location of the property, date of purchase, and purchase price.

28 **FIELD CANVASS**

29 Field canvassing is a technique that involves physically viewing every business location. It is
30 used to confirm current business information in comparison to the assessor's roll, and it can be a
31 reliable technique for discovery. However, the field canvass method of discovery is very time
32 consuming and thus may be inappropriate for frequent use.

²⁶⁸ Article XIII, section 19.

1 **FIELD CHECKS**

2 A field check is a modified version of the field canvas. Instead of visiting every business, an
3 appraiser visits only those where information, or partial information, is already available. For
4 example, field checks can be used as a follow-up on undelivered ~~B~~business ~~P~~property
5 ~~S~~statements and when property statements are not filed for an account in consecutive years.

6 Valuable information may be discovered when the auditor-appraiser is physically at the business
7 location. In addition to obtaining information regarding the owner, the auditor-appraiser can
8 secure data necessary to estimate the value of the business property. Such data, and the value
9 estimate, becomes essential if the assessee does not file the ~~B~~business ~~P~~property ~~S~~statement.

10 **OTHER SOURCES OF INFORMATION**

11 Other sources of information that are available to assessors for the discovery of new businesses
12 include, but are not limited to: change in ownership statements, building permits, certificates of
13 occupancy, health permits, documents filed with the Secretary of State, and business web sites.
14 Each may provide valuable information that is necessary to make a valid assessment. Discovery
15 methods differ from county to county and each county should determine the most effective
16 means of discovering new businesses and updating information on existing businesses.

17 **OBTAINING STATEMENTS**

18 **FILING REQUIREMENTS**

19 Some assessees are required to file property statements. Others are required to file only upon
20 request of the assessor. Section 441(a) identifies the requirements, as follows:

21 Each person owning taxable personal property, other than a ~~mobilehome~~
22 manufactured home subject to Part 13 (commencing with Section 5800), having
23 an aggregate cost of one hundred thousand dollars (\$100,000) or more for any
24 assessment year shall file a signed property statement with the assessor. Every
25 person owning personal property that does not require the filing of a property
26 statement or real property shall, upon request of the assessor, file a signed
27 property statement. Failure of the assessor to request or secure the property
28 statement does not render any assessment invalid.

29 Property Tax Rule 171, subdivision (df), provides that the assessor shall furnish the pertinent a
30 property statement form and instructions to every person required by law or requested by the
31 assessor to file a property statement. For those taxpayers not required to file a property
32 statement, w~~When~~ the county assessor mails or otherwise provides a property statement to an
33 assessee, the assessor has thereby requested the assessee to file. These statements must then be
34 filed timely and signed under penalty of perjury by the deadline as prescribed under section

1 441.²⁶⁹ If a property statement is filed by May 7, and accepted by the assessor, as required by
 2 section 441, a property owner may amend the statement for errors or omissions that were not the
 3 result of willful intent to erroneously report until May 31.²⁷⁰ If a filing deadline falls on a
 4 weekend or holiday, the deadline is extended to the next business day.²⁷¹

5 The assessor may accept the filing of property statements by use of electronic media. *Electronic*
 6 *media*, as defined in new subdivision (k) of section 441 includes, but is not limited to, computer
 7 modem, magnetic media, optical disk, and facsimile machine. Property statements filed by the
 8 use of electronic media must be authenticated by methods specified by the assessor and approved
 9 by the Board.

10 If the assessee does not file the property statement by May 7, the assessor shall estimate a value
 11 and add a 10 percent penalty to that estimated assessed value.²⁷² For existing businesses, this
 12 value might be the value from the previous roll year. For new businesses, this value may be
 13 estimated by the appraiser based on similar businesses or based on the initial information
 14 received when the business was originally added to the assessment roll. No matter what method
 15 is used to estimate the current roll value, it should be a reasonable estimate of market value based
 16 on available information.²⁷³

17 When a property statement is filed timely in duplicate (on or before the prescribed deadline), the
 18 assessee may request the assessor to provide the full value computed by the assessor for each
 19 category (supplies, equipment, etc.). Under section 443.1, the assessor has the obligation to
 20 comply. Further, the assessor is required to return the duplicate, with the full value for each
 21 category, to the assessee by July 15th of the year in which the statement was filed.

22 **DIRECT BILLING**

23 For smaller businesses and other selected accounts, assessors may use direct billing.²⁷⁴ Direct
 24 billing systems select accounts to appraise periodically, normally once every three or four years,
 25 in lieu of annual property statements. When the total (personal property and fixture) value of a
 26 business changes very little from year to year, direct billing can have a number of advantages
 27 over annually sending a property statement. The advantages for both the assessor and the
 28 property owner are efficiency and cost savings. The process (1) reduces the number of property
 29 statements mailed out, received and processed each year, thus reducing administrative costs, and

²⁶⁹ Property statements should be filed with the assessor between the lien date (January 1) and 5 p.m. on April 1. A late penalty applies if the statement is filed after May 7 (section 441(b)).

²⁷⁰ Section 441(i)

²⁷¹ Section 441(ib).

²⁷² Section 441(b), 463, and 501 and section 463.

²⁷³ Section 501.

²⁷⁴ *Direct billing* is not mandated or even discussed in the statutes. Direct billing is a system of assessment developed by the counties. Taxpayers cannot be required to participate in a direct billing system. In addition, the assessor is not precluded from processing roll corrections if applicable.

1 (2) deletes the filing requirement for the assessee (unless material changes are made to taxable
2 property in that year).

3 Accounts appropriate for direct billing are usually established (older) businesses, having tangible
4 personal property costing less than \$100,000, and minor changes in equipment holdings from
5 year to year. Small barbershops and small retail stores with minimal equipment holdings are
6 good examples. The total personal property and fixture value of these businesses usually does
7 not change much annually.

8 Many accounts are not appropriate for direct billing. Direct billing cannot, for example, be used
9 for accounts whose tangible personal property cost is \$100,000 or more, sine these accounts are
10 required to file in accordance with section 441. New businesses, no matter what the value, should
11 not be put on direct billing. New businesses tend to acquire equipment more often than do older
12 businesses of similar type. Even if a new business seems to fit the description of a business that
13 could appropriately be put onto the direct billing system, the assessor may wish to have property
14 statements for the first year(s) in the business file. These property statements would establish a
15 starting point for determining a valid assessment and confirm that the account is a good
16 candidate for direct billing due to little or no change in property acquisitions or disposals.

17 **PROCESSING PROPERTY STATEMENTS**

18 **PRELIMINARY REVIEW: REQUIRED INFORMATION**

19 Upon receipt of a property statement, the statement should be logged as received and verified as
20 complete. If the statement is not complete, an accurate assessment cannot be accomplished. The
21 guidelines used in the determination of a complete property statement are identified in the
22 statutes and are discussed below.

23 To verify completeness pursuant to these sections, and to aid in processing a statement, it may be
24 helpful to use a checklist. An example of a property statement checklist is found later in this
25 chapter.

26 In lieu of completing the property statement provided by the assessor, an assessee may furnish
27 information as attachments to the property statement (i.e., assessee prepared computerized
28 version of the property statement). This filing is acceptable provided that the property statement
29 attachments (1) are in a format specified by the assessor, (2) include one copy of the property
30 statement, as printed by the assessor and executed by the taxpayer, and ~~(3)~~ includes appropriate
31 reference to the data, or (3) the statement if filed electronically and authenticated as provided in
32 section 441(k).²⁷⁵ The property statement (and attachments) should be reviewed, as is any other
33 property statement pursuant to guidelines discussed below.

²⁷⁵ Section 441.5.

1 **Contents of Statement**

2 "The property statement shall show all taxable property owned, claimed, possessed, controlled,
 3 or managed by the person filing it and required to be reported thereon."²⁷⁶ This information
 4 ensures that the assessor can fulfill his/her statutory duty to enroll all property that it is his/her
 5 duty to assess.²⁷⁷ This includes property that may later be found exempt. Personal property can
 6 be exempt by reason on its ownership, use, and/or type. Not all exemptions are automatic,
 7 however. Some are allowed only if appropriate forms are filed timely and approved by the
 8 assessor, and in these cases, the property remains assessable unless an exemption claim is filed
 9 and approved. Other exemptions, however, are automatic in that no application for exemption is
 10 necessary because the property is of a type that is simply not subject to property taxation.

11 The property statement is made up of several sections, titled "parts" in addition to Schedule A
 12 and Schedule B. Each section requests information necessary for a valid assessment. It is
 13 important to review each section of the statement for possible errors.

14 **Situs**

15 A valid assessment requires a specific location; property must be assessed in the appropriate
 16 county, city, and district. Therefore, the property statement shall also show: (a) the county where
 17 the property is taxable and (b) if taxable in the county where the statement is made, any city or
 18 revenue district where it is situated.²⁷⁸ This generally requires the assessee to report the physical
 19 address of the property or the assessor's parcel number on which it is located. The statement is
 20 not complete if the location of the property, as specified in section 443, is not shown.

21 It is not only important to verify that the situs of the property is reported, but it is also important
 22 to verify that the property is reported to the appropriate county. It is not uncommon for an
 23 assessee, owning several businesses at various locations in California, to file a statement with the
 24 wrong county. At times, erroneous assessment(s) can be avoided simply by reviewing the
 25 reported situs on the property statement. (Other times, however, situs errors may not be
 26 identified until an audit is conducted.)

27 **Description of Property**

28 "The property statement shall show a description of property, in the detail required."²⁷⁹ Such
 29 detail shall include the cost of the property, if the information is within the knowledge of the
 30 assessee or is available from his or her own or other records, and the classification of the
 31 equipment (the physical description).²⁸⁰ The property statement instructs the assessee to report
 32 the equipment by category (machinery and equipment, office equipment, computer equipment,
 33 etc.) year of acquisition, and cost. Further description (other than total cost by year and

²⁷⁶ Section 442(a).

²⁷⁷ Revenue and Taxation Code section 601, Property Tax Rule 252.

²⁷⁸ Section 443. Each city or district may have different tax rates within the jurisdiction.

²⁷⁹ Section 445.

²⁸⁰ As noted earlier the statement is signed under penalty of perjury. Therefore, unless additional information indicates otherwise, it must be assumed that the taxpayer classified the property accurately.

1 classification) is required for reported additions and deletions of improvements and construction
2 in progress.

3 It is important to determine whether the property is properly described in order to make an
4 accurate assessment. Some statements, for example, are received with the total cost reported on
5 the front sheet, but without costs classified or reported by year of acquisition on Schedule A.
6 Others are received with a valid signature but no costs reported anywhere on the form (or with a
7 statement "same as last year"). Still other statements may be filed with costs which appear
8 inappropriate (i.e., the rendition does not resemble the costs that were reported in the previous
9 year). Review of property statements filed in previous years or a phone call to the assessee, or
10 both, may clear up some discrepancies or inconsistencies in the current property statement. In
11 some cases it is necessary to mail the statement back to the assessee to request that the omitted
12 information be submitted. (It may be advisable for the assessor to keep a copy of the statement
13 prior to sending the statement back.) In these situations, the statement is not considered filed by
14 the assessee unless the deficiencies are corrected and the completed statement is returned prior to
15 the filing deadline.

16 Tax Day

17 As previously noted, a property statement shall show all information as of 12:01 a.m. on the *lien*
18 *date*.²⁸¹ The lien date, pursuant to sections 2192 and 722 is January 1.²⁸²

19 It is important to remind assessesees that an assessment is based on information (as reported on the
20 property statement) and value of property owned on the preceding lien date, although the tax bill
21 may be not be received until either July²⁸³ or November²⁸⁴ of that same year. An assessee filing
22 a 20029 property statement (which declares property owned as of 12:01 a.m. January 1, 20029)
23 for example, will receive a tax bill for:

- 24 • an unsecured account by mid-July 20029 for the fiscal year July 1, 20029 - June 30,
25 200310.²⁸⁵
- 26 • a secured account in November 20029 for the fiscal year July 1, 20029 - June 30, 200310.

27 The tax bills, in both cases, reflect property reported on 20029 property statements as of the lien
28 date, January 1, 20029; the cost of all taxable property acquired and owned or controlled as of or
29 through December 31, 20048. Sale or disposal of the personal property (business property,
30 vessels, and aircraft) between the lien date and start of the fiscal year does not relieve the

²⁸¹ Section 448.

²⁸² Prior to January 1, 1997, the lien date was 12:01 a.m. March 1 pursuant to these sections.

²⁸³ In general, section 2910.1 requires that the tax collector mail or electronically transmit the tax bills (or copies) for property on the unsecured roll no later than 30 days prior to the date on which taxes are delinquent. Unsecured taxes are delinquent on August 31 (section 2922).

²⁸⁴ In general, section 2610.5 requires that the tax collector mail or electronically transmit tax bills (or copies) for property on the secured roll on or before November 1.

²⁸⁵ Unsecured taxes are due on January 1: therefore, some counties mail the unsecured tax bills as soon as the assessments are prepared.

1 assessee of any tax liability²⁸⁶ unless the assessment is secured and the new real property owner
 2 does not own, claim, possess, or control the personal property at any time between the lien date
 3 and the date the assessment was made.²⁸⁷ Personal property taxes are not prorated and are
 4 assessed to the owner on the lien date.

5 **Authorized Signature**

6 Property statements and mineral production report forms prescribed by the Board, and filed with
 7 the assessor or the Board, must be signed by the assessee, a partner, a duly appointed fiduciary,
 8 or an authorized agent.²⁸⁸ Statements filed on behalf of a corporate assessee must be signed by
 9 an officer or by an employee or agent for whom the board of directors has submitted written
 10 authorization to sign on behalf of the corporation. When signed by an agent who is not a member
 11 of the bar, a certified public accountant, a public accountant, an enrolled agent, or a duly
 12 appointed fiduciary, then the assessee must authorize appointed agents by filing a statement with
 13 the assessor's office.

14 Facsimiles or copies of original signatures are not acceptable as valid signatures. A copy of the
 15 original may be accepted, but the original document and signature should be provided timely to
 16 constitute a valid filing since facsimiles and copies merely represent the likeness of the original.
 17 A property statement that is unsigned, or signed by an unauthorized agent, does not constitute a
 18 valid filing.²⁸⁹ Such a statement is incomplete and invalid, and should be returned to the
 19 assessee. (It may be advisable to keep a copy of the statement prior to sending the statement
 20 back.)

21 **SPECIFIC SECTIONS OF THE PROPERTY STATEMENT**

22 When it is concluded that a property statement is complete, it is a valid filing. The next phase is
 23 reviewing the reported information and processing the data into an estimate of value. The
 24 appraiser should initially review sections on the form that may require extra attention or where
 25 the assessee needs to be contacted for additional information or clarification. For example, costs
 26 reported as construction in progress and costs reported on Schedule B usually require review and
 27 coordination by both a real property appraiser and auditor-appraiser. If the itemized and detailed
 28 descriptions of these costs are missing from the filing, the assessee may need to be contacted.

29 ~~Besides~~ In addition to reviewing specific areas that may require special attention or follow up
 30 work, it is also important to focus on the statement in whole. That is, does the total reported cost
 31 for this type of business seem appropriate? Review (and processing) of specific parts of the
 32 property statements are discussed below. The Business Property Statement is used as an
 33 example, although there are other statements filed with the business division of the assessor's

²⁸⁶ See Example 1.1.

²⁸⁷ Section 2189 provides that in such a case the assessment of the personal property must be transferred to the unsecured roll.

²⁸⁸ Rule 172(a).

²⁸⁹ Rule 172(e).

1 office.²⁹⁰ In all cases, the statements request data on the owner, location, and cost of the
2 property.

3 **Part I: General Information**

4 This section of the property statement provides general information on the business, including:
5 ~~and indicates~~ (a) the type of business, (b) the telephone number, fax number, email address, (c)
6 an indication if the assessee owns the realty where the business is located, (d) when the business
7 started at this location, (e) confirmation of the business location, (f) an indication where the
8 records are located, (g) ~~and whether~~ if a change in ownership or control has occurred during the
9 last year, and (h) if whether the company or business has any related business entities in the
10 county.

11 (a) ~~— **Type of business:** Business type (retail, manufacturing, service, etc.) is information~~
12 ~~useful when applying appropriate valuation factors and for gauging whether the reported costs~~
13 ~~appear reasonable for that type of business.~~

14 (b) ~~— **Telephone number:** The phone number provides a convenient way to contact the~~
15 ~~assessee in the event questions arise during the review and processing of the statement.~~

16 (c) ~~— **Owner of realty:** Business personal property can be secured to realty if in fact the~~
17 ~~owners of the personal property and the real property are one in the same. It is, therefore,~~
18 ~~important to determine the ownership of the realty where the business is located. Business~~
19 ~~personal property held by a corporation, for example, cannot be secured to real property if held~~
20 ~~in the name of an individual.~~

21 (d) ~~— **Date business started at current location:** It is important to know when the business~~
22 ~~started at the current business location. It is possible that the business was at a different location~~
23 ~~within the county, operating in another county or escaped assessment in prior years.~~

24 (e) ~~— **Business location:** The business location, or situs of property, indicates whether the~~
25 ~~business is physically located in the county and it is used to designate the appropriate tax rate~~
26 ~~area.~~

27 (f) ~~— **Location of records:** If an audit is required or needed, the audit is normally conducted at~~
28 ~~the location of the original books and accounting records (which may or may not be at the~~
29 ~~business location within the county).~~

30 (g) ~~— **Change in ownership or control during the last fiscal year:** A change in ownership of~~
31 ~~the real property or a change in control of the partnership, corporation or legal entity owning the~~
32 ~~property is important information that must be conveyed to the real property division. An~~
33 ~~appraiser should also note how this section is completed because it may affect the costs reported~~
34 ~~in Part II of the statement.~~

²⁹⁰ ~~A sample of a Business Property Statement is included in the appendix for reference purposes.~~

1 ~~(h) — **Related business entities in the county:** If the assessee owns other businesses in the~~
 2 ~~county, all the assessments of personal property and fixtures must be accumulated to determine~~
 3 ~~whether the business is subject to mandatory audit. It could also be a source of information in the~~
 4 ~~discovery of new businesses, and other related businesses.~~

5 **Part II: Declaration of Property Belonging to You**

6 This is the section of the statement where the assessee reports property owned by the business.
 7 The property is reported by type including ~~(a)~~ supplies, ~~(b)~~ equipment, ~~(c)~~ equipment out on
 8 lease or rent to others, ~~(d)~~ buildings building improvements, and/or leasehold improvements,
 9 land improvements, land and land development, and ~~(e)~~ construction in progress.

10 With the exception of supplies and construction in progress (discussed below), property reported
 11 by the assessee should be classified and reported by year of acquisition. The statement gives
 12 instructions to the assessee on classification of the property and applicable costs to be included in
 13 the reported cost of the property. However, the assessee is not required to value the property.²⁹¹
 14 Valuation is conducted by the assessor's office.²⁹²

15 **Supplies**

16 Supplies are a category of personal property that is frequently not reported, although the majority
 17 of assessee have at least minimal taxable supplies. Many times the cost is low and it is simply
 18 forgotten by the assessee. In reviewing the statement, an auditor-appraiser should check the
 19 reported supplies figure. Is a supplies cost reported? If so, is it appropriate for that type of
 20 business? If not, what should it be?

21 Following is an example of supplies reported on a Business Property Statement.

22

²⁹¹ *Clunie v. Siebe* (1896) 112 Cal. 593, 597.

²⁹² Classification and valuation are discussed in other chapters of this manual.

EXAMPLE 7.1
SUPPLY COST REPORTED ON THE BUSINESS PROPERTY STATEMENT

The owner of a small ~~video~~ movie rental store reports \$21,500 of supplies, \$15,000 of equipment, and \$5,000 of leasehold improvements.

DOES THE REPORTED SUPPLIES COST APPEAR REASONABLE (IN TERMS OF QUANTITY, COST, AND TYPE) IN RELATIONSHIP TO THE SIZE, LOCATION, AND TYPICAL OPERATION OF A ~~VIDEO~~ MOVIE RENTAL STORE?

No. The reported supplies cost does not appear reasonable based on a "typical" ~~video~~ movie rental store. It appears that the assessee either misclassified property, or reported property that is considered business inventory for property tax purposes. The assessee may have reported the total cost of the movies in the rental stock. If so, supplies are overreported. Only the movies out on rent on the lien date are reportable and assessable. The movies "held for rent" are exempt inventory. The appraiser should contact the assessee to clarify what cost items are included in the \$21,500 cost reported as supplies on the property statement. The value of a ~~video~~ tape-movie is the assessable value of the blank DVD/video tape only.

1
 2 As shown in the example above, it is important to review reported supplies for reasonableness
 3 and contact the assessee or other sources for more information if necessary.

4 **Construction-In-Progress (CIP)**

5 The instructions require the assessee to attach a schedule supporting CIP reported on the property
 6 statement. This schedule should identify all of the costs ~~which~~ that make-up the reported CIP
 7 total. Using this schedule, the costs can be classified; the total may include costs that are not
 8 assessable, and/or costs that should be allocated between the secured or real property assessment
 9 and the personal property assessment. It is important to coordinate the classification and
 10 assessment of these items with a real property appraiser to avoid duplicate or under assessment.

11 **Schedule A:²⁹³ Equipment**

12 On the Business Property Statement, Form BOE-571-L, Schedule A includes seven categories
 13 of equipment: (1)-*machinery and equipment for industry, profession, or trade*, (2) *office furniture*
 14 *and equipment*, (3) *other equipment*, (4) *tools, molds, dies, jigs*, (5) personal computers
 15 ~~(component cost of \$25,000.00 or less), and (6) local area network equipment (plus mainframe~~
 16 ~~computers) (components cost of \$25,000.01 to \$500,000.00), and (7) computers (components~~
 17 ~~costing \$500,000.01 or more)~~. All equipment should be reported here at the proper trade level,
 18 including short-lived and expensed equipment, and equipment acquired through lease-purchase
 19 agreement at the selling price effective at the inception of the lease.

²⁹³ The Agricultural Property Statement includes similar schedules, but also includes Schedule D, "Movable Farm Equipment." This schedule requests each piece of equipment to be reported separately. See Form 571-F, *Agricultural Property Statement*.

1 **Schedule B: ~~Proper Classification of Fixture and Structure Items (Schedule B)~~**

2 Schedule B includes four categories of improvements: structure items only, fixtures only, land
3 improvements, and land and land development.²⁹⁴ These costs should be reviewed to avoid
4 erroneous assessments. Not only should proper classification be verified (i.e. reported in the
5 appropriate column?), but coordination between the real property appraiser and the auditor-
6 appraiser must take place to ensure that an accurate and valid assessment is made. Chapter 5 of
7 this manual provides a discussion on the classification and valuation of improvements related to
8 a business property.

9 **Supplemental Schedule**

10 Form BOE-571-D, Supplemental Schedule for Reporting Monthly Acquisitions and Disposals,
11 of the Business Property Statement, usually may be furnished with the annual Business Property
12 Statement; The supplemental schedule provides an opportunity for businesses to provide detail as
13 indicated. A careful review of this information should assist in this important task of
14 coordination and classification.

15 **Part III: Declaration of Property Belonging to Others**

16 Part III, *Declaration of Property Belonging to Others*, on the Business Property Statement
17 applies to equipment that may be assessable to an assessee other than the one filing the
18 statement. As discussed in Chapter 6, title to the property may be held by a party other than the
19 one who files the statement and it may be assessable to that other party.

20 Equipment reported in this section is reported by type: leased equipment, lease-purchase option
21 equipment, capitalized leased equipment, vending equipment, other businesses, and government-
22 owned property. ~~They are~~ Equipment is also reported by tax obligation: lessor or lessee. Each
23 lease should be cross-referenced with renditions received from the lessors to avoid duplicate
24 assessments or escaped assessments, and to ensure accurate assessment of the equipment. ~~For~~
25 ~~example, the assessee (lessee) may classify a lease as a capitalized lease assessable to the lessee.~~

26 The taxpayer is also required to report any property that is subject to a lease. For example, The
27 lessor of property that is leased under a conditional sales agreement is required to list that leased
28 property on the lessor's property statement.²⁹⁵ Lessees under capital leases are considered the
29 owner and assessee of the leased properties. As such, lessees are responsible for filing business
30 property statements to report their leased properties.²⁹⁶ Additionally, lessors are required to
31 report property leased under a capital lease unless the capital lease is with a free public
32 librariesy, free museums, public school, and/or colleges as specified in Article XIII, section 3,
33 subdivisions (d) and (e). Section 442(c), provides:

²⁹⁴ For a thorough discussion of classification, see Chapter 2, *Classification* and Chapter 5, *Assessment of Improvements Related to Business Property*.

²⁹⁵ Section 442(b).

²⁹⁶ Section 441.

1 Property that is the subject of a contract designated as a lease that provides that the lessee
 2 has the option of acquiring the property at the end of the lease term for one dollar (\$1), or
 3 any other nominal consideration, shall be reported by the lessor on the lessor's property
 4 statement. If that property qualifies for the property tax exemption provided for by
 5 subdivision (d) or (e) of Section 3 of Article XIII of the California Constitution, that
 6 property shall be regarded as owned by the lessee and is not required to be shown on any
 7 property statement of the lessor.

8 Capital leases to parties other than free public libraries, free museums, public school, and/or
 9 colleges are not eligible for this exemption from filing business property statements.
 10 Additionally, if the lessor is leasing equipment to a free public librariesy, free museums, public
 11 school, and/or colleges and the lease is not a capital lease, the lessor is required to report the
 12 lease with their other leased property on the business property statement.

13 Referencing the statement received from the lessor indicates it is a true lease assessable to the
 14 lessor. Reconciling these differences prior to assessment, and close of the roll, will help to avoid
 15 subsequent roll changes. Cross-referencing may involve an additional step when there are
 16 changes in ownership: e.g., when one leasing company buys the portfolio of another or when a
 17 lessee experiences an ownership or name change. The lessee(s) may continue to reference the
 18 former company in Part III of their statement; the lessor may continue to reference the former
 19 lessee's name in his or her reporting. In such cases, the assessor's system of cross-referencing is
 20 extremely important to minimize erroneous, duplicate, and escape assessments.

21 **INCONSISTENT REPORTING**

22 Sometimes costs reported on property statements are not consistent with costs reported in
 23 previous years. Differences may be due to equipment transfers or dispositions within the last
 24 year, a buyout of previously leased equipment, or simply misreporting. Differences, particularly
 25 changes other than dispositions, should be researched and analyzed as much as possible prior to
 26 enrolling an assessed value.

27 When it is found that inconsistencies affect past assessment years, roll changes may be
 28 necessary. In most instances, these roll changes will be done at the close of the current year's
 29 roll. These changes are discussed further in Chapter 98, *Roll Procedures*.

30 **REVIEW OF PREVIOUS AUDIT FINDINGS**

31 When an audit is conducted it is important to use the audited costs, or incorporate audit findings
 32 as appropriate, in subsequent years when a property statement is processed. Although a property
 33 statement as filed may reflect costs as reported in the previous year, rather than
 34 recommendations made through the audit, an appraiser should make an effort to identify and
 35 correct problems prior to enrollment.

1 **PROPERTY STATEMENT CHECKLIST**

2 Following is a sample *property statement checklist* that may be used to verify completeness of a
3 property statement. The checklist also provides a summary of the information discussed in this
4 section.

TABLE 7A
SAMPLE PROPERTY STATEMENT PROCESSING CHECKLIST

- Log property statement as received.
- Check signature, if not authorized signature property statement not valid (some counties retain a copy prior to returning original for signature).
- Check statement for any changes to situs, mailing address, and/or business name; make any necessary changes.
- Check for any change of ownership regarding business and/or real property. Make any necessary changes (e.g., notify the real property division, make changes to unsecured account).
- Confirm that account is appropriately classified as secured or unsecured (review responses to Part I: General Information questions).
- Confirm that property is reported and described as required.
- Are costs summarized on the front of the form classified and broken down by year of acquisition on schedules A and B?
- Does the statement include a description of costs reported as construction in progress, and costs added to or deleted from Schedule B?
- Did the assessee report supplies? If yes, does the reported cost seem reasonable? If it is not reasonable, estimate supplies on hand on lien date. (For suggested method of estimating supplies, see the section on *Supplies* in Chapter 6.)
- Did the assessee report leased equipment? If yes, cross reference to lessor files to confirm reported information and to prevent duplicate assessment or escaped assessments.
- Check current reported costs with costs reported in previous years. Are the costs consistent? If not, a phone call to the assessee may be required.
- Are CIP (construction in progress) costs reported? If yes, reference description of costs provided by assessee and coordinate assessment with real property appraiser.
- Are CIP costs from the previous year accounted for on the current year's property statement?
- Are additions (or deletions) reported on Schedule B, *Buildings, Building Improvements, and/or Leasehold Improvements, Land Improvements, Land and Land Development*? If yes, reference description of additions/deletions provided by assessee and coordinate assessment with real property appraiser.

1 VALUATION

2 Finally, after the property statement has been reviewed and is considered complete, the auditor-
 3 appraiser must value the taxable property reported on the statement. As discussed earlier, in most
 4 cases this involves using the cost approach to value and the application of equipment index
 5 factors and percent good factors. Sound appraisal judgment is required to determine which
 6 factors or approach(es) applies in each situation. For new accounts, reviewing the factors or
 7 approach adopted by the assessor's business division and reviewing lives given to the equipment
 8 used by similar businesses will help with this process. For older or existing accounts, and
 9 statements that show little or no change from previous assessment years, the same approach,
 10 table and/or economic life estimate as previously assigned are usually appropriate. Referring to
 11 the previous year's property statement electronically or in the physical file will verify the factors
 12 used. Additionally, refer to equipment index and percent good factors included in AH 581;
 13 *Equipment and Percent Good Factors*.

14 In some cases, as the result of physical inspections, audits, assessment appeals, income approach
 15 estimates, sales data, or other data gathered in prior years, the assessor's office has agreed that
 16 the standard cost approach is not appropriate for specific accounts. The agreed upon approach
 17 should be reviewed and used, when appropriate, in subsequent years. This will avoid the same
 18 problem from occurring year after year.

19 LATE FILINGS AND NON-FILINGS

20 Section 463(a) provides that:

21 If any person who is required by law or is requested by the assessor to make an
 22 annual property statement fails to file an annual property statement within the
 23 time limit specified by Section 441 or make and subscribe the affidavit respecting
 24 his or her name and place of residence, a penalty of 10 percent of the assessed
 25 value of the unreported taxable tangible property of that person placed on the
 26 current roll shall be added to the assessment made on the current roll.²⁹⁷

27 The penalty of 10 percent applies if the property statement is filed after May 7.²⁹⁸ If that date
 28 falls on a Saturday, Sunday or legal holiday, property statements filed on the next business day
 29 are considered timely filed. The postmark date as affixed by the United States Postal Service, or
 30 a date certified by a bona fide private courier service, shall serve as the date filed.²⁹⁹

31 In the case of late filings, the 10 percent penalty is added to the value computed using the
 32 reported costs on the property statement filed late. If a statement is not filed, the 10 percent
 33 penalty is applied to the auditor-appraiser's best estimate of value based on the best information
 34 available.

35

²⁹⁷ ~~Section 463.~~

²⁹⁸ ~~Section 463.441(b).~~

²⁹⁹ ~~Section 441(b).~~

1 **Verification of Existing Business**

2 If a statement is not filed for one or more years (time period at the discretion of the assessor),
 3 existence of the business should be verified. Verification may be accomplished with a phone call
 4 or a field check of the business. If the verification process indicates that the business is no longer
 5 in operation, the next step is to confirm when the business ceased operation to prevent any
 6 erroneous assessments. Confirmation of the closing date can be accomplished by contacting the
 7 subject business owner (if possible), landlord, neighboring tenants, or the current tenant of the
 8 same location.

9 **BUSINESS CLOSE-OUTS**

10 Information regarding business close-outs may come from any one of the sources indicated
 11 earlier, or from the business owner who uses the property statement to notify the assessor that the
 12 business is no longer in operation in the county. This is also an opportunity to identify new
 13 businesses. Is a new business at the site, or is the site vacant? What happened to the assessable
 14 property?

15 **LOW VALUE PROPERTY (LOW VALUE EXEMPTION ORDINANCE)**

16 When a property statement is processed, resulting in classes³⁰⁰ of (1) personal property with a
 17 value so low that, if not exempt, the total taxes, special assessments, and applicable subventions
 18 on the property would amount to less than the cost of assessing and collecting them and/or (2)
 19 real property/fixtures base year value or full value of \$~~510~~,000 or less, the assessment may be
 20 exempt if authorized by the county board of supervisors.³⁰¹ Pursuant to section 155.20,
 21 *Exemption of property having a low value*, the board of supervisors may adopt an ordinance
 22 implementing these low value provisions in that county. Most counties have enacted a low value
 23 ordinance (section 155.20) using various minimum values. Others have not enacted the
 24 ordinance at all, and therefore have no value minimum.

25 **PROPERTY STATEMENTS FOR SPECIAL TYPES OF PROPERTY**

26 Other property statements that are filed and processed in the business division of an assessor's
 27 office include agricultural, apartment, aircraft, and vessel property statements. One type of
 28 property statement, the racehorse property statement, is filed with the tax collector. The format
 29 of the forms is different, the type of property that is reported is different, but the purpose of the
 30 forms is the same. The forms are filed by the assessee, and signed under penalty of perjury, and
 31 used by the assessor (or the tax collector) to determine the assessable value (and/or tax) of the
 32 property located in the county on the lien date.

³⁰⁰ For purposes of section 155.20, "class" is defined as a statutory class of property or other class of property separately enrolled and designated by the board of supervisors as eligible for exemption.

³⁰¹ This limitation is increased to \$50,000 "in the case of a possessory interest, for a temporary and transitory use, in a publicly owned fairground, fairground facility, convention facility, or cultural facility." (Section 155.20(b)).

1 The steps in processing the agricultural and apartment statements are similar to the processing of
 2 the business return. Thus, a discussion of each individual statement will not be included here.
 3 The aircraft, vessel, and racehorse property statements, however, are unique and require mention.

4 **Aircraft**

5 Section 5365 specifically discusses the aircraft statement. It states that: "Upon request of the
 6 assessor of the county in which an aircraft is habitually based, the owner shall file with ~~him~~ the
 7 assessor a statement setting forth information about the aircraft that is necessary to ascertain the
 8 full value of the aircraft, including, but no limited to, the serial number, the make, model-and
 9 year of manufacture of the aircraft, and engine and maintenance information, including the total
 10 hours logged on the aircraft following the major overhaul of the engine of the aircraft." ~~As~~
 11 ~~previously discussed, this is the one statement that is not Board prescribed but a penalty is~~
 12 ~~applicable if the owner does not return the statement timely.~~

13 In addition, section 5366 requires airport owners and/or operators to file statements reporting
 14 aircraft that are located at their airports or that use their airports as a base. This section of the
 15 code, in part, states:

16 Owners, as well as operators, of private and public airports shall, within 15 days
 17 following the lien date of each year, provide the assessor of the county in which
 18 the airport is situated with a statement containing a list of names and addresses of
 19 the owners, and the make, model, and aircraft registration number, of all aircraft
 20 which were using the airport as a base.

21 For the most part, the discovery of aircraft located in a county is through the statements filed by
 22 the airport owners and/or operators. After the discovery of an aircraft (in a particular) county, an
 23 account is established by the assessor's office and an aircraft statement is mailed to the owner of
 24 the aircraft. Two basic sets of Board prescribed forms are used for the assessment of aircraft; one
 25 is designed by the assessor for the assessment of general aircraft, and several ~~Board prescribed~~
 26 ~~statements are designed~~ are designed for certificated aircraft. Specific statutes exist for each type.
 27 Thorough discussions of aircraft assessment are contained in AH 570, *Assessment of*
 28 *Commercial Aircraft*, and AH 577, *Assessment of General Aircraft*. A discussion on situs of
 29 aircraft is included in Chapter 3, *Situs*, of this manual.

30 **Vessels**

31 The requirements set forth in section 441, ~~Property statement; other information~~, also apply to
 32 property statements filed for vessels. A standard property statement used for all types of vessels
 33 includes questions that require the assessee to describe the vessel in a manner sufficient for an
 34 accurate assessment. Similar to other types of personal property, vessels are assessed at market
 35 value each year. The information received from the assessee on the vessel property statement
 36 identifies the vessel type, the cost, ~~the~~ age, and ~~the~~ size of the vessel, and it significantly aids in
 37 the valuation of the property. Many assessors use questionnaires in lieu of property statements
 38 for smaller vessels (less than \$100,000 cost).

1 Sources and methods that may be used to discover vessels located in the county on the lien date
 2 include records from the DMV, Certificates of Documentation, referrals from other counties, the
 3 use of field canvassing, reports from marinas, and reports from other types of boat storage
 4 facilities. Registration information is received monthly from DMV regarding (1) vessels moved
 5 in and out of the county, and (2) sales of new or used boats to assessees that claim situs in the
 6 county. Many assessors have also established an on-line communication link to the DMV's
 7 database. Operators of marinas and other boat storage facilities are requested by the assessor to
 8 annually file reports that list boats located at their facilities on the lien date. For further
 9 information on vessels see Chapter 3 of this manual ("Situs of Vessels") and AH 576,
 10 *Assessment of Vessels*.

11 **Racehorses**

12 "Property statements" utilized for taxation of racehorses are unique and are treated differently
 13 than other types of property statements.³⁰² Most significantly, as provided in section 5782, this
 14 Board prescribed form, ~~BOEAH~~ 571-J, *Annual Racehorse Tax Return* (provided by the assessor)
 15 is filed with the tax collector's office rather than the assessor. No valuation is required by the
 16 assessor because the assessee reports an annual tax due based on a schedule in the statute.³⁰³
 17 However, the assessor must audit the tax records of any racehorse owner who had a gross tax
 18 liability exceeding \$4,000 for each of four consecutive calendar years.³⁰⁴ The lien date ~~regarding~~
 19 for the assessment of racehorses is the same as other types of personal property, January 1, but,
 20 unlike other types of property, the tax becomes delinquent at 5 p.m. February 15 of the same
 21 calendar year.³⁰⁵

³⁰² The taxation of racehorses is discussed in sections 5701 through 5790 (~~Part 12~~) and Rules 1045 through 1047.

³⁰³ Section 5722.

³⁰⁴ Rule 1045(d)(1).

³⁰⁵ Section 5762.

CHAPTER 98: ROLL PROCEDURES

IDENTIFYING ROLL ERRORS

For a wide variety of reasons, the initial assessment roll inevitably contains errors. Common errors include errors in value judgment, "clerical" (calculation) errors, errors caused by the failure of property owners to report correctly (or to report at all), and various misunderstandings. Typical examples specific to the business division include:

- A property statement disclosing information erroneously omitted in previous year(s) (either by the assessee when reported or by the assessor when processing)
- An audit resulting in a net change (increase or decrease) in assessed value
- An assessee failing to inform the assessor that a business was closed and/or assets were disposed of prior to the lien date
- An assessor discovering a business owning taxable property after the initial year of operation and assessability

Such errors result in overassessments, underassessments, misclassifications, assessments to the wrong assessee, assessments assigned to the wrong tax-rate jurisdictions, and other problems that result in incorrect assessments.

In general, California law provides procedures for correcting errors and omissions on the assessment roll, regardless of the cause of the error or omission and regardless of whether the error resulted in an overassessment or an underassessment. If the value of property that should be on the roll is determined to be different than the enrolled value (an audit resulting in a net increase, for example), the enrolled value must be corrected according to statutory provisions. Both the limitation on time (i.e., statute of limitations), if applicable, and the procedure for making a correction vary greatly according to the nature and the cause of the error. The procedures set forth in the statutes must be followed.

ESCAPE ASSESSMENTS

An *escape assessment* is an assessment made after the completion of the regular assessment roll, as an addition to that roll. The regular assessment roll is complete after the assessor has certified the completion of the local roll prepared pursuant to section 601.³⁰⁶ An escape assessment is any addition to that roll regardless of the reason.

³⁰⁶ Escape assessments for state assessed properties may either be added to the fiscal year in which it is discovered or included with the assessments for the succeeding fiscal year (section 864).

1 Section 531 requires the assessor to make an escape assessment if: (1) upon the discovery of any
 2 property belonging on the local roll that has escaped assessment (for any reason)³⁰⁷ (2) the
 3 assessee does not file a property statement and the result is (a) no assessment; or (b) an
 4 assessment at a valuation lower than would have obtained had the property been properly
 5 reported.³⁰⁸ ~~(2) upon discovery of any other underassessment of property.~~ When an escape is
 6 based on failure to file a property statement (including circumstances where the statement is
 7 incomplete when filed and returned to the assessee), the assessor is also required to add penalties
 8 and interest to the assessment. Section 531 states:

9 If any property belonging on the local roll has escaped assessment, the assessor
 10 shall assess the property on discovery at its value on the lien date for the year for
 11 which it escaped assessment. It shall be subject to the tax rate in effect in the year
 12 of its escape except as provided in Section 2905 of this code.

13 Property shall be deemed to have escaped assessment when its owner fails to file
 14 a property statement pursuant to the provisions of Section 441, to the extent that
 15 this failure results in no assessment or an assessment at a valuation lower than
 16 would have obtained had the property been properly reported. Escape assessments
 17 made as the result of an owner's failure to file a property statement as herein
 18 provided shall be subject to the penalty and interest imposed by Sections 463 and
 19 506, respectively. This paragraph shall not constitute a limitation on any other
 20 provision of this article.

21 Escape assessments are also required when it is discovered that an exemption was granted in
 22 error,³⁰⁹ and when the business inventory exemption was incorrectly applied.³¹⁰ The statutes also
 23 provide for escape assessments when assessees do not provide accurate information requested by
 24 the assessor necessary to compute a valid assessment. When accurate information is available to
 25 the assessor that indicates a higher assessment is required than the originally enrolled, the
 26 additional value is enrolled as an escape assessment. Sections 531.3 and 531.4 both provide for
 27 escape of the property incorrectly reported. Section 531.3 provides, in part:

28 If the assessor requires an assessee to describe personal property in such detail as
 29 shows the cost thereof but the assessee omits to report the cost of the property
 30 accurately, notwithstanding that this information is available to the assessee, to
 31 the extent that this omission on the part of the assessee causes the assessor not to
 32 assess the property or to assess it at a lower valuation than he would enter upon
 33 the roll were the cost reported to him accurately, that portion of the property as to
 34 which the cost is unreported, in whole or in part, shall be assessed as required by
 35 law. . . .

³⁰⁷ Section 531.4.

³⁰⁸ Section 531.4.

³⁰⁹ Section 531.1.

³¹⁰ Section 531.5.

1 Section 531.4 provides, in part: ~~specifically discusses escape assessments in terms of inaccurate~~
 2 ~~property statements. In part, it reads:~~

3 When ~~the~~ an assessee files with the assessor a *property statement* or report on a
 4 form prescribed by the board with respect to property held or used in a profession,
 5 trade or business and the statement fails to report any taxable tangible property
 6 accurately, regardless of whether this information is available to the assessee, to
 7 the extent that this failure causes the assessor not to assess the property or to
 8 assess it at a lower valuation than he would enter on the roll if the property had
 9 been reported to him accurately, that portion of the property which is not reported
 10 accurately, in whole or in part, shall be assessed as required by law. (Italics
 11 added.)

12 In addition, both sections 531.3 and 531.4 discuss the application of penalties and interest as
 13 provided in sections 504 and 506. When it is discovered that an additional assessment is required
 14 for a previous roll year, it is important to determine the reason for the missed assessment. For
 15 example, the missed assessment may be due to either an assessor or assessee error. If it is an
 16 assessee error, the failure to report costs accurately may be due to an unintentional mistake or
 17 willful misreporting. Provisions in the code allow for penalties and interest depending in part on
 18 the reason for the escape assessment. For example, if the omission by the assessee in reporting
 19 was willful or fraudulent, the penalties and interests provided in sections 504 and 506 shall be
 20 added to the additional assessment; otherwise, only the interest provided in section 506 is
 21 added.³¹¹

22 **TAX RATE AND INTEREST**

23 Section 506 indicates the appropriate tax rate and interest to be applied to escape assessments.
 24 The language provides that the tax rate applicable to any escape assessment shall be:

25 . . .the tax rate to which the property would have been subject if it appeared upon
 26 the roll in the year when it should have been lawfully assessed. To the tax there
 27 shall be added interest at the rate of three-fourths of 1 percent per month from the
 28 date or dates the taxes would have become delinquent if they had been timely
 29 assessed to the date the additional assessment is added to the assessment roll.

30 Basically, the *tax rate* is the rate of the year of escape, and the *delinquency date* is the date the
 31 taxes would have become delinquent if the property was reported timely. The date the escape
 32 assessment is entered on the roll (the *date of enrollment*) is important in terms of the interest
 33 computation. The *date of enrollment* of the escape is the date the interest computation stops
 34 (interest computation starting with delinquency date if the property was reported and assessed
 35 timely). The *interest rate* is applied for the number of months from delinquency date to roll entry
 36 date (three-fourths of 1 percent per month).

³¹¹ See sections 531.3 and 531.4

1 **PENALTIES**

2 Penalties are applied to escape assessments under certain conditions. If the property statement is
3 not filed or was not filed timely in accordance with sections 441 and 463, a 10 percent penalty
4 must be applied to the assessed value. The application of the penalty may only be abated by the
5 county board of equalization or assessment appeals board. Therefore, if an assessee does not
6 agree with the penalty and wishes to have the penalty abated, an application for changed
7 assessment (appeal) must be filed.

8 A 25 percent penalty may be applied to the assessed value if the assessor discovers that the
9 assessee or agent willfully concealed information that resulted in a lower assessed value.³¹²
10 Section 503 provides for the application of a penalty in the amount of 75 percent of the
11 additional penalty to the assessed value if it is discovered that the property is underassessed due
12 to a fraudulent act or omission, or fraudulent collusion between the assessee (or the assessee's
13 agent) and the assessor (or the assessor's deputy). The interest and the penalties (if appropriate)
14 of the additional assessed value are added to escape assessments calculated on that additional
15 assessed value.

16 **STATUTE OF LIMITATIONS**

17 In most cases, escape assessments must be made within four years after July 1 of the assessment
18 year the property escaped assessment. This time period is extended to eight years if conditions
19 exist that warrant the 25 percent penalty application in sections 502 and 504.³¹³ This time period
20 is also extended to eight years if property escaped assessment as a result from an unrecorded
21 change in ownership for which either a change in ownership statement, as required by section
22 480, or a preliminary change in ownership report, as required by section 480.3, is not timely filed
23 with respect to the event giving rise to the escape assessment or underassessment.³¹⁴

24 The statutory time period for making an escape assessment is also extended if the assessee and
25 the assessor agree in writing to extend the time. Section 532.1 (a) provides that: in part reads:

26 If, before the expiration of the period specified in Section 532 for making an
27 escape assessment, the taxpayer and the assessor have agreed in writing to extend
28 the time for making an assessment, correction, or claim for refund, the assessment
29 may be made at any time prior to the expiration of the period agreed upon. The
30 period may be extended by subsequent agreements in writing made before the
31 expiration of the period previously agreed upon.

32 This written agreement is in writing may also be known as a waiver of the statute of limitations
33 (waiver). Each county develops its own form; therefore the titles of the forms, in addition to the

³¹² Sections 502 and 504.

³¹³ Section 532(b)(1).

³¹⁴ Section ~~531.5~~ 532(b)(2).

1 actual agreements may be different.³¹⁵ In all cases, however, the waiver should indicate that it
 2 extends the time allowed for making an escape assessment, correction, and refund. If the waiver
 3 does not specifically state that it extends the time for corrections and refunds, then it only
 4 extends the time for making an escape assessment.

5 **LOW VALUE ESCAPE ASSESSMENTS**

6 Section 531.9 provides that a county may adopt an ordinance that authorizes the assessor not to
 7 issue an escape assessment that would result in an amount of taxes that is less than the cost of
 8 assessing and collecting the tax; this amount may not exceed \$50.
 9

10 **NOTICE OF PROPOSED ESCAPE ASSESSMENT**

11 Pursuant to section 531.8, assessors are ~~It is required to notify that the assessees be notified using~~
 12 of any proposed escaped assessments by sending them a *Notice of Proposed Escape Assessment*
 13 at least 10 days prior to the entry of a value on the roll, ~~pursuant to section 531.8.~~ In relevant
 14 part, section 531.8 reads:

15 No escape assessment shall be enrolled under this article before 10 days after the
 16 assessor has mailed or otherwise delivered to the affected taxpayer a "Notice of
 17 Proposed Escape Assessment" with respect to one or more specified tax years.

18 The intent of this provision is to provide assessees with advance notice of an escape assessment
 19 before its enrollment, thereby increasing their opportunity to ask questions and prepare to file an
 20 appeal. The notice may differ in appearance and content from county to county ~~(as it is not~~
 21 ~~required on a~~ the form is not Board-prescribed form), but certain information must be included in
 22 order to meet the statutory requirements. For example, every *Notice of Proposed Escape*
 23 *Assessment* must: (1) have a prominent heading showing the statutory title of the notice; (2)
 24 show the amount of any the proposed escape assessment for each tax year as estimated by the
 25 assessor; and (3) provide the a name and telephone number of a person at the assessor's office
 26 who is knowledgeable with respect to the proposed escape assessment and to whom the assessee
 27 can so the assessee can contact the assessor's office to voice any concerns with respect to the
 28 proposed escape assessment or to, submit additional information,³¹⁶ ~~or otherwise discuss the~~
 29 ~~assessment; and have a prominent heading stating the statutory title of the Notice. As stated~~
 30 above, ~~¶~~ this notice must be sent by the assessor ten days prior to enrolling any escape
 31 assessment. Absent such notice, no escape assessment may be levied, and, if levied is invalid and
 32 void. When an audit results in escape assessments, the *Notice of Proposed Escape Assessment*
 33 may be attached to the audit findings or may be sent independently along with other sources of
 34 information.

³¹⁵ The form with the agreement that extends the time limitation for processing an escape is not a Board-prescribed form. The format and title of the form may differ ~~between~~ among counties.

³¹⁶ Section 531.8

1 Receipt of the Notice of Proposed Escape Assessment, however, does not constitute proper
 2 notice of the escape assessment for purposes of sections 534(b)-(d) and 1605. Therefore, the
 3 assessor should include express language on the notice to this effect:

4 You may not file an appeal based on this notice. After this proposed escape assessment
 5 has been processed and enrolled, you will be advised that the escape assessment has been
 6 enrolled by a Notice of Enrollment of Escape Assessment. You will also be provided
 7 with information regarding your right to appeal either (1) the enrollment of the escape
 8 assessment or (2) the value established for the escape assessment.

9 **ENTRY ON ROLL**

10 ~~When an escape assessment is made, the entry on the roll must reference the year the property~~
 11 ~~escaped assessment and applicable sections of the Revenue and Taxation Code. Section 533~~
 12 ~~gives specific wording that must be entered on the roll. In part, the section states:~~

13 ~~... if this is not the roll for the assessment year in which the property escaped~~
 14 ~~assessment, the entry shall be followed with "Escaped assessment for year 19__~~
 15 ~~pursuant to Sections _____ of the Revenue and Taxation Code."~~

16 Since appropriate sections of the Revenue and Taxation Code must be referenced when the entry
 17 on the roll is made, it is important to determine if the ~~missed~~ escaped assessment was due to an
 18 assessee error or an assessor error and/or concealment or fraud. The cause of the escape
 19 assessment determines the appropriate section references.

20 ~~As indicated earlier, an escape assessment shall not be enrolled unless the assessor has mailed or~~
 21 ~~delivered a *Notice of Proposed Escape Assessment* at least 10 days prior to the entry of the value~~
 22 ~~on the roll.³¹⁷ After an escape assessment is enrolled, section 534 requires that the assessor mail~~
 23 ~~a Board-prescribed notice to the assessee to notify the assessee that the escape assessment was~~
 24 ~~enrolled.³¹⁸ This notice is described below.~~

25 **NOTICE OF ENROLLMENT OF ESCAPE ASSESSMENT**

26 Unless a county has adopted a resolution pursuant to the provisions of section 1605(a) and (c),
 27 (explained below, at the end of this section), Section 534(b) requires that after an escape
 28 assessment is enrolled, the assessor must notify the taxpayer personally or by United State mail
 29 of the enrollment of the escape assessment. The assessment is not considered effective for any
 30 purpose, including its review, equalization or adjustment by the board of supervisors until the
 31 assessee has been notified of the enrollment of the escape assessment.³¹⁹ ~~a Board approved~~
 32 notice to the assessee serving notice that the escape assessment was enrolled.

³¹⁷ ~~Section 531.8.~~

³¹⁸ See section 534(b)-(d), Rule 305.3(d), and the section titled *Notice for Filing an Application* in Chapter 8 for more information.

³¹⁹ Section 534(b).

1 Section 534(d) provides that the notice given by the assessor be on a form approved by the
 2 Board. If a county has not adopted the provisions of section 1605(c), section 534 requires that a
 3 The Board has developed the form, *Notice of Enrollment of Escape Assessment*, for assessors to
 4 mail to assessee ~~must be mailed~~ at the time of enrollment of escape assessments. Pursuant to
 5 section 534(c), ~~the~~ notice must include the following information:

- 6 • The date of mailing
- 7 • Information regarding the assessee's right to an informal review, and the right to appeal
 8 the assessment
- 9 • The assessment appeal filing period—specified as within 60 days of the date of mailing
 10 printed on the notice or the postmark date, whichever is later

11 There are no constraints on the time between the mailing of the *Notice of Proposed Escape*
 12 *Assessment* and the subsequent *Notice of Enrollment of Escape Assessment* or tax bill. If,
 13 however, the *Notice of Proposed Escape Assessment* is mailed within 90 days of the expiration
 14 of the period provided by statute for making the escape assessment, then that period is
 15 automatically extended 90 days.³²⁰ Subsequent mailings of the *Notice of Proposed Escape*
 16 *Assessment* for the same assessment year do not establish any further extension.

17 The *Notice of Enrollment of Escape Assessment* need not be sent in Los Angeles County and any
 18 county that has adopted a resolution as described in section 1605(a) and (c) allowing a taxpayer
 19 to file an assessment appeal based upon receipt of the tax bill. In such counties, the tax bill is the
 20 proper notice, provided that specific appeal information is included in the tax bill.³²¹

21 **ROLL CORRECTIONS**

22 Errors and omissions not involving the assessor's exercise of value judgment and not involving
 23 escape assessments caused by the assessee's failure to report the information required by section
 24 441 must be corrected within four years after making the original assessment.³²² A change to the
 25 original entry on the assessment roll is a *roll correction* when:

- 26 • A clerical error is caused by the assessor or another county official, whether the error
 27 resulted in an increase or a decrease to the original entry on the roll (sections 4831(a);
 28 4832).
- 29 • A clerical error is caused by an assessee, based on a defect of description or other
 30 information discovered upon an audit, and the error resulted in an assessment at a higher
 31 valuation than would have otherwise been entered on the roll (section 4831.5).³²³

³²⁰ Section 532.1(b).

³²¹ See section 534(c)(3).

³²² Section 4831(a)(1)-(2).

³²³ Assessee error that results ~~with~~ in an addition to the roll is an escape assessment, see sections 501 to 534; see also
discussion regarding escape assessments under this chapter.

1 Roll corrections are different from escape assessments in several respects.

- 2 • No penalties are involved with roll corrections.
- 3 • While escape assessments may result from a roll correction, a roll correction cannot be
4 made for escape assessments when caused by the assessee's failure to report the
5 information required under section 441 (section 4831(a)(2)).
- 6 • Roll corrections are limited to clerical errors only, and cannot be made for errors or
7 omissions involving the exercise of value judgment (section 4831(a)(1)) except in limited
8 circumstances per section 4831(b).
- 9 • The roll correction could result in a refund to the assessee, and if based on an assessor
10 error, the assessee is entitled to interest.³²⁴

11 REFUNDS

12 If a roll correction decreases the amount of taxes because of an error by either the assessee or the
13 assessor, a refund of the overpayment of taxes is possible. Refunds of taxes paid are authorized
14 solely under the conditions described in sections 5096 through 5180. While a thorough
15 discussion of these sections (sections 5096 through 5180) is not within the realm of this manual,
16 it is important to note that it is the assessor's duty to deliver the corrected entry to the auditor,
17 who is required by section 4834 to implement correction procedures. The tax collector is
18 required to notify the assessee of the right to file a refund claim.

19 It may be appropriate for taxes to be offset by the auditor and the tax collector pursuant to
20 section 533. ~~In part, the section reads:~~ This section provides that the tax liability for an escape
21 assessment may generally be offset against a tax refund resulting from an audit and that the
22 audited assessee must be notified by the tax collector of any excess and the procedure for
23 claiming a refund of the excess amount.

24 ~~If the assessments are made as a result of an audit which discloses that property~~
25 ~~assessed to the party audited has been incorrectly assessed either for a past tax~~
26 ~~year for which taxes have been paid and a claim for refund is not barred by~~
27 ~~Section 5097 or for any tax year for which the taxes are unpaid, the tax refunds~~
28 ~~resulting from the incorrect assessments shall be an offset against proposed tax~~
29 ~~liabilities, including accumulated penalties and interest, resulting from escaped~~
30 ~~assessments for any tax year covered by the audit.~~

³²⁴ Section 5151(c)(1)(A)-(C).

BASE YEAR VALUE CORRECTIONS

1

2 Although applicable only to real property (including fixtures) valued under ~~an~~ Article XIII A of the

3 California Constitution, it is important to make the distinction between *roll corrections* and *base*

4 *year value corrections*. Roll corrections and base year value corrections are not identical.

5 Section 51.5 provides authority for assessors to make corrections to a base year value whenever

6 it is discovered that a base year value does not reflect applicable constitutional or statutory

7 valuation standards or the base year value was omitted. If an error or omission involves the

8 exercise of the assessor's judgment as to value, the error can be corrected only if it is placed on

9 the current roll or roll being prepared within four years after July 1 of the assessment year for

10 which the base year value was established. Escape assessments, refunds or the cancellations of

11 taxes are authorized where appropriate as the result of a base year value correction.

SUMMARY OF REVENUE AND TAXATION CODE SECTIONS REGARDING ROLL PROCEDURES

12

13

14 The following table represents a summary of the Revenue and Taxation Code sections referenced

15 regarding roll procedures (escape assessments, corrections, refunds, and base year value

16 corrections). This table is supplied as a reference tool only. It does not quote the sections listed,

17 but rather provides a brief synopsis of each section for quick reference to the authoritative law on

18 each subject.

1

TABLE 98A	
REVENUE AND TAXATION CODE SECTIONS APPLICABLE TO ROLL PROCEDURES	
R&T Code Reference	Remarks
Section 463	<i>Penalty for failure to file statement.</i> A penalty, 10 percent of assessed value, is applied when a property statement is not filed in accordance with filing requirements and deadlines as identified in sections 441 and 463, respectively. The penalty may be applied to the regular roll, or applied to additions made to the roll after originally completed and published. It may only be abated by the county board of equalization or assessment appeals board.
Section 502	<i>Concealment, etc., of tangible personal property.</i> A penalty, 25 percent of the additional assessed value as provided in section 504, is applied if the taxpayer or agent willfully conceals information that results with a lower assessed value. The penalty is applied to additions made to the roll after originally completed and published.
Section 503	<i>Fraudulent act, collusion, causing escape of taxable tangible property.</i> A penalty, 75 percent of the additional assessed value, is applied if through a fraudulent act or omission, or fraudulent collusion, the property is underassessed in whole or in part. The penalty is applied to additions made to the roll after originally completed and published.
Section 504	<i>Penalty assessments; amounts.</i> Indicates percentage of penalty added if required per section 502 (25 percent).
Section 506	<i>Tax rate applicable, interest.</i> The tax rate is the rate of the year of escape. Apply interest for the number of months from delinquency date to roll entry date. Interest is applied at the rate of three-fourths of 1 percent per month from the date the taxes would have become delinquent if filed timely.
Section 531	<i>Escaped Property.</i> Property is deemed to have escaped assessment under this section when its owner fails to file a property statement per section 441 resulting in no assessment or an underassessment. No willful or fraudulent act is involved.
Section 531.1	<i>Escaped property, incorrect exemption.</i> If it is discovered that an exemption was incorrectly allowed, an escape assessment shall be made.
Section 531.3	<i>Escaped personal property, failure to report cost accurately.</i> Escape assessment due to inaccurate report of personal property cost when assessor required a cost report.
Section 531.4	<i>Escaped business property, inaccurate statement or report.</i> Escape assessment due to inaccurate business property statement or report.
Section 531.5	<i>Escaped property, business inventory exemption.</i> Escape assessment due to the application of an incorrect business inventory exemption.

TABLE 98A	
REVENUE AND TAXATION CODE SECTIONS APPLICABLE TO ROLL PROCEDURES	
R&T Code Reference	Remarks
Section 531.8	<i>Notice of Proposed Escape Assessment.</i> Requires 10 day notice to taxpayer prior to enrollment of escape assessment.
<u>Section 531.9</u>	<u><i>Escape assessment; low value exemption.</i> Escape assessments up to \$50 in taxes may be exempted by county ordinance.</u>
Section 532	<i>Statute of limitations.</i> Eight year statute of limitations where 25 percent (sections 502 and 504) nondisclosure or fraud penalty applies. Four year statute of limitations where no penalty involved.
Section 532.1	<i>Extension of time for making escape assessment.</i> Extends the time period specified in section 532 for making an escape assessment, correction, or claim for refund. (Extension only applies to corrections and refunds if specifically stated in the written agreement between the taxpayer and assessor.)
Section 533	<p><i>Entry on roll.</i> For assessments made pursuant to article 3 or 4 (commencing with sections 501 and 531 respectively), the entry on the roll is to state: "Escaped assessment for year 19__ pursuant to Sections _____ of the Revenue and Taxation Code."</p> <p>If the <u>an</u> escape assessments are <u>is</u> made as a result of an audit, which discloses that property assessed to the party audited has been incorrectly assessed either for a past tax year for which taxes have been paid and a claim for refund is not barred by section 5097 or for any tax year for which the taxes are unpaid, the tax refunds resulting from the incorrect assessments shall be offset against proposed tax liabilities, including accumulated penalties and interest, resulting from escaped assessments for any tax year covered by the audit.</p>
Section 534	<i>Procedure after assessment.</i> Tax rate to be applied: same rate as used for year of escape. (See also section 506.) Notification to the assessee of an escape assessment <u>must be provided to make escape assessment effective and shall be on a form prescribed</u> approved <u>by the State Board of Equalization Board unless the county has adopted a resolution in accordance with section 1605, allowing the tax bill to serve as notice of the enrollment of the escape assessment.</u>
Section 4831	<i>Incorrect entries; transfers to unsecured roll.</i> Any assessor error. Result of an incorrect entry on the roll or clerical error.
Section 4831.5	<i>Correction of errors caused by the assessee.</i> Correction to the roll when information furnished to the assessor resulted with an overassessment of the property.
Sections 5096-5180	<i>Refunds.</i> Various code sections related to refunds.
Section 51.5	<i>Errors and omissions in determination of base year value.</i> Provides authority to correct base year values.

TABLE 98A	
REVENUE AND TAXATION CODE SECTIONS APPLICABLE TO ROLL PROCEDURES	
R&T Code Reference	Remarks
Sections 830, 862 - 866, 4876 - 4880	<i>Failure to File Statement, Escape Assessments of State-Assessed Property; Errors on the Board Roll.</i> Code sections governing roll changes for state-assessed property.

1

1 **APPENDIX AB: COORDINATION OF LANDLORD AND LEASEHOLD**
 2 **IMPROVEMENT APPRAISALS**

3 **DEVELOP AN INTER-DEPARTMENTAL MEMORANDUM FOR COORDINATION**

4 Transferring information between the real property and business property divisions within an
 5 assessor's office can help to avoid duplicate or escape assessment of landlord and leasehold
 6 improvements – both of which may include structure items and fixtures. One method used to
 7 track and monitor this transfer of information in some assessors' offices is an inter-departmental
 8 memorandum. This memorandum is sent between departments (i.e., between the real property
 9 division and business division) with a copy of the improvement source document (e.g., building
 10 permit, change in ownership statement, etc.). As shown in the table below, the memorandum
 11 includes three copies: one copy kept by the originator to verify completion of the assessment,
 12 one copy for the real property file, and one copy for the business property file.

13 The intent of the memorandum is to provide a complete record of the appraisal, including
 14 classification, valuation, and assessee. It summarizes all appraisal information for the business
 15 file and real property record. The following table illustrates how an inter-departmental
 16 memorandum may be used in practice.

EXAMPLE <u>BA</u>.1 INTER-DEPARTMENTAL MEMORANDUM
<ul style="list-style-type: none"> • The business property division receives a property statement reporting additions on Schedule B. After reviewing the property statement, the auditor-appraiser initiates a memorandum to the real property division addressing these additions. • The originator (auditor-appraiser) keeps the original memorandum (copy #1). Next, the auditor-appraiser attaches copies #2 and #3 to a copy of Schedule B and forwards that information to the real property division. The auditor-appraiser retains the original (copy #1) to track the appraisal of the improvements. • Using the memorandum and its attachments, the real property appraiser determines any applicable value changes. After valuing the property, the real property appraiser places copy #2 in the real property file. • Using the final copy (copy #3), the real property appraiser notifies the business property division of the appraisal, along with any recommendations for the auditor-appraiser.

17

1 **DESCRIPTION OF METHOD**

2 The following steps describe one method of coordinating the appraisal of landlord and leasehold
3 improvements as it is used by some assessors' offices. Under this method, information regarding
4 landlord or leasehold improvements is referred to and from the real property and personal
5 property divisions for evaluation and appropriate action.

6 After proper classification, the real property appraiser values the property reported in Columns 1,
7 3, and 4 (i.e., *Structure Items Only, Land Improvements, Land and Land Development*), while the
8 auditor-appraiser values the property reported in Column 2 (i.e., *Fixtures Only*).³²⁵ This method
9 requires that the business division provides a copy of Schedule B (and the Supplemental
10 Schedule) from the Business Property Statement to the real property appraiser each year, or
11 whenever a change is reported from the prior year's schedule.

12 As discussed above, a memorandum should be attached to this documentation. After a review of
13 the statement and/or inspection of the property, the real property appraiser notifies the auditor-
14 appraiser of the action taken (on copy #3 of the memorandum). In the event that the assessee
15 does not correctly classify the improvements, the real property appraiser's review should include
16 consideration of both non-fixture real property items (Columns 1, 3, and 4) and fixtures (Column
17 2). Based on a building permit received earlier in the year, for instance, the real property
18 appraiser may add value to real property, believing those improvements to be structure items.
19 However, the assessee may report the same improvements on the property statement as fixtures.
20 If the real property appraiser does not receive a copy of Schedule B of this statement, and review
21 the costs as they were reported, a duplicate assessment may occur.

22 This communication process works in both directions. Although the memorandum could
23 originate from either division, it more often it originates from the business division.

24 ***Example***

25 Following is an example of an assessment of leasehold improvements using the suggested
26 procedures outlined above. The example demonstrates only one method to coordinate the
27 assessment of leasehold improvements; it is not the only proper method.

³²⁵ On Schedule B of the Business Property Statement

1

EXAMPLE <u>BA</u>.2	
ASSESSMENT OF LEASEHOLD IMPROVEMENTS	
•	In August 2004 8 , a tenant obtained a building permit valued at \$60,000 to install restaurant improvements in a new strip mall. During September 2004 8 , the real property division received a copy of this building permit. The real property appraiser copied the permit and forwarded it to the business division with an attached memorandum. Since this was done in a timely manner, a copy of the permit was in the business file prior to receipt of the Business Property Statement.
•	In April 2002 9 , the business division received a property statement from the assessee (the tenant) reporting the actual cost of the improvements as \$48,000. The assessee classified and reported all leasehold improvements as fixtures on Schedule B, Column 2. No items were reported in Columns 1, 3, and 4.
•	The property statement included a supplemental schedule that broke down the total cost additions on Schedule B. Following is the list of additions and their cost are shown below:

2

EXAMPLE <u>BA</u>.2 (CONTINUED)	
SUPPLEMENTAL SCHEDULE (SCHEDULE B)	
Description	Cost
Electrical wiring to restaurant equipment	\$ 2,500
Flooring	5,000
Rough plumbing to restaurant equipment	5,000
Walk-in refrigerator	10,000
Store front	2,500
Sign in front of restaurant	500
Interior wall paint	1,000
Light fixtures & ceiling fans	3,500
Stainless steel sink in kitchen	1,000
Booths	10,000
Counters	3,000
Dishwasher	2,500
Hood	1,500
Total	<u>\$ 48,000</u>

3

4 **Step 1: Verification of Costs**

5 Since the amount on the building permit did not match the actual cost reported by the business
6 owner, it was appropriate to verify actual costs. It is important to note when the value indicated
7 on a building permit varies from the total costs reported on a property statement. In general, this
8 variance may occur due to several reasons: (1) the tenant may have overestimated the cost of

1 improvements; (2) the landlord and tenant may have split the cost of the improvements; or (3)
2 the business owner may have underreported the cost of the leasehold improvements.

3 In this case, the auditor-appraiser contacted the business owner prior to sending a copy of the
4 property statement to the real property appraiser. The auditor-appraiser found that the business
5 owner overestimated the cost of improvements when applying for the permit. Thus, the property
6 statement represented actual cost.

7 **Step 2: Transfer of information**

8 The business property division forwarded a memorandum to the real property division with
9 copies of Schedule B and the supplemental schedule. On the memorandum, the auditor-appraiser
10 referenced (1) the September 2004~~8~~ memorandum received from the real property division and
11 (2) the information received from the assessee in step 1. Utilizing all information available aids
12 in the proper classification of improvements.

13 **Step 3: Classification**

14 Depending upon the established policy of the assessor's office, either the auditor-appraiser or real
15 property appraiser may classify the property. For this example, the real property appraiser
16 classified the leasehold improvements. The real property appraiser classified the property as
17 follows:

EXAMPLE BA.3			
CLASSIFICATION BY REAL PROPERTY APPRAISER			
	Cost	Structure	Fixture
Electrical wiring to restaurant equipment	\$ 2,500		\$ 2,500
Flooring	5,000	\$ 5,000	
Rough plumbing to restaurant equipment	5,000		5,000
Walk-in refrigerator - not integral part of building	10,000		10,000
Store front	2,500	2,500	
Sign in front of restaurant	500		500
Interior wall paint	1,000	1,000	
Light fixtures and ceiling fans	3,500	3,500	
Stainless steel sink in kitchen	1,000		1,000
Booths	10,000		10,000
Counters	3,000		3,000
Dishwasher	2,500		2,500
Hood	<u>1,500</u>		<u>1,500</u>
Total	<u>\$ 48,000</u>	<u>\$12,000</u>	<u>\$ 36,000</u>

18

1 **Step 4: Determination of Assessee**

2 In this example, the assessee was determined to be the tenant. As discussed earlier,
3 improvements can be assessed to either the landlord or the tenant, on either the secured or
4 unsecured roll. Commonly, as in this example, they are assessed to the party that paid for the
5 improvements.

6 **Step 5: Valuation**

7 **Valuation of Structure Items**

8 After classification, the real property appraiser determined the value of the structure items listed
9 above. If land improvements, land, and land development were reported (Columns 3 and 4 of
10 Schedule B), the real property appraiser would have valued these improvements as well.

11 **Valuation of Fixtures**

12 After valuing the structure items, the real property appraiser forwarded a copy of Schedule B
13 along with copy #3 of the memorandum – detailing the action taken – to the auditor-appraiser.
14 Using that information, the auditor-appraiser must then value the fixtures. As discussed earlier,
15 fixtures are real property, which they must be valued, at the lesser of: (1) their full cash value or
16 fair market value, or (2) their factored base year value. The auditor-appraiser valued and enrolled
17 the fixtures as shown below:

EXAMPLE BA.4					
VALUATION OF FIXTURES					
	Cost	Index Factor	Percent Good Factor ³²⁶	Fair Market Value	Indexed Value (2% Inflation)
Total 2004 8 Cost of Fixtures	\$ 36,000	100	.93 .94	\$ 33,480 <u>\$33,840</u>	<u>\$ 36,720</u>
Enrolled Value				<u>\$ 33,480</u> <u>\$33,840</u>	

18

19 **Step 6: Enrollment of Value**

20 In general, the assessed value can be enrolled to either the secured or unsecured roll account
21 depending on how the assessor's office enrolls leasehold improvements (i.e., on the secured roll
22 to the land and building owner or on the unsecured roll to the tenant who paid for
23 improvements). As discussed in sStep 4, the tenant was determined to be the assessee, both

³²⁶ The appraiser in this example has determined an average 12-year service life for these types of fixtures, using the 2009 update of AH 581.

1 values (structure value and fixture value) were enrolled on an unsecured account with the
2 business personal property. Since the value of fixtures is used in ~~the~~ for the purposes of
3 determining those taxpayers with the largest assessments for determination of a mandatory audit
4 purposes under section 469, separation of the structure and fixture values on the unsecured
5 account is necessary.

6 ***Step 7: Clearly Identify the Leasehold Improvements on the Appraisal Records***

7 In ~~the~~ final step, the appraisers must documents the assessment in the on appraisal records.
8 Notes regarding the leasehold improvements in both the real property appraisal records and in
9 the business property files will assist in verification of the assessment(s) and can help to avoid
10 double efforts in future assessment years. These notes summarize the information relied upon
11 during the appraisal and identify the actions taken. The memo(s) and attached copies of source
12 documents are kept in the appraisal records as support.

APPENDIX BG: SAMPLING

GENERAL

When an assessor, assessee, or third party chooses to use some type of sampling methodology to develop their own factors for determining percent good or depreciation, it is important to be familiar with some of the basic concepts of statistical sampling in order to properly analyze the results. *Sampling* is a statistical method ~~which~~ that enables one to make observations regarding an entire group of items (population) based on a study of a smaller sub-set (sample) of this group. It is a powerful tool in studying large populations. The advantage of a statistical sample is that sound inferences can be drawn regarding a population at only a fraction of the cost of investigating each item in the population. In some cases, a thorough investigation of a sample can actually produce more reliable results than a cursory enumeration of the entire population.

In the valuation of a group of items for assessment purposes, for example, sampling may be applied to:

- Derive valuation schedules by analyzing market values
- Derive replacement cost new (RCN) factors and indexes
- Derive physical deterioration, and functional and economic obsolescence indexes
- Estimate economic lifetime and survival characteristics of a population of assets
- Calculate appropriate trade level adjustments

Sampling design, potential pitfalls, and the reasonable expectations as to the confidence associated with various samples will vary greatly depending upon the population being sampled. Therefore, few rigid rules apply in all situations. Independent professional judgment is necessary in selecting testing techniques and/or selecting or developing a sampling plan. However, certain principles are encountered and/or applied in nearly all sampling situations. For example, in every case, the sample result must be objective and defensible. The following discussion is an introductory summary of some of the more important aspects that should be considered in designing and conducting a sample. For a more thorough understanding of the subject, it is advisable to consult a textbook on sampling and/or statistics, some of which are referenced at the conclusion of this text.

REPRESENTATIVENESS

Accepted sampling theory requires that a sample be drawn randomly from a population ~~in order to make sure statistical inferences regarding that population~~. In statistics, a *population* is a set of all objects or units to be measured or studied. A *sample* is a subset of a given population. A *random sample* is a sample selected in such a manner that every unit of the population has an equal chance of being included in the sample.

1 Ideally, the population that is sampled should coincide with the entire population under study.
 2 Sometimes, usually for practicality or convenience, they will not coincide. If so, any statistical
 3 inferences drawn from the sample apply to the sampled population only. The extent to which
 4 those inferences can be applied to a target population which is different from the sampled
 5 population will be a question of judgment.

6 In many cases it is not possible, or practical, to draw a random sample; the sample drawn will be
 7 non-random or "biased."³²⁷ Deviating from the theoretical approach is not necessarily wrong, nor
 8 does it necessarily invalidate conclusions regarding a target population drawn from a sample,
 9 providing that if potential bias is identified, it is not large and/or there are no practical
 10 alternatives available. However, if bias does exist great care needs to be taken to avoid reaching
 11 invalid conclusions.

12 For example, the set of assets for which sales transactions have occurred is not at all a random
 13 selection, as it excludes items that no buyer would want (zero or even negative value) and also
 14 items an owner would be unlikely to sell. Such a "sample" might be representative of the
 15 inventory of certain used equipment dealers, but not representative of the totality of assets held
 16 by an industrial firm.

17 **SAMPLE SIZE**

18 The sample size needed to obtain a certain degree of confidence in the results is largely
 19 independent of the size of the population. Sample sizes must be large enough to provide
 20 meaningful results, but not so large to create wasteful effort. Needed sample sizes will vary
 21 greatly, depending upon the nature of the population being sampled. As the size of the
 22 population increases, the needed sample size expressed as a percentage of the population
 23 decreases. A sample consisting of far less than \pm one percent of the population is often
 24 appropriate for large populations

25 The most important factor in determining the appropriate sample size is the variability (or
 26 variance) within the population of the characteristic being sampled. The larger the variability, the
 27 larger the sample size needed. For example, a particular sample size could be satisfactory for the
 28 study of one population, but be quite inadequate for the study of a second population with a
 29 substantially larger variance than the first.

30 One aspect of applying sampling to the field of valuation that will tend to increase needed
 31 sample size is that many populations are effectively comprised of subpopulations, each of which
 32 requiring a separate finding. For example, in conducting a sample to establish a table of
 33 valuation factors to apply to a particular type of equipment, a sample size of n might be sufficient
 34 to estimate the average value of all such equipment as a percent of its original cost. However, the
 35 resultant value estimate would have no usefulness since (1) it would be an average across all
 36 years of acquisition and (2) factors are needed for each year of acquisition. Establishing a

³²⁷ Inferences may be drawn from a biased sample, but it must be remembered that the conclusions will be based on the assumption of a random sample model and will not reflect the influence of the bias.

1 reliable table would require for each year a sample size large enough to allow one to draw
 2 meaningful conclusions regarding that year. The variance of each of the subpopulations of
 3 individual years would not be as large as the variance of the population of all years considered
 4 together. Therefore, the needed sample size for each of the individual years would be something
 5 less than n . However, the total needed sample size for all of the years would probably be much
 6 larger than the n that would be sufficient to estimate the population when considered as a whole.

7 Due to large variances within some subpopulations subject to sampling and the scarcity of
 8 sample item observations, results that are not completely consistent among subpopulations may
 9 occur. Raw data indicating 60% depreciation after 3 years, 40% after 4 years, and 50% after 5
 10 years, for example, would not be reasonable. A 60% - 59% - 49% pattern, although not as
 11 inconsistent, would not be acceptable either. When such inconsistencies occur, there will be a
 12 need to fit a nonlinear curve to the findings for the subpopulations by selecting the appropriate
 13 standard curve or set of curves or by constructing a best-fitting curve.

14 If the general form of the curve is known, or can be assumed, in advance, it may be reasonable to
 15 establish a table of factors by fitting a curve to a sample of individual data points rather than
 16 formally dividing the population into subpopulations. However, in order for the curve to yield
 17 reliable estimates for each year, the sample would need to contain a sufficient number of items
 18 for each year. The effect could be close to the same as dividing the population into
 19 subpopulations to begin with, although some reduction in sample size will result from being able
 20 to utilize the relationships among years as an indicator for any given year.

21 **STRATIFICATION**

22 Stratification is the segregation of a population into smaller homogeneous groups, with the
 23 expressed purpose of improving sample efficiency and/or sample reliability. For populations
 24 with a large variance among their elements, sampling efficiency and reliability may be increased
 25 by dividing the population into strata, sampling the strata separately, projecting the sample of
 26 each stratum to estimate the entire stratum, and combining the projections of the strata based on
 27 the weight each stratum contributes toward the total population. This process can often be
 28 effective by ensuring that infrequently occurring items are represented in the sample in the same
 29 proportion as in the population.

30 It should be noted that although separating a population into subpopulations (discussed under
 31 Sample Size) and dividing it into strata appear to be similar, the two actions are quite different
 32 and are done for different reasons. Subpopulations are formed when a separate estimate is
 33 needed for each of the subpopulations. Taking this action increases the total number of sample
 34 items compared to what would be required if a single estimate for the population as a whole were
 35 needed. Stratification is used in order to increase the efficiency and reliability of a sample that is
 36 being used to make a single estimate for the overall population. ~~It tends to reduce the standard
 37 error of the sample in contrast to the resultant errors that would occur with stratification.~~
 38 Stratification also allows one to make an estimate for the population, using a smaller sample than
 39 would be required without stratification, but still achieves the same degree of confidence.

1 MEASUREMENT

2 A random sample of adequate size with improperly measured observations would be of no more
3 validity than a biased sample of inadequate size. It is quite possible that the observable value for
4 the items in a sample will not be the value that is the true focus of the study. The true focus of
5 many studies will be the market value of a certain type of equipment. The observable value may
6 need to be adjusted for factors such as trade level or quantity discounts to estimate this market
7 value. Although adjustments may be appropriate in some circumstances, care needs to be taken
8 in making any such adjustments. For example, if retirements are not promptly reflected on an
9 assessee's books, then those records may be a poor reflection of economic life. However,
10 attempting to adjust those records for non-recorded retirements could reduce the study to a level
11 little better than guesswork. Similarly, when studying the retirement pattern of equipment that is
12 of a type so new that the length of time period studied is less than the total useful life of the
13 equipment, substituting someone's opinion as to when a piece of equipment will be retired would
14 be of questionable validity.

15 OUTLIERS

16 One of the most difficult areas of judgment in the practical application of statistics is the
17 handling of outliers. *Outliers* are sample items with extreme values that do not appear to be
18 representative of the population from which they were drawn (or at least not in the same
19 proportion as indicated by the sampling frequency). Various guidelines for the identification of
20 outliers can be found in statistical texts. Sometimes those guidelines are expressed in terms of
21 statistical parameters (e.g. more than three standard deviations from the sample mean). These
22 guidelines give the appearance of providing a precise means of identifying outliers; however, this
23 is somewhat illusory. Identifying outliers is always a question of judgment. Rejecting a sample
24 item as an outlier means that the sample that will be projected is not random. A truly
25 unrepresentative item that seriously distorts the projection of the sample needs to be rejected, but
26 the number of such occurrences should be very small. If more than just a few observations have
27 to pass the test of being representative in the eyes of the party conducting the sampling, the entire
28 sampling process is reduced to a question of judgment.

29 VALIDITY OF RESULTS

30 Whether the sampling is performed by an assessor, an assessee, or another party, it is important
31 that all the involved parties have confidence in the results. To this end it is desirable that there be
32 a discussion among the parties before the sampling is started. Methodology should be discussed
33 and, to the extent possible, agreed upon. A clear audit trail must be maintained in order that all
34 parties can be satisfied that the sample was selected and projected properly.

35 The party conducting the sampling study should be prepared to make a confidence statement,
36 which consists of both a *confidence level* and a *confidence interval*. The interval estimate of a
37 parameter is called a *confidence interval*, and the lower and upper values of the interval are the
38 *confidence limits*. The *confidence level* indicates the probability that the interval will contain the

1 true value of the parameter. (If the sample is not random, these will not be true confidence
2 intervals. However, they will serve to indicate the relative variability within the sample.)

3 Because of large differences among populations it is difficult to recommend a particular degree
4 of confidence that must be reached in order for the results to be considered meaningful. A
5 finding that a class of property had depreciated by 50% after five years with an 80% confidence
6 level and an interval bounded by 0% and 100% would have little meaning. On the other hand, a
7 confidence interval bounded by 49.5% and 50.5% would be of almost remarkable precision.
8 Actual results will tend to fall between these two extremes.

9 The confidence interval is a measure of the variability of the units included in the sample. In and
10 of itself, it is not a measure of whether a sample is acceptable or unacceptable. However, the
11 smaller the interval the more reliable the results of the sample will be. When a large interval is
12 disclosed the assessor, assessee, and/or a third party must make a decision regarding the
13 acceptability of the sample based upon the best information available. Some of the options to be
14 considered in making this decision include:

- 15 • Accept the sample
- 16 • Increase the sample size
- 17 • Stratification
- 18 • Do not accept the sample

19 SUMMARY

20 This appendix is provided to afford the reader with a basic understanding of sampling and its
21 possible application in the context of property tax. For further information on sampling theory
22 and application, it is recommended that an interested reader consult a textbook on statistics. The
23 following are among the books offering further information and additional examples:

24 Cochran, William G., *Sampling Techniques, 3rd Edition*, John Wiley & Sons, 1977.

25 Freund, Rudolf J. and Wilson, William J., *Statistical Methods Revised Edition*, Academic
26 Press, 1997.

27 Arkin, Herbert, *Handbook of Sampling for Auditing and Accounting 2nd Edition*,
28 McGraw-Hill Book Company, 1974.

29 Arens, Alvin A. and Loebbecke, James K., *Applications of Statistical Sampling to*
30 *Auditing* Prentice-Hall, Englewood Cliffs, New Jersey, 1981.

1 Neter, John and Loebbecke, James K., *Behavior of Major Statistical Estimators in*
2 *Sampling Accounting Populations: An Empirical Study*, American Institute of Certified
3 Public Accountants, New York, New York, 1975.

4 Also recommended, as an example, is the *Sales and Use Tax Audit Manual*, California State
5 Board of Equalization, Department of Business Taxes, Chapter 13: *Statistical Sampling*.

6

1 ***APPENDIX C H: APPLICATION OF THE MARKET METHOD***

2
3 As stated in Chapter 4, the market method is any method of calculating value factors (and/or
4 developing depreciation tables) which relies on market data, with adjustments made for relevant
5 property characteristics incorporated in the data.³²⁸ Using a variation of this methodology, an
6 appraiser may gather market data for identical or similar property to compare the price of a used
7 asset to the original price new of that same asset. Market data (i.e., prices new and/or used) may
8 come from actual invoices, other reliable records of sales of used equipment, or reliable price
9 guides (blue books, etc.) in some cases, with adjustments as appropriate. The price used and
10 original price new of the asset is used by the appraiser to estimate the value factor (used price /
11 new price = value factor)³²⁹ at the age it was at the time of sale. The estimates are reduced to a
12 table of value factors (similar to a depreciation table and/or the percent good tables published by
13 the Board) and arrayed on a scattergram. A best-fit curve, passing through the entire mass of
14 points, estimates average value factors at each age and the average decline in value per year. (It
15 is usually, but not always, set to 100% at age 0 in order to correspond with the assumption that a
16 new asset is purchased at its market value when new.)

17 This appendix does not include all the possible opportunities and problems involved in
18 developing valuation factors by any methodology. Thus, the examples provided should not be
19 deemed the only proper models. The models do not represent methods that are appropriate, and
20 necessarily complete for all circumstances. A large group of representative assets or an explicit
21 random sample of assets can be used to develop the depreciation factors. Sound judgment and
22 accepted statistical methods should be used in developing and applying the methodology in each
23 individual situation where a market method is considered appropriate.

24 The following list is provided to illustrate the basic methodology.

- 25 • Obtain the sales prices of used assets that are similar to the assets to be valued (for
26 example, assets of the same type, age and price range), on or close to the lien date.
- 27 • Obtain the average selling prices new for the same asset during each previous year (or
28 quarter, if available).
- 29 • Adjust selling prices new and/or used as required to account for such factors as features,
30 upgrades, trade level, volume discounts etc.
- 31 • Calculate the percent good of this used asset as a fraction of its price new for each of the
32 ages represented.

³²⁸ Sampling should be used when gathering market data, see Appendix C G on sampling.

³²⁹ Using the market method, a combined factor may be estimated similar to the result of multiplying the index factor and the percent good factor used from AH 581 tables discussed in ~~this~~ chapter 4.

- 1 • Perform these same steps for as many assets as possible to obtain a database of prices of
 2 used versus new assets.
- 3 • Reduce the data to a single schedule of value factors that relate age to value as a percent
 4 of price new.

5 DEVELOPING COMBINED FACTORS

6 A *combined factor*, as used in this text, is (1) the product of multiplying the replacement cost
 7 index factor and the percent good factor, or (2) can be derived directly, without computing the
 8 replacement cost index and the percent good factors individually, using a market method. When
 9 such factors are derived directly, one arithmetic step is saved. A combined factor is a product of
 10 the replacement index factor and percent good factor. Examples of methods to compute
 11 combined factors directly from a market method are included below. These methods create
 12 several data points for each asset in the sample or group of assets to be studied. All data points
 13 combined for all assets should then be reduced to a single schedule.

14 METHOD 1: COMPUTE CHANGES BETWEEN CURRENT LIEN DATE AND PREVIOUS 15 YEARS

16 The methodology illustrated in the example below is the most theoretically accurate method for
 17 developing combined factors; it is the method used to develop percent good factors for real
 18 property. It requires annual updating to be useful and reliable.

19 Example

20 A rapidly depreciating item of equipment was selling used on January 1, ~~1998~~ 2009 for \$1,000.
 21 The average selling prices new of comparable equipment were as follows in previous years, and
 22 the resulting factors deriving from this data are shown:

YEAR	SELLING PRICE NEW	FACTOR (%)	
1998 <u>2009</u>		100	(1000/1000)
1997 <u>2008</u>	\$1,200	83	(1000/1200)
1996 <u>2007</u>	\$1,500	67	(1000/1500)
1995 <u>2006</u>	\$1,900	53	(1000/1900)
1994 <u>2005</u>	\$2,300	43	(1000/2300)
1993 <u>2004</u>	\$3,000	33	(1000/3000)

23

24 Note that for this item, selling prices new declined over time as technological improvements
 25 occurred.

1 **METHOD 2: COMPUTE HISTORICAL CHANGES IN PRICE**

2 Factors derived using the methodology illustrated in the example below are easily verifiable
3 when prices can be determined at specific points in time and data are available. Care must taken
4 when applying factors derived using this method in subsequent years. These markets are not
5 static. Several problems that may occur when this method is used include the following:

- 6 1. When value is measured over a long period, the earliest data points are several years old and
7 possibly inaccurate.
- 8 2. It may be difficult to locate data for one-year-old equipment.
- 9 3. If the equipment is of the type that is subject to rapid technological changes, it is difficult to
10 find old equipment that is functionally identical to new equipment.

11 **Example**

12 An item is selling new for \$1,000 on January 1, 1993~~2009~~. Following are selling prices of
13 comparable used equipment on the same date in subsequent years, and the resulting factors
14 derived from this data:

DATE	AGE (in years)	SELLING PRICE USED	FACTOR (%)	
01/01/93 09	0	\$1000 (new)	100	(1000/1000)
01/01/94 08	1	\$900	90	(900/1000)
01/01/95 07	2	\$790	79	(790/1000)
01/01/96 06	3	\$720	72	(720/1000)
01/01/97 05	4	\$670	67	(670/1000)
01/01/98 04	5	\$580	58	(580/1000)

15

16

SUMMARY

17 The foregoing discussion does not include all the possible opportunities and problems involved
18 in developing valuation tables for machinery and equipment for use in the cost approach to
19 value. This appendix is meant only to give a basic background on different methods that may be
20 used to develop cost approach tables using current market data.

APPENDIX D I: LIFING STUDIES

1
2 As discussed generally in Chapter 4 and more specifically in Assessors' Handbook Section 582
3 (AH 582), *Explanation of the Derivation of Percent Good Factors*, an average service life
4 estimate is necessary in order to effectively utilize equipment index and percent good tables.
5 Mortality studies are statistical studies, typically based upon a sample of a population, which
6 estimate a percentage of items that live at any given age and their life expectancy at any given
7 age. A mortality study identifies a group of items, records the life term of each term in the group,
8 and averages the life term or probable life expectancy of the items when new, by summing the
9 life terms of all items in the group and dividing that number by the total number in the group.
10 The probable total life expectancy of survivors of the group is similarly calculated by summing
11 their total life expectancies and dividing that number by the number of survivors at that age. The
12 result is a "forecast" of the total life expectancy as time passes.

13 Mortality studies may come in many forms. Actuarial tables compiled by insurance companies to
14 predict the life expectancy of humans at all ages are probably the most common. Similar studies
15 of personal property and various types of equipment are often referred to as *lifing studies*.

16 The Iowa State University, Department of Engineering mortality (or lifing) studies, published in
17 the form of a series of graphs and tables for various types of industrial machinery and equipment
18 are useful for assessment purposes.³³⁰ However, other studies and/or methods of conducting
19 lifing studies may also be appropriate for assessment purposes, provided that they are timely,
20 properly designed, appropriately conducted, and carefully evaluated. In such circumstances these
21 studies may, in some cases, provide extremely accurate results.

22 The following is a general discussion of lifing study methodology. Although not intended to be
23 directly applicable to any one fact situation, this information may be helpful in evaluating lifing
24 studies submitted by assesses in various circumstances. In contrast to the Iowa State University
25 study discussed in AH 582, the methodology explained here is modeled after a brief treatise set
26 forth in *Engineering Valuation and Depreciation*.³³¹ In practice, those designing and conducting
27 a lifing study using the concepts of this methodology may employ numerous variations of it,
28 either expanding upon it, or interposing other methods deemed more appropriate for the
29 particular property involved.

³³⁰ A brief discussion of the Iowa State University study is included in AH 582.

³³¹ Marston, Winfrey, and Hemstead, McGraw-Hill, *Engineering Valuation and Depreciation* (1953), p 154-155.

DATA SOURCES

1
2 Every lifing study reflects the particular data sources inputted. Generally, the most reliable
3 sources of data for a lifing study are the retirement records of assesseees, related to the specific
4 category of property subject to study. Generally, recorded retirements contain data that are more
5 complete and verifiable than other data sources. Accordingly, this type of data source should be
6 given greater weight in the study than a less reliable source, such as, unrecorded retirements. For
7 example, if one business owner seldom conducts physical inventories and/or has significant
8 unrecorded retirements, those data should be given little weight, except as in indication of an
9 upper bound of lifetime, since it is incomplete and unverified.

10 When verifying the accuracy of retirement records or determining the existence of unrecorded
11 retirements, it may be necessary to conduct a complete inventory or review of all records related
12 to the property. Relevant data to be reviewed and evaluated consists of the following information
13 for each asset in the group studied:

- 14 • Original in-service date
- 15 • Original acquisition date
- 16 • Date of retirement, if any
- 17 • Proceeds at retirement, if any (if significant proceeds were realized at retirement, the
18 appraiser should verify that a true retirement occurred).

19 While information obtained from Business Property Statements should be considered, it may be
20 incomplete from the standpoint of the statistical data required here and may not always be
21 reliable for use in a lifing study. Furthermore, acquisitions and retirements of the property are not
22 the only events that affect the reported totals on these statements. All of the following may
23 impact totals for a given category:

- 24 • Transfers in
- 25 • Transfers out
- 26 • Lease buy-outs
- 27 • Purchases of used equipment
- 28 • Reclassifications of assets
- 29 • Consolidations
- 30 • Differences in recording information
- 31 • Conversions of information systems

32 Only studies based on reliable and complete records specific to individual assets can give reliable
33 estimates of lifetime. Therefore, a review of the records specific to each asset is appropriate and
34 generally necessary when such a specific study is conducted.

GENERAL STEPS

Lifing studies consist of three general steps:

- Calculating the survivor curve of known assets
- Matching the survivor curve to known standard curves (by average lifetime and shape of curve)
- Applying the parameters of the matching curve to determine probable remaining economic lifetime at each age.

CALCULATING THE SURVIVOR CURVE

As discussed in AH 582, a "survivor curve" expresses the percentage or number of survivors of an original group of items for each year of existence in the group. From the mathematician's viewpoint, "Survivor curves and their derived curves expressing the service age in percent of average life are useful in classifying curves by their shapes, in using standard or type curves for extending and smoothing original data curves, and in predicting the probable service life of a particular unit by use of group experience."³³² The objective of this methodology is to find the curve and its parameters most accurately representing the actual observed survivor curve relative to the specific property studied.

To calculate the survivor curve, the analyst/appraiser conducting the study first computes the total dollar amount of the original cost of assets and the surviving costs after retirements for each year assets were put into service.³³³ The costs are entered on a spreadsheet with the latest year to the left (see Exhibit 1).

In the second step, the analyst calculates the total dollar amount of ~~dollars~~ the original cost for the surviving assets and the total dollar amount of ~~dollars~~ the original cost for the assets actually exposed to retirement for each year (see Exhibit 2). The percentage of assets surviving for each year is the ratio of surviving costs to exposed costs. The exposed cost at each age is the total amount of assets for which the survivors are known. The surviving costs at each age are the total amount of assets for which the exposed costs are known after retirements for that year. (This calculation combines the totals for all in-service years.)

The plotted points on the survivor curve are determined by multiplying the value for each preceding point on the curve by the percentage surviving for the succeeding year (see Exhibit 3). The computer curve is usually not complete and is called a "stub survivor curve."

³³² Marston, Winfrey, and Hempstead, McGraw Hill, *Engineering Valuation and Depreciation*, 1953, *supra* at page 149.

³³³ Item counts may be used in lieu of dollar costs in calculating a survivor curve in certain situations, consistent with *Engineering Valuation and Depreciation*, Marston, Winfrey, Hempstead, Ninth *supra*, (9th printing, 1982), at page-154. For example, when similar objects with similar costs are studied use of item counts may provide accurate results.

1 **MATCHING TO KNOWN PATTERNS OF SURVIVAL**

2 There are several well-known families of "standard curves" that are useful for life study
 3 analysis. As discussed above, the Iowa State University Engineering Department developed a
 4 series of 18 standard curves with a variety of different characteristics in conducting economic
 5 studies of utility properties. Most survivor curves fit one of the Iowa curves, and life studies
 6 traditionally attempt to match the calculated survivor curve to one of the set of the standard Iowa
 7 curves.³³⁴

8 By matching the known portion of a standard statistical curve with the survival characteristics of
 9 a certain group of assets, the analyst can estimate the remaining economic lifetime at any given
 10 age. This is because the standard curves are well understood and tabulated. This third step of the
 11 appraiser's study rests on the assumption that if survival characteristics of a group of assets
 12 match some standard curve for certain ages, then those characteristics will match the standard
 13 curve for the rest of the ages in question.

14 **APPLYING THE PARAMETERS OF THE MATCHING CURVE**

15 Whatever family of curves is utilized, the final step in the analysis is to find the curve and
 16 parameters that best fit the actual real observed survivor curve. Two methods may be utilized.
 17 The traditional method is known as the "least squares fit method." In this method, various curves
 18 and combinations of parameters are tried and tested, and for each combination, the sum of the
 19 squares of the differences between the known data and the theoretical curve is calculated. The
 20 combination "curve and parameter set," which produces the lowest sum of squared differences, is
 21 said to be the "best fit", i.e., the most reliable complement (see Exhibits 4 and 5). The examples
 22 used for Exhibits 4 and 5 compares two Iowa curves (L-0 and S-0, respectively) to the calculated
 23 survival data, for different lifetimes. In practice, the remaining curves should also be examined
 24 for goodness of best fit, and all curves should be tested to find the best fitting curves for each.

25 Another method for finding the curve and parameters that best fit the actual real observed
 26 survivor curve is the "maximum likelihood estimation." In this method, the arithmetic
 27 differences are not squared and summed, but the ratios of the real data and the fitted curve data
 28 (i.e., the "likelihoods") are squared and multiplied together. The combination curve and
 29 parameter set that produces the maximum combined "likelihood" is the best fit. Although the
 30 "least squares fitting method" is more easily understood, the "maximum likelihood estimation
 31 method" is more reliable.

³³⁴ In cases where two or more Iowa curves provide almost equally good matches to observed data, the appraiser/analyst should use great care to assure a reasonable result, as use of different curves can give widely different valuation results.

1 Once the best-fitting standard, matching survivor curve is identified, its characteristics can easily
2 be determined and employed in the methodology for finding the percent good for the particular
3 type of property under study. Therefore, the analyst's subsequent steps should follow the
4 methods discussed in AH 582, ~~*Explanation of the Derivation of Equipment Percent Good*~~
5 ~~*Factors.*~~

1

EXHIBIT 1

2

COMPANY NAME
TOTAL PRODUCTION EQUIPMENT

ACQ YEAR	<u>REPORTING YEAR</u>											
	1997	1996	1995	1994	1993	1992	1991	1990	1989	1988	1987	
1997	98,964,070											
1996	153,448,288	169,990,761										
1995	182,580,048	208,876,140	231,759,101									
1994	96,031,282	110,243,378	118,136,366	132,197,405								
1993	57,805,330	69,696,484	87,949,290	91,810,652	104,702,302							
1992	56,079,852	70,599,183	82,243,750	85,447,803	92,756,127	95,649,687						
1991	51,106,528	63,819,036	69,034,721	78,924,765	83,566,290	84,899,167	87,264,411					
1990	37,973,937	44,224,012	47,105,779	50,586,786	58,450,217	61,020,961	64,714,926	83,918,314				
1989	23,499,363	29,803,541	31,294,917	41,324,487	48,782,829	49,794,962	50,468,073	56,681,656	60,314,739			
1988	8,462,511	9,211,305	10,302,978	11,942,492	12,119,445	16,957,580	17,829,925	21,614,975	27,712,608	29,596,847		
1987	4,399,738	5,968,139	9,788,393	10,127,846	11,486,846	13,435,764	13,980,642	16,797,158	18,445,041	20,382,424	20,552,152	
TOTALS	770,350,947	782,431,979	687,615,295	502,362,236	411,864,056	321,758,121	234,257,977	179,012,103	106,472,388	49,979,271	20,552,152	

1
2
3

EXHIBIT 2

COMPANY NAME
TOTAL PRODUCTION EQUIPMENT

AGE:

<u>ACQ YEAR</u>												
1997	98,964,070											
1996	169,990,761	153,448,288										
1995	231,759,101	208,876,140	182,580,048									
1994	132,197,405	118,136,366	110,243,378	96,031,282								
1993	104,702,302	91,810,652	87,949,290	69,696,484	57,805,330							
1992	95,649,687	92,756,127	85,447,803	82,243,750	70,599,183	56,079,852						
1991	87,264,411	84,899,167	83,566,290	78,924,765	69,034,721	63,819,036	51,106,528					
1990	83,918,314	64,714,926	61,020,961	58,450,217	50,586,786	47,105,779	44,224,012	37,973,937				
1989	60,314,739	56,681,656	50,468,073	49,794,962	48,782,829	41,324,487	31,294,917	29,803,541	23,499,363			
1988	29,596,847	27,712,608	21,614,975	17,829,925	16,957,580	12,119,445	11,942,492	10,302,978	9,211,305	8,462,511		
1987	20,552,152	20,382,424	18,445,041	16,797,158	13,980,642	13,435,764	11,486,846	10,127,846	9,788,393	5,968,139	4,399,738	
\$'s Surviving	1,114,909,789	919,418,354	701,335,859	469,768,543	327,747,071	233,884,363	150,054,795	88,208,302	42,499,061	14,430,650	4,399,738	
\$'s Exposed		1,015,945,719	765,970,066	518,755,811	373,737,261	269,941,741	177,804,511	98,948,267	50,234,365	18,999,698	5,968,139	

1
2
3

EXHIBIT 3

COMPANY NAME
PRODUCTION EQUIPMENT

Exposed	Age	Surviving	Year %	Survivor
Costs		Costs	Surviving	Curve
	0	1,114,909,789	100.00%	100.00%
1,015,945,719	1	919,418,354	90.50%	90.50%
765,970,066	2	701,335,859	91.56%	82.86%
518,755,811	3	469,768,543	90.56%	75.04%
373,737,261	4	327,747,071	87.69%	65.80%
269,941,741	5	233,884,363	86.64%	57.01%
177,804,511	6	150,054,795	84.39%	48.12%
98,948,267	7	88,208,302	89.15%	42.89%
50,234,365	8	42,499,061	84.60%	36.29%
18,999,698	9	14,430,650	75.95%	27.56%
5,968,139	10	4,399,738	73.72%	20.32%

EXHIBIT 4								
Company Name								
Data Analysis Percent Surviving								
Curve>			LO	LO	LO	LO	LO	LO
Lifetime								
Year	Test Data	AGE	1	2	3	4	5	6
1997	100.00%	0	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
1996	90.5	1	44.81	74.74	85.17	89.78	92.45	93.98
1995	82.86	2	7.73	44.81	64.8	74.74	80.95	85.17
1994	75.04	3	0.24	21.53	44.81	59.3	68.51	74.74
1993	65.8	4	0	7.73	29.76	44.81	56.3	64.39
1992	57.01	5	0	1.85	15.78	32.05	44.81	54.31
1991	48.12	6	0	0.24	7.73	21.53	34.44	44.81
1990	42.89	7	0	0	3.18	13.46	25.45	36.08
1989	36.29	8	0	0	0.97	7.73	18.01	28.28
1988	27.56	9	0	0	0.24	4.02	12.13	21.53
1987	20.32	10	0	0	0	1.85	7.73	15.89
1986	0	11	0	0	0	0.73	4.02	11.31
1985	0	12	0	0	0	0.24	1.85	7.73
1984	0	13	0	0	0	0.06	0.73	5.07
1983	0	14	0	0	0	0	0.24	3.16
1982	0	15	0	0	0	0	0.06	1.85
1981	0	16	0	0	0	0	0	1.02
Data Fit Sum of Least Squares								
1997	100.00%	0	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
1996	90.5	1	20.87	2.48	0.28	0.01	0.04	0.12
1995	82.86	2	56.44	14.47	3.26	0.66	0.04	0.05
1994	75.04	3	55.95	28.63	9.14	2.48	0.43	0
1993	65.8	4	43.3	33.72	12.99	4.4	0.9	0.02
1992	57.01	5	32.5	30.43	17	6.23	1.49	0.07
1991	48.12	6	23.15	22.92	16.31	7.07	1.87	0.11
1990	42.89	7	18.4	18.4	15.77	8.66	3.04	0.46
1989	36.29	8	13.17	13.17	12.47	8.15	3.34	0.64
1988	27.56	9	7.6	7.6	7.46	5.54	2.38	0.36
1987	20.32	10	4.13	4.13	4.13	3.41	1.58	0.2
1986	0	11	0	0	0	0	0.16	1.28
1985	0	12	0	0	0	0	0.03	0.6
1984	0	13	0	0	0	0	0	0.26
1983	0	14	0	0	0	0	0	0.1
1982	0	15	0	0	0	0	0	0.03
1981	0	16	0	0	0	0	0	0.01
Total			275.51%	175.95%	98.81%	46.61%	15.30%	4.31%
Avg.			16.21%	10.35%	5.81%	2.74%	0.90%	0.25%
Square Root			40.26%	32.17%	24.10%	16.55%	9.49%	5.00%

EXHIBIT 5								
Company Name								
Data Analysis Percent Surviving								
CURVE>		S0	S0	S0	S0	S0	S0	S0
Lifetime								
Year	Test Data	AGE	1	2	3	4	5	6
1997	100.00%	0	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
1996	90.5	1	50	82.54	90.98	94.44	96.18	97.17
1995	82.86	2	0	50	72.51	82.54	87.85	90.98
1994	75.04	3	0	17.45	50	67.1	76.68	82.54
1993	65.8	4	0	0	27.48	50	63.76	72.51
1992	57.01	5	0	0	9.01	32.83	50	61.49
1991	48.12	6	0	0	0	17.45	36.23	50
1990	42.89	7	0	0	0	5.55	23.31	38.43
1989	36.29	8	0	0	0	0	12.14	27.47
1988	27.56	9	0	0	0	0	3.81	17.45
1987	20.32	10	0	0	0	0	0	9.01
1986	0	11	0	0	0	0	0	2.8
1985	0	12	0	0	0	0	0	0
1984	0	13	0	0	0	0	0	0
1983	0	14	0	0	0	0	0	0
1982	0	15	0	0	0	0	0	0
Data Fit Sum of Least Squares								
1997	100.00	0	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
1996	90.5	1	16.4	0.63	0.002	0.15	0.32	0.44
1995	82.86	2	68.66	10.79	1.07	0	0.25	0.66
1994	75.04	3	56.31	33.17	6.27	0.63	0.03	0.56
1993	65.8	4	43.3	43.3	14.68	2.5	0.04	0.45
1992	57.01	5	32.5	32.5	23.04	5.85	0.49	0.2
1991	48.12	6	23.16	23.16	23.16	9.41	1.41	0.03
1990	42.89	7	18.4	18.4	18.4	13.94	3.83	0.2
1989	36.29	8	13.17	13.17	13.17	13.17	5.83	0.78
1988	27.56	9	7.6	7.6	7.6	7.6	5.64	1.02
1987	20.32	10	4.13	4.13	4.13	4.13	4.13	1.28
1986	0	11	0	0	0	0	0	0.08
1985	0	12	0	0	0	0	0	0
1984	0	13	0	0	0	0	0	0
1983	0	14	0	0	0	0	0	0
1982	0	15	0	0	0	0	0	0
Total			283.63%	186.85%	111.52%	57.38%	21.97%	5.70%
Avg.			17.73%	11.68%	6.97%	3.59%	61.37%	0.36%
Square Root			42.10%	34.18%	26.40%	18.95%	11.70%	6.00%

APPENDIX E-J: SUMMARY OF COURT CASES

- 1
- 2
- 3 *Allstate Insurance Co. v. County of Los Angeles* (1984) 161 Cal.App.3d 877, 891-892. The Court
- 4 of Appeal held that "standardized off-the-shelf, general purpose computers and computer
- 5 components, placed in general purpose office buildings, and connected to a power source by
- 6 means of standardized plugs, and to each other by means of standardized cables, are and remain
- 7 personalty regardless of whether or not use of a computer is essential to efficient and competitive
- 8 operation of the business in which they are employed." "The key factors determinative of
- 9 whether a computer system is personalty are that the system can be removed from the realty
- 10 without damage to itself or to the realty and without diminishing the value of the realty, and the
- 11 objective reality is that ownership of the computer is unrelated to ownership of the land or a
- 12 leasehold interest in it."
- 13 *Amdahl v. County of Santa Clara* (2004) 116 Cal.App. 4th 604. Spare computer parts, used for
- 14 replacements parts under extended service contracts and for diagnosis and troubleshooting with
- 15 particular computer equipment, were not eligible for the business inventory exemption because:
- 16 (1) the assessee treated the parts as fixed assets rather than as business inventory, (2) customers
- 17 were not charged for the replacement parts, and (3) the spares parts pool was not reduced when
- 18 Amdahl swapped a good part for a defective one. Such spare parts were not held or intended to
- 19 be held for sale or lease in the ordinary course of business.
- 20 *Beckman Instruments, Inc. v. County of Orange* (1975) 53 Cal.App.3d 767. Interdivisional
- 21 transfers of manufactured goods with an accompanying markup in value, for purposes of
- 22 delivery or to facilitate marketing, result in a trade level increase and corresponding increase in
- 23 value in accord with Property Tax Rule 10.
- 24 *Bell v. Bank of Perris* (1942) 52 Cal.App.2d 66. "The mere fact that pumps annexed to realty
- 25 were removed on one occasion for the purpose of being overhauled and then put back in place
- 26 does not show that their installation was not intended to be permanent. In order to make an
- 27 article a permanent accession to land its annexation need not be perpetual; it is sufficient if the
- 28 article shall appear to be intended to remain where fastened until worn out or until it is
- 29 superseded by another article more suitable for the purpose."
- 30 *Brock & Co. v. Board of Supervisors* (1937) 8 Cal.2d 286. The term "situated" connotes a more
- 31 or less permanent location or situs and the requirement of permanency must attach before
- 32 tangible property which has been removed from the domicile of the owner will attain a situs
- 33 elsewhere. Thus, where personal property was removed from the state shortly prior to the first
- 34 Monday in March (the lien date for the purpose of sale and of reducing the owner's personal
- 35 property tax and returned shortly thereafter, it remained taxable as its permanent situs in the
- 36 Sstate. The Sstate's jurisdiction was not lost by virtue of the temporary excursion out of the
- 37 Sstate.

- 1 *Clunie v. Siebe* (1896) 112 Cal.593. The taxpayer is not required to affix a valuation to any part
2 of his property.
- 3 *Coe v. Errol* (1885) 116 U.S. 517. Delivery of California-grown rice to, and its storage in, the
4 port district's elevators were no part of the process of exportation which begins when the goods
5 cross the water's edge. Delivery to a common carrier and subsequent handling of the rice at the
6 port was not part of the export process. *Coe v. Errol* makes it clear that it is only entry with a
7 common carrier for transportation to the goods' ultimate destination, that will suffice.
- 8 *Crocker National Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881. The
9 California Supreme Court held that bank electronic data processing equipment not physically
10 attached to the building by permanent connections, but merely by standardized "quick
11 disconnect" plugs inserted into the power source, was not a fixture but personalty where: (1)
12 neither the equipment nor the building was designed or modified for each other and factors
13 showing a lack of annexation; and (2) adaptability were not outweighed by other objective
14 manifestations of permanence (i.e., the interrelation between the purpose and structural form of
15 the building and the capacity and physical characteristics of the equipment, and the equipment's
16 weight and size.
- 17 *De Luz Homes Inc. v. County of San Diego* (1955) 45 Cal.2d 546. The absence of an actual
18 market for a particular type of property does not mean that it has no value or that it may escape
19 from the mandate of ~~Constitution~~, article XIII, §1 of the California Constitution, that all property
20 shall be taxed in proportion to its value, but only that the assessor must then use such pertinent
21 factors as replacement costs and analyses for determining valuation. In valuing a leasehold
22 interest in exempt lands and improvements by the capitalization of income method, it is
23 improper; in computing the anticipated net income to be capitalized, to deduct from anticipated
24 gross income the lessee's charges for rent, amortization of his or her investment, or payments of
25 principal and interest on his or her mortgage debt. The proper method of valuing a taxable
26 possessory interest in a housing project at a permanent military installation is to deduct from
27 annual anticipated gross income the operating and maintenance expenses and the amount
28 required by the leased to be deposited ~~to~~ in a replacement reserve, and to capitalize the difference
29 for the remaining years of the lease at a rate ~~which~~ that will allow for risk, interest, and taxes.
- 30 *Dennis v. County of Santa Clara* (1989) 215 Cal.App.3d 1019. Under section 110, an arm's
31 length, open market sale for a price that is not influenced by an exigency of either buyer or seller
32 permits the assessor to presume fair market value from the purchase price, but the presumption
33 may nevertheless be rebutted by evidence that the fair market value of the property is otherwise.
- 34 *Flying Tiger Line Inc. v. County of Los Angeles* (1958) 51 Cal.2d 314. Taxation of aircraft
35 owned by a domiciliary airline and used in the Korean airlift was found to violate the federal
36 constitution since taxable situs was not established. The decision was rendered by the California
37 Supreme Court without a majority opinion.

- 1 *General Dynamics Corp. v. County of Los Angeles* (1958) 51 Cal.2d 59. A possessory interest in
2 government-owned personal property is not a taxable possessory interest in the absence of
3 legislative authority.
- 4 *GeoMetrics v. County of Santa Clara* (1982) 127 Cal.App.3d 940. A county may not impose an
5 unapportioned tax on aircraft located physically in foreign countries and engaged in foreign
6 commerce for all or part of a tax year, as such a tax is barred by the Commerce Clause of the
7 United States Constitution. Taxation of the aircraft according to the number of days the aircraft
8 was located in the county is permissible, however.
- 9 *GTE Sprint Communications Corp. v. Alameda County* (1994) 26 Cal.App.4th 992. Unit taxation
10 of public utilities and railroads is properly characterized as the taxation of property as a going
11 concern, not as the taxation of real property or personal property, or even a combination of both.
12 Under the unit taxation method, the Board considers the earnings of the property as a whole, and
13 does not consider, less still assess, the value of any single real or personal asset.
- 14 *Hahn v. State Bd. Of Equalization* (1999) 73 Cal.App.4th 985. The Board's 1996 amendment to
15 Property Tax Rule 152, which clarified what constitutes a computer's basic operational program,
16 as opposed to other, separate programs, was a legitimate exercise of the Board's rulemaking
17 authority, and was consistent with the Legislature's intent in enacting this section to exempt basic
18 computer programs from taxation.
- 19 *Hughes Aircraft Company v. Orange County* (2002) 96 Cal.App.4th 540. Title of personal
20 property, including manufacturing supplies, expensed equipment and office space partitions,
21 used by Hughes Aircraft Company (Hughes) serving as a defense contractor in the performance
22 of its contract with fixed-price the United States Government (Government) contracts with
23 progress payments, was deemed vested in the Government because the overhead property, in this
24 case, was consumed or used in the performance of the contracts. Thus, the property was not
25 subject to the county's ad valorem property tax.
- 26 *Ice Capades Inc. v. County of Los Angeles* (1976) 56 Cal.App.3d 745. Where the movable
27 property of a domiciliary corporation engaged in interstate commerce has acquired an out of state
28 tax situs, the county of domicile must apportion the tax by excluding such property values that
29 are subject to potential out of state taxation.
- 30 *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434. "If a state tax is applied to an
31 activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate
32 against interstate commerce, and is fairly related to the services provided by the state, no
33 impermissible burden on interstate commerce will be found; however, a more elaborate inquiry
34 is necessary when a state seeks to tax the instrumentalities of foreign rather than interstate,
35 commerce."
- 36 *Kaiser Co. v. Reid* (1947) 30 Cal.2d 610. The lessor's right under a lease to remove shipyard
37 facilities does not fix their status as personalty for tax purposes and preclude the assessor from

1 classifying the property as improvements to realty in accordance with the physical facts of their
2 annexation to the land.

3 Lake Forest Community Association v. County of Orange (1978) 86 Cal.App.3d 394. Under
4 Revenue and Taxation code section 224, personal property owned by a homeowners' association
5 for use by its members, who were homeowners in a planned residential community, used in
6 connection with a common clubhouse, was exempt from taxation as personal effects and
7 household furnishings.

8 *Lyons v. Estes* (1969) 6 Cal.App.3d 979. The county assessor is a tax official of the state within
9 the meaning of section 19286 of this code and may inspect income tax returns to assist him in
10 assessing taxpayer's property.³³⁵

11 *Massachusetts Mutual Life Ins. Co. v. City and County of San Francisco* (1982) 129 Cal.App.3d
12 876. The court held that in light of the purpose and objective of former article XII, § 14-4/5, the
13 "in lieu" tax exemption should not and did not apply to personal property owned by an insurance
14 company but used in an unrelated business.

15 *Mayhew Tech Center Phase II v. County of Sacramento* (1992) 4 Cal.App.4th 497. Land and
16 improvements occupied by the Franchise Tax Board under a lease-purchase agreement were
17 exempt under California Constitution, this Article XIII, section 3, since, despite the lease
18 agreement, the state held the essential indicia of ownership. The financing arrangement closely
19 resembled the financing of a purchase through a loan secured by a deed of trust on the subject
20 property, most of the property rights were vested in the state, and the lease provided for
21 automatic vesting of title in the state at the expiration of the lease if all rental payments were
22 made. The state thus occupied the property as a beneficial owner and would eventually hold all
23 incidents of ownership if it so chose. State property is not to be taxed unless there is express
24 authority for taxation.

25 *Minnesota v. Blasius* (1933) 290 U.S. 1, 10. Under the Commerce Clause of the United States
26 Constitution, "where property which has come to rest within a sState, being held there at the
27 pleasure of the owner, for disposal or use, so that he may dispose of it either within the sState, or
28 for shipment elsewhere, as his interest dictates, is deemed to be part of the general mass of the
29 property within the sState and thus subject to its taxing power."

30 *Mobilease Corp. v. County of Orange* (1974) 42 Cal.App.3d 461. Since 1935, the Legislature has
31 expressly declared that there shall be no local ad valorem taxation on vehicles subject to
32 registration under the Vehicle Code. Section 10758, ~~Revenue and Taxation Code~~, provides in
33 pertinent part, as follows: "The license fee imposed under this part is in lieu of all taxes
34 according to value levied for state or local purposes on vehicles of a type to registration under
35 the Vehicle Code whether or not the vehicles are registered under the Vehicles Code ~~section~~
36 ~~4000..~~" Local taxation of vehicles as personal property under the Revenue and Taxation Code is

³³⁵ Revenue and Taxation code section 19286 was renumbered to 19551.

1 authorized by finding that they are special mobile equipment and, therefore, under Vehicle Code,
2 section 4010, exempt from registration by the DMV. In this case, however, the court held that
3 relocatable office trailers leased to various companies and registered with DMV were not subject
4 to property tax.

5 *Morse Signal Devices v. County of Los Angeles* (1984) 161 Cal.App.3d 570. In determining
6 whether an article is a fixture, there are three tests under Rule 122.5: the manner of its
7 annexation, its adaptability to the use and purpose for which the realty is used, and the intention
8 of the party making the annexation. The manner of annexation and the use to which the realty is
9 put are relevant in determining the crucial element of intention to make the article a permanent
10 part of the realty. Great expense or difficulty in removal is indicative of intended permanence.

11 *Mutual Life Insurance of New York v. City of Los Angeles* (1990) 50 Cal.3d 402. The Court ruled
12 that by virtue of the "in lieu" provision of subdivision (f), section 28, article XIII of the
13 California Constitution, the personal property owned by insurance companies is exempt from
14 property taxation regardless of whether the property is used for insurance related business or not
15 and that the controlling factor in determining whether the exemption applies is ownership of the
16 personal property.

17 *M.P. Moller Inc. v. Wilson* (1936) 8 Cal.2d 31. Whether an article has lost its character as
18 personal property and becomes a fixture is a question of fact and whether the article is or was
19 physically affixed to the building is only one of the criteria in determining whether there was an
20 intention to make it a permanent accession to the real property; and annexation by weight and
21 gravity is not always alone a sufficient indication of an intent to make the article a permanent
22 fixture and part of the realty, but it must appear from the nature of the chattel that if used for the
23 purpose for which it was designed it would naturally and necessarily be annexed to and become a
24 permanent and integral part of some realty, in that it would become essential to the ordinary and
25 convenient use of the property to which it was annexed."

26 *People v. Niles* (1868) 35 Cal. 282. "To authorize the taxing of personal property in any other
27 county than that in which the owner resides, it must appear that such property is kept or
28 maintained in such county, and is not here casually, or in transit, or temporarily, in the ordinary
29 course of business or commerce."*Rinaldi v. Goller* (1957) 48 Cal.2d 276. "A building need not
30 be physically anchored to the land to be considered realty; it may be found to be a fixture though
31 it is secured to the realty by force of gravity alone."

32 *Rosasco v. County of Tuolumne* (1904) 143 Cal. 430. Permanent situs, as distinguished from
33 place of temporary sojourn, is the controlling force in the assessment of property in transit,
34 migrating herds, or rolling stock. When cattle are brought permanently into one county, they are
35 to be assessed there irrespective of the residence of the owner.

36 *San Diego County v. Assessment Appeals Bd. No. 2* (1983) 140 Cal.App.3d 52. Under the trade
37 level theory of assessment, if the owner of property at the consumer level is subject to

1 application of a sales tax element in the valuation of the property, the lessor of the same kind of
2 property at the consumer level is subject to the same sales tax element.

3 *San Diego County v. Lafayette Steel* (1985) 164 Cal.App.3d 690. In determining whether an
4 article is a fixture, there are three tests: the manner of its annexation, its adaptability to the use
5 and purpose for which the realty is used, and the intention of the party making the annexation.
6 The manner of annexation and the use to which the realty is put are relevant in determining the
7 crucial element of intention to make the article a permanent part of the realty. Great expense or
8 difficulty in removal is indicative of intended permanence.

9 *San Diego Trust & Savings Bank v. San Diego County* (1940) 16 Cal.2d 142. Bank vaults and
10 vault doors, including those installed by lessees, have been held to constitute improvements.

11 *San Francisco v. Talbot* (1883) 63 Cal. 485. "Plying" the waters in a particular location implies
12 regularity, and is not the term used to express the character of the irregular and transient
13 visitations of a ship to a port.

14 *Sea-Land Services, Inc. v. County of Alameda* (1974) 12 Cal.3d 772. Cargo containers used
15 exclusively for transportation of cargo for hire in interstate and foreign commerce are subject to
16 an apportioned local tax. The habitual presence of such containers creates a taxable situs, even
17 though the identical containers are not within the county every day and even though none of the
18 containers is continuously within the county. Note: all ocean-going cargo containers of 1,000
19 cubic feet or more are now exempt under section 232. This exemption does not affect the
20 principle of tax situs due to habitual or average presence.

21 *Seatrains Terminals of California, Inc. v. County of Alameda* (1978) 83 Cal.App.3d 69. Exclusive
22 use of two 750 ton cargo cranes, mounted on rails specially installed on the wharf, constitutes a
23 taxable possessory interest. The cranes were properly classified as fixture since they were
24 intended to be a permanent part of the wharf.

25 *Security Pacific National Bank v. Los Angeles County* (1984) 161 Cal.App.3d 877. In
26 determining whether an article is a fixture, there are three tests under Rule 122.5: the manner of
27 its annexation, its adaptability to the use and purpose for which the realty is used, and the
28 intention of the party making the annexation. The manner of annexation and the use to which the
29 realty is put are relevant in determining the crucial element of intention to make the article a
30 permanent part of the realty. Great expense or difficulty in removal is indicative of intended
31 permanence.

32 *Seegmiller v. County of Nevada* (1997) 53 Cal.App.4th 1397. A taxpayer requested the
33 apportionment of the property tax on his machine shop, which he had moved from Truckee
34 (California) to Reno, Nevada, subsequent to July 1st on the new fiscal year. The court held that
35 the situs of this property (movable business personal property) on the lieu date was controlling
36 for the assessment of the entire year. The taxpayer is not entitled to apportionment based on the
37 actual amount of time the property was located in California because the lien date is the method

1 adopted for determining that the taxpayer has enjoyed the benefit of governmental services
2 during the year preceding the assessment.

3 *Simms v. County of Los Angeles* (1950) 35 Cal.2d 303. In determining whether articles constitute
4 fixtures, and therefore improvements, within the meaning of section 105, the determining factor
5 is whether there was an intention to make a permanent accession to the real property as
6 reasonably manifested by outward appearances. Neither the status of the party by whom the
7 articles have been installed, nor the length of the lease under which party is in possession of the
8 property, is controlling. The fact that the fixtures are removable pursuant to express or implied
9 contract between the landlord and tenant does not necessarily negate the element of permanence,
10 nor is the contract binding upon the taxing authority.

11 *Southern California Telephone Co. v. State Board of Equalization* (1938) 12 Cal.2d 127. The
12 central office equipment of a telephone company installed in a building owned by the company
13 and especially designed for its use constitutes an improvement. This includes such items as
14 headsets, operators' stools, etc., which although readily detachable, are usable only with the
15 attached items with which they constitute a single unit.

16 *Specialty Restaurants, Corp. v. County of Los Angeles* (1980) 111 Cal.App.3d 607 (Queen Mary
17 case). The use of a special wharf area, developed as a tourist attraction by the city, manifested
18 the intent to make a vessel (the Queen Mary) a permanent addition to realty.

19 *Tele-Vue Systems, Inc v. County of Contra Costa* (1972) 25 Cal.App.3d 340. A permanently
20 affixed interior household connection to a cable television system installed by the system owner
21 who neither owns nor controls the connection constitutes a fixture and is assessable to the owner
22 of the realty rather than to the system owner.

23 *Trabue Pittman Corp. v. County of Los Angeles* (1946) 29 Cal.2d 385. For purposes of taxation,
24 the definitions of real property in the revenue and taxation laws of the state control irrespective
25 of whether they conform to definitions used for other purposes. In determining whether articles
26 constitute fixtures, and therefore improvements, within the meaning of section 105, the
27 determining factor is whether there was an intention to make a permanent accession to the real
28 property as reasonably manifested by outward appearances. Neither the status of the party by
29 whom the articles have been installed, nor the length of the lease under which party is in
30 possession of the property, is controlling. The fact that the fixtures are removable pursuant to
31 express or implied contract between the landlord and tenant does not necessarily negate the
32 element of permanence, nor is the contract binding upon the taxing authority. Bank vaults and
33 vault doors, including those installed by lessees, were held to constitute improvements.
34 Similarly, tellers' cages, partitions, coupon booths and counters installed by a lessee bank have
35 been held to be improvements taxable to the owner of the building in which they were installed.

36 *Travelers Indemnity Co. v. Colonial Ins. Co.* (1966) 242 Cal.App.2d 227. "Not all motor vehicles
37 are required to be registered and exemption of a motor vehicle from registration does not make it

1 any less a motor vehicle or signify its removal from all other applicable sections of the Vehicle
2 Code."

3 *TRW Space & Defense Sector v. County of Los Angeles* (1996) 50 Cal.App.4th 1703. Federal
4 government cost-reimbursement and fixed-price contracts, which provided that title to property
5 acquired in the performance of those contracts passed to the federal government did not establish
6 federal government ownership of overhead personal property such as consumable supplies and
7 low-value office and plant equipment, and, thus was not immune from state property taxation.
8 The title provision in the cost-reimbursement contracts applied only to property subject to
9 controlling regulations, which did not include overhead personal property wherein the
10 government acquired title solely because of partial, advance, or progress payments. With regard
11 to fixed-price contracts, the title provision applied only to enumerated types of property, which
12 did not include overhead personal property.

13 *Valley Fair Fashions, Inc. v. Valley Fair* (1966) 245 Cal.2d 614. An assessment of
14 improvements to the lessee in possession and control was not erroneous even though the land
15 was assessed to the landlord and he owned the improvements.

16 *Ventura, County of v. Channel Islands State Bank* (1967) 251 Cal.App.2d 240. A sign and a
17 night depository constituting trade fixtures, owned by a bank and installed on a leased premises
18 were properly classified as improvements under section 105 and real property under section 104
19 even though assessed to the lessee and placed on the unsecured roll. The lessee-bank (owning
20 trade fixtures attached to landlord's realty) was the proper assessee. Where a statement of
21 separate ownership as provided in section 2188.2 is not filed, the assessor is not required to
22 assess lessee-owned trade fixtures to the landlord.

23 *Westinghouse Beverage Group, Inc. v. County of San Diego* (1988) 203 Cal.App. 3d 1442.
24 Reusable containers in which a soft drink manufacturer supplied carbon dioxide gas and
25 component syrup to its wholesale customers did not constitute business inventory exempt from
26 property taxes pursuant to Revenue and Taxation Code sections 129 and 219. Unlike the
27 situation with returnable bottles which are sold by the retailer, the syrup and carbon dioxide
28 containers were not sold to the wholesalers. Rather, the soft drink manufacturer easily retained
29 control over the containers, and they were subject to retrieval by the manufacturer's salesperson.
30 Thus, the containers were not intended for sale within the meaning of the inventory statute, and
31 therefore, were subject to property taxes.

32 *Weyse v. Crawford* (1890) 85 Cal. 196. Property in a warehouse is not assessable to the
33 warehouseman as the person in possession. If the owner is not known, the property should be
34 assessed to unknown owners and the tax collected by seizure and sale.

35 *Xerox Corporation v. County of Orange* (1977) 66 Cal.App.3d 746. Under the market value
36 concept, where price is the basis of value, the sales tax and freight charges are elements of value
37 (but see *Auerbach v. Los Angeles County Assessment Appeals Bd. No. 2* (2008) 167 Cal.App.4th

- 1 1428, 1444, distinguishing *Xerox*, holding that: "Sales tax should not be included as an element
- 2 of value in the assessment of a common carrier aircraft, exempt from sales or us tax."

GLOSSARY OF TERMS

Term	Definition
Air Taxi	Aircraft used by an air carrier, which: (1) does not utilize aircraft having a maximum passenger capacity of more than 30 seats, (2) does not have a maximum payload capacity of more than 7,500 pounds in air transportation, and (3) which does not hold a certificate of public convenience and necessity or other economic authority issued by the Civil Aeronautics Board of the United States, or its successor, or by the California Public Utilities Commission, or its successor.
Aircraft	Also referred to as general aircraft. Any contrivance used or designed for the navigation of or for flight in the air which has been flown at least once. It is not a parachute or similar emergency safety device, rockets or missiles, or certificated aircraft or scheduled air taxis.
Annuity	A periodic series of obligatory payments; an annuity can be level, increasing, decreasing, or a combination thereof.
Apportionment	Process used to allocate or eliminate, based on the time of presence, the assessments or the taxes for time spent out of state.
Appraisal Unit	The unit that (1) people in the market typically buy and sell or (2) that is normally valued separately.
Assessed Value	The taxable value of a property against which the tax rate is applied.
Assessee	Person who owns, claims, possesses, or controls the property on the lien date.
Assessment Roll	A listing of all taxable property within a county. It identifies, at a minimum: (1) the property (usually by assessor's parcel number), (2) the tax-rate area where the property is located, (3) the name (if known) and mailing address of the assessee, (4) the assessed value of the property, including separate assessed values for land, improvements, and personal property, (5) penalties (if any), and (6) the amount (if any) of specified exemptions (e.g., Homeowners', Church, Welfare, etc.). Distinct assessment rolls include the locally assessed secured and unsecured regular assessment rolls, the locally assessed supplemental assessment roll, and the state-assessed roll (which is added to the locally assessed secured roll).

Term	Definition
Audit	Means of collecting data relevant to the determination of taxability, situs, and value of property.
Audit Program	System used to select and conduct audits.
Average Service Life	The average life term of a group of items.
Base Year Value	In accordance with section 110.1, a property's base year value is its fair market value as of either the 1975 lien date or the date the property was last purchased, newly constructed, or underwent a change in ownership after the 1975 lien date.
Basic Operational Programs (Software)	Programs that are fundamental and necessary to the functioning of a computer. The part of the operating system including supervisors, monitors, executives and control or master programs which consist of the control program elements of that system.
Board Roll	Part of the secured roll, containing State-assessed property.
Book Value	Capitalized cost less depreciation as estimated by the accountant.
Building Improvements	Improvements to a structure
Capitalization	Any method of converting expected future benefits into an indicator of present value; the discounting of projected income to a present value.
Capitalization Rate	Any rate used to convert income into an indicator of value; a ratio that expresses a relationship between income and value.
Capitalized Cost	Recorded cost of asset in assessee's books and records
Capitalized Interest	Cost associated with use of money during construction of an asset whether the source of funds is debt or equity and whether or not the interest is actually incurred.
Certificated Aircraft	Aircraft operated by an air carrier or foreign air carrier engaged in air transportation while there is in force a certificate or permit issued by the Civil Aeronautics Board of the United States, or its successor, or a certificate by the California Public Utilities Commission authorizing such air carrier to engage in such transportation.

Term	Definition
Change in Ownership	A transfer of a present interest in property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.
Comparative Sales Approach	An approach to value by reference to sales prices of the subject property or comparable properties.
Compound Interest	Interest on the sum of principal and the accrued interest, combined at regular intervals; interest on interest.
Conditional Sales Contract	Form of sales contract in which seller reserves title until buyer pays for goods or land, at which time, the condition having been fulfilled, title passes to buyer. Such contract under Uniform Commercial Code is a purchase money security agreement. UCC Section 9-105(h). (See also <i>financing lease</i> .)
Confidence Interval	Describes the limits of accuracy of an inference. This precision interval is a statistical measure of the inability to predict the true population error because the test is based on a sample rather than a census.
Confidence Level	An inference from a sample that tells the proportion of times a statement about the population is likely to be true in the long run.
Confidence Limits	Confidence interval expressed as a range, the lower and upper bound on the confidence interval.
Cost	The expenditure required to develop and construct an improvement or acquire personal property.
Cost Approach	A value approach using the following procedures to derive a value indicator: (1) estimate the current cost to reproduce or replace an existing property without untimely delays, (2) deduct for all accrued depreciation, and (3) add an amount to compensate for entrepreneurial profit (if present).
Data	Factual information used as a basis for analysis.
Depreciation	A decrease in utility resulting in a loss in property value; the difference between estimated replacement or reproduction cost new as of a given date and market value as of the same date. There are three principal categories of depreciation: physical deterioration, functional obsolescence, and external obsolescence.

Term	Definition
Direct Billing	System developed and implemented by an assessor to appraise selected accounts periodically, in lieu of annual property statements.
Direct Capitalization	A capitalization method used to convert a single year's income expectancy into an indicator of value, either by dividing the income estimate by an appropriate rate or by multiplying the income estimate by an appropriate factor.
Direct Costs	Expenditures required for the labor and materials necessary to develop and construct an improvement (or personal property); sometimes referred to as "hard costs":
Documented Vessel	Any vessel which is required to have and does have a valid marine document issued by the Bureau of Customs of the United States or any federal agency successor or DMV.
Economic Life	Useful or profitable life of property, which may be shorter than the physical life.
Economic Obsolescence	See <i>External Obsolescence</i> .
Economic Rent	The amount of rental income that could be expected from a property if available for rent on the open market, as indicated by the prevailing rental rates for comparable properties under similar terms and conditions; economic rent is distinguished from contract rent, which is the actual rental income for the subject property as specified in a lease; economic rent is also referred to as market rent.
Effective Age	The age indicated by the condition and utility of the property.
Effective Gross Income	The estimated potential gross income less allowances for vacancy and collection losses.
Equipment Index Factor	Multiplier used to "trend" the historical cost of property to an estimated reproduction or replacement cost new.
Escape Assessment	Assessment made after the completion of the regular assessment roll.
Exposed Costs	Cost of property in service at the beginning of each age interval that are exposed to retirement.
Extended Term Lease	Lease with duration of more than six months. (Commonly referred to as <i>long-term lease</i> .)

Term	Definition
External Obsolescence	Form of depreciation. Also referred to as <i>Economic Obsolescence</i> . The loss in utility and value due to an incurable defect caused by external negative influences outside the property itself.
Factor	One of two or more numbers that when multiplied together produce a third number, a multiplier. A capitalization factor is the reciprocal of a capitalization rate.
Financial Corporation	Banks and financial institutions exempt from property taxation by the California Constitution, article XIII, section 28 and section 23182.
Financing Lease	See <i>Conditional Sale Contract</i> .
Fixed Machinery and Equipment	A type of fixture. Equipment which is physically or constructively annexed and intended to remain indefinitely with the realty.
Fixture	An item of tangible property, the nature of which was originally personal property, but which is classified as real property for assessment purposes because it is physically or constructively annexed to real property with the intent that it remain annexed indefinitely.
Full Cash Value	See <i>Market Value</i> .
Full Economic Cost	Cost for appraisal purposes. Includes all market costs (direct and indirect) necessary to purchase or construct equipment and make it ready for its intended use.
Functional Obsolescence	Form of depreciation. The loss in utility and value due to changes in the desirability of the property; attributable to changes in tastes and style or the result <u>of</u> a poor original design. Functional obsolescence is curable if the cost to cure is is equal to or less than the value added by curing it.
General Aircraft	Also referred to as aircraft. Any contrivance used or designed for the navigation of or for flight in the air which has been flown at least once. It is not a parachute or similar emergency safety device, rockets or missiles, or certificated aircraft or scheduled air taxis.
Historical Cost	The total cost of a property when it was originally constructed or purchased.

Term	Definition
Improvements	All buildings, structures, fixtures, and fences erected on or affixed to the land; all fruit, nut bearing, ornamental trees and vine, not of natural growth, and not exempt from taxation, except date palms under eight years of age.
Income Approach	Any method of converting an income stream or a series of future income payments into an indicator of present value.
Indirect Costs	The outlay for items, other than labor and materials, required to develop and construct an improvement or personal property; includes such costs as (1) legal fees, property taxes, construction financing, administrative expenses, appraisal fees, and lease-up expenses for real property and/or (2) freight, installation, interest on borrowed funds, and testing costs for personal property. Sometimes referred to as "soft costs."
Inference	Act of passing from statistical sample data to generalizations (as of the value of population parameters) usually with calculated degrees of certainty.
Interest Rate	The rate of return on debt capital; the price paid for borrowing money.
Inventory	Exempt items of personalty that become part of the product or are themselves a product that is held for sale or lease in the ordinary course of business.
Land	Real estate, or real property, except improvements. It includes: the possession of, claim to, ownership of, or right to possession of land, and all mines, minerals, and quarries in the land, all standing timber whether or not belonging to the owner of the land, and all rights and privileges appertaining thereto.
Landlord Improvements	Improvements made by the real property owner.
Leasehold/Tenant Improvements	Improvements made by the lessee/tenant.
Lessee	One who has the right to use (or occupy) property under a lease agreement. (In terms of real property a tenant)

Term	Definition
Lessor	One who conveys the right to use (and/or occupy) property under a lease agreement. (In terms of real property a landlord.)
Lien Date	All taxable property (both state and locally assessed) is assessed annually for property tax purposes as of 12:01 a.m. on January 1, which is called the lien date. It is referred to as the lien date because on this date the taxes become a lien against all real property assessed on the secured roll. Note: Taxes on the unsecured roll are not a lien on property; they are a personal obligation of the assessee.
Lifing Studies	See <u>Mortality Studies</u> .
Long –Term Lease	See <u>Extended-Term Lease</u> .
Mandatory Audit	Audits required by law. For taxpayers owning or possessing tangible business personal property and fixtures with a full cash value of \$400,000 or more, section 469 requires an audit at least once in each four year period.
Market Value	Also referred to as full cash value or fair market value. It 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 buyer nor seller could take advantage of the exigencies of the other and both with knowledge of all the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes.
Mortality Studies	Statistical studies, typically based upon a sample of a population, whose results estimate the percentage of things which live at any given age the life expectancy of those things at any given age; (also known as <i>lifing studies</i>).
Movable Property	All property which is intended to be, and is, moved from time to time from one location to another.
Net Income Before Recapture and Taxes (NIBR&T)	The annual net income remaining after deducting all operating expenses, but before deducting other charges, such as recapture, debt service, and property taxes. For property tax appraisal purposes, NIBR&T is capitalized into an indicator of value using various income capitalization techniques.

Term	Definition
New Construction	Any addition to real property, whether land or improvements (including fixtures) since the last lien date; any alteration of land or improvements (including fixtures) since the last lien date that constitutes a major rehabilitation thereof or which converts the property to a different use.
Nondocumented Vessel	Any vessel not required to be documented.
Nonmandatory Audit	Audits not required by law, but authorized by section 470 and Rule 192(e).
Operating Expenses	The periodic expenditures necessary to maintain the real/personal property and continue production of the effective gross income, assuming prudent and competent management; sometimes referred to as "allowable expenses."
Outliers	Sample items with extreme values that do not appear to be representative of the population from which they were drawn (or not in the same proportion as indicated by the sampling frequency).
Parameters	Set of physical properties that describes a population such as the mean, number of transactions in the population, standard deviation, etc.
Percent Good	The complement of depreciation; if a property is 20 percent depreciated, its percent good is 80 percent. Percent good refers to the portion of benefits remaining in an asset compared to the total benefits when new.
Personal Property	All property except real property (section 106).
Physical Deterioration	Form of depreciation. The loss in utility and value due to some physical deterioration in the property; considered curable if the cost to cure is equal to or less than the value added by curing it.
Population	A group of units with some characteristics in common. The total units from which the sample is drawn.
Potential Gross Income	The total income of a property before deducting vacancy and collection losses or operating expenses.
Processing Program	Software used to develop and implement the specific applications which the computer is to perform. Its operation is possible only through the facilities provided by the basic operational program (or control program). It is not fundamental to the functioning of the computer.

Term	Definition
Property	Property includes all matters and things – real, personal, and mixed – that are capable of private ownership.
Random Sample	Sample where every unit still remaining in the population has an equal chance of selection on each draw.
Real Property	The possession of, claim to, ownership of, or right to the possession of land, all mines, minerals, and quarries in the land, all standing timber whether or not belonging to the owner of the land, and all rights and privileges appertaining thereto, and improvements; in California property tax law, the term is synonymous with "real estate."
Recapture	The return of invested capital; in real estate investments, capital may be returned gradually as part of the annual income; it may be recaptured all or in part through resale of the property, or through a combinations of both. The variety of the methods of recapture requires <u>the application of the</u> various capitalization techniques.
Regular Assessment Roll	Roll covering <u>the</u> period starting July 1 of the current calendar year to June 30 of the next year. Assessment period for the regular roll must be completed on or before July 1.
Replacement Cost	The cost required to replace an existing property with a property that has equivalent utility.
Reproduction Cost	The cost required to reproduce an exact replica of an existing property.
Reversion	A lump-sum benefit in property that an investor receives or expects to receive at the termination of an investment.
Sale Price	The amount of money a buyer agrees to pay and a seller agrees to accept in an exchange of property rights; sale price is based on a particular transaction, not necessarily on what the typical buyer would pay or the typical seller would accept.
Sales Tax	A state or local-level tax on the retail sale of specified property or services. It is a percentage of the cost of such. Generally, the purchaser pays the tax, but the seller collects it, as an agent for the government. Various taking jurisdictions allow exemptions for purchases of specified items, including certain foods, services, and manufacturing equipment. If the purchaser and seller are in different states, a use tax usually applies.

Term	Definition
Salvage Value	The value of property at the end of its economic life in its present use.
Sample	Subset of a given population; any number of units drawn from a population.
Sampling	Statistical method which <u>that</u> enables one to make observations regarding an entire group of items (population) based on a study of a smaller sub set (sample) of this group.
Scarcity	The present or anticipated under-supply of an item relative to the demand for it.
Secured Property	Property on the secured roll.
Secured Roll	That part of the assessment roll containing state-assessed property and property, the taxes on which, are a lien on real property, sufficient, in the opinion of the assessor, to secure payment of taxes.
Service Life	Period of time (or service) extending from the date of installation to the date of retirement from service.
Short-Term Lease	Lease of property on a daily, weekly, or other short-term basis (defined as a period of six months or less).
Situs	The place where property is legally situated; the more or less permanent location of the property.
Statistical Sample	Sample where the selection of the items to be included is independent of the sample and one that provides a means of establishing the sample size objectively and a means of objectively appraising the sample results.
Statute of Limitations	Time period during which an assessment can <u>legally</u> be made. See section 532.
Stratification	Physical segregation of the population into homogeneous groups with the expressed purpose of improving sample efficiency and/or sample reliability.
Structure	An edifice or building; an improvement whose primary use or purpose is for housing or accommodation of personnel, personalty, or fixtures and has no direct application to the process or function of the industry, trade, or profession.

Term	Definition
Structure Items	Integral parts of the structure. Improvement that has a primary use or purpose for housing or accommodation of personnel, personalty, or fixtures and has no direct application to the process or function of the industry, trade, or profession.
Stub Survivor Curve	An incomplete survivor curve, that is, one which does not extend to zero percent surviving because of a lack of retirement data.
Supplemental Assessment	An assessment of the full cash value of property as of the date a change in ownership occurs or new construction is completed which establishes a new base year value for the property or for the new construction.
Supplies	Property used up in the normal operation of a business, but which are not intended for sale or lease.
Survivor Curve	Curve showing the property surviving in service at successive ages. The ordinates to the curve give, at any particular age, the percentage (or the actual number) surviving in service.
Taxable Value	For real property subject to article XIII A of the California Constitution, the base year full -value adjusted for any given lien date as required by law or the full cash value for the same date, whichever is less, as set forth in section 51(a). For personal property, the full cash value (market value) on the lien date each year.
Tenant Improvements	See <i>Leasehold Improvements</i> .
Trade Fixture	A type of fixture which is "trade-related."
Trade level	Property normally increases in value as it progresses through production and distribution channels.
Trade-in Allowance	Property used for payment in whole or in part for acquisition of other property (usually older property used as partial payment for new property).
True Lease	Agreement under which an owner gives up possession and use of his/her property for valuable consideration and for a definite term and at the end of the term, the owner has the absolute right to retake, control, or convey the property.

Term	Definition
Undocumented Vessel	Any vessel not required to be documented as defined in the context of property tax. (See <i>Documented Vessel</i> .)
Unsecured Property	Property on the unsecured roll.
Unsecured Roll	See definition of <i>secured roll</i> . Remainder of the roll is the unsecured roll. The taxes are a personal liability of the owner.
Use Tax	<p>A sales tax that is collectible by the seller where the purchaser is domiciled in a different state. A tax on the use, consumption, or storage of tangible property, usually at the same rate as the sales tax, and levied for the purpose of preventing tax avoidance by the purchase of articles in a state or taxing jurisdiction which <u>that</u> does not levy sales taxes or has a lower rate.</p> <p>A levy on <u>the</u> privilege of using, within <u>a</u> taxing state, property purchases outside the state, if the property would have been subject to the sales tax had it been purchased in state at home. Such tax ordinarily serves to complement sales tax by eliminating incentive to make major purchases in states with lower sales taxes; it requires resident who shops out-of-state to pay use tax equal to sales tax savings.</p>
Utility	The capacity of goods to evoke a desire for possession, wantedness, want-satisfying power.
Value	The power of one commodity to command other commodities in exchange, a ratio of exchange, present worth of future net benefits.
Vehicle	A device by which any person or property may be propelled, moved, or drawn upon a highway, excepting a device moved exclusively by human power or used exclusively upon stationary rails or tracks. See text for discussion of assessable and exempt vehicles.
Vessel	Every description of watercraft used or capable of being used as a means of transportation on water.
Yield	The return on investment.
Yield Capitalization	A capitalization method used to convert future benefits to present value by discounting each future benefit at an appropriate yield rate or by developing an overall rate that reflects the investment's income pattern, value change, and yield rate.

Term	Definition
Yield Rate	A measure of investment return (usually annualized) that is applied to a series of incomes to obtain the present value of each; examples are the interest rate, the discount rate, the internal rate of return, and the equity yield rate.

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