Best Practices

Deducting Intangible Asset Value for Property Tax Purposes: How "Necessary Intangibles" Are Treated in Two Recent Cases

Richard G. Smith, Esq.

Two recent judicial decisions provide professional guidance on when—and how—intangible asset value can be excluded from the taxpayer's total unit value. This issue is particularly complicated when the subject intangible assets are the types of intangible assets that are "necessary" for the taxpayer to operate as a going concern business. Such right-to-do-business intangible assets include various types of licenses, permits, and franchises.

Introduction

Two recent state Supreme Court cases examine an important set of issues involving the unit valuation of companies for property tax purposes. The issues relate to the exemptions for intangible assets that are common in many states.

The two cases address the treatment of the taxpayer intangible assets that are necessary to the operation of the business. If the taxpayer intangible assets are necessary, can they be excluded? Or, do the intangible assets represent assets or rights like building permits that cannot effectively be excluded because they do not generate a specific stream of income, or cannot be held separately from the subject unit of property?

These two cases—*Gold Creek Cellular of Montana dba Verizon Wireless and AT&T Mobility v. Department of Revenue*,[1] and *Elk Hills Power v. Board of Equalization*[2]—may add to the debate concerning when intangible assets can be deducted from a unit value. Although each case was decided under a statute that was specific to the state and has unique language, the cases still provide guidance to taxpayers, legal counsel, and valuation analysts on how courts may apply intangible property exemptions in the future.

This discussion analyzes these cases and argues that the Montana Supreme Court was correct in holding that the intangible asset exemption includes assets necessary to the operation of the taxpayer business enterprise.

The California Supreme Court was also correct in holding that the replacement cost of certain necessary intangible assets cannot be legally added to the value of the taxpayer business determined under the cost approach. However, the court's analysis was incomplete in suggesting that an exemption could be denied in the income approach when the intangible assets' income contribution cannot be specifically determined.

After reviewing these and other cases, this discussion concludes that the proper analytical procedure is to exclude intangible property in each valuation approach, consistently. Indeed, the best procedure, and the procedure that could have avoided the confusion introduced in *Elk Hills*, is to exclude the intangible asset value from the reconciled overall unit value in order to obtain the same result.

Background

For over 120 years, it has been the practice of states to value certain types of taxpayer companies using the "unit" approach to valuation.[3] The taxpayer companies valued in this way are typically public utilities like electric, gas and water transmission and distribution companies, telephone companies, railroads and airlines. The premise of the unit approach

Distributed by: Montana Taxpayers Association