

DRAFT OVERVIEW OF SELECTED STATES METHODS FOR VALUING CENTRALLY ASSESSED PROPERTY

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by

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INTRODUCTION

This report describes the methods used in Arizona, Idaho, New Mexico, Oregon, and Utah to value property operated in more than one county of the state or in more than one state. The property described in this report is centrally assessed by the state, but the unitary approach is not always used.

For each state, the report describes constitutional provisions related to the valuation of property and the statutory provisions and administrative rules for valuing centrally assessed property.

The report also includes a discussion of two court cases, one in Oregon and one in Utah, dealing with the valuation of centrally assessed property within the limited context of the state's constitutional and statutory framework for valuation.

The states included in the report were not selected randomly, but their inclusion illustrates the different valuation methods used by states. The intent of the report is to illustrate the complexity involved with the valuation of certain types of property.

Finally, the report suggests questions related to the central assessment of property that may be asked of panelists if the members of the Revenue and Transportation Interim Committee decide to proceed with a panel discussion.

ARIZONA

Article 9, section 1, of the Arizona Constitution provides: "The power of taxation shall never be surrendered, suspended or contracted away. Except as provided by section 18 [dealing with residential property values] of this article, all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax, and shall be levied and collected for public purposes only."

Article 9, section 2, of the Arizona Constitution provides: "All property in the state not exempt under the laws of the United States or under this constitution or exempt by law under the provisions of this section shall be subject to taxation to be ascertained as provided by law."

Article 9, section 11, of the Arizona Constitution provides: "The manner, method and mode of assessing, equalizing and levying taxes in the state of Arizona shall be such as is prescribed by law."

Property in Arizona is valued at "full cash value" as determined by statutorily prescribed methods. If a statutorily prescribed method is not in effect, full cash value has the same meaning as market value (the estimate of value using standard appraisal methods and techniques).¹ The Arizona Department of Revenue centrally assesses mines; railroads; private car companies; electric, gas, and water utilities; pipelines; airlines; and telecommunications providers that are located in more than county. The values are determined for the entire system and apportioned to local taxing jurisdictions, except for airlines and private car companies. Airlines and private car companies are taxed at the average statewide rate, and their taxes are deposited into the state general fund.

Arizona has nine classes of property. Most centrally assessed property is classified as class one property (42-12001, Arizona Revised Statutes). The property of railroads, private railroad car companies, and airlines are classified as class five property (42-12005). The department determines net assessment ratios for other types of property in determining the assessed valuation of railroad and airline property as required by federal law (42-15005, ARS).

Electric and Gas Utilities (42-14154, ARS): Electric and gas utilities (exclusive of generation property) are valued by using the original plant in service² cost less accumulated straight line depreciation. The value is further reduced to take into account federal or state government orders prohibiting the use of the property. The department may not value contributions in aid of construction. Construction work in progress is valued at 50% of the amount spent in the preceding calendar year. The assessed value of environmental protection facilities that are required by law is 50% of the depreciated cost.

Electric generation property (43.14151, ARS): The valuation of electric generation facilities is determined as follows:

- the value of land is the cost to the current owner as of December 31 of the preceding calendar year;
- the value of improvements to real property is the replacement cost new less depreciation schedules adopted by the Arizona Department of Revenue or the cost of the property in an arm's length transaction;
- the value of personal property is the acquisition cost less depreciation schedules adopted by the department. The assessed value of personal property is adjusted as follows:
 - ▶ in the first year of assessment, 35% of the depreciated value;
 - ▶ in the second year of assessment, 51% of the depreciated value;

¹New York State Department of Taxation and Finance, "Survey of Railroad and Utility Taxation Practice Among the States: 2005 Update". <http://www.tax.ny.gov/research/property/reports/rr/index.htm>.

²The term "plant" means all property in Arizona that is used for the transmission or distribution of electric power or distribution of natural gas.

- ▶ in the third year of assessment, 67% of the depreciated value;
- ▶ in the fourth year of assessment, 83% of the depreciated value;
- ▶ in the fifth year and subsequent assessment, the scheduled depreciated value (but not below a minimum value).

Personal property associated with construction work in progress is not valued until the property is placed in commercial service.

The value of real property and personal property may not be below 10% of the cost of real property improvements or the cost of personal property. The department must also take into account all forms of obsolescence using standard appraisal methods.

The valuation of existing generation plants was adjusted to stabilize changes in the valuation that may have occurred using the valuation formulas for new plants.³

Airlines (42-14254, ARS): Airline property is valued by fleet type using original cost less depreciation. Depreciation is computed using 15 year straight line depreciation. The salvage value of aircraft out of production is 10% of original cost and the salvage value of aircraft in production is 25% of original cost. Additional obsolescence is allowed if supported by market evidence.

The value of airline property apportioned to Arizona is the sum of:

- 50% of the percentage that the total state ground time during the preceding calendar year is of the total system ground time in the preceding calendar year; and
- 50% of the percentage that the total mileage scheduled within the state of the fleet type on flights operated in the state during the preceding calendar quarter is of the total system mileage of the fleet type during the preceding calendar year.

Telecommunications (42-14403, ARS): Telecommunications real estate is valued at market value, and personal property is valued on a unitary basis at original cost less straight line depreciation. The department must also consider all forms of obsolescence using standard appraisal methods. The useful life of real estate is 25 years, cable is 15 years, telecommunications equipment is 5 years, and all other telecommunications property is 7 years.

For wireless telecommunications providers, the taxable unit is the applicable metropolitan statistical area or rural statistical area. Assessed value does not include the value of a license issued by the Federal Communications Commission.

³See Jeff Martin, "The Valuation of Electrical Generation Property in Selected States", pp. 2-3. http://leg.mt.gov/css/Committees/Interim/2003_2004/rev_trans/default.asp. The valuation changes were made in response to electric utility restructuring.

Mines (42-14053, ARS): Mines are valued by using the three approaches to value, the income approach, the cost approach, and the market approach. The income approach is based on a discounted cash flow method. The cost approach is based on reproduction cost new, less depreciation. The market approach is based on an arms-length transaction of more than 50% interest in the assets, or the sale of more than 50% of the stocks, bonds, notes, or other instruments that represent a share in a corporation or a debt owed by a corporation.

The income approach is the preferred method of valuing mines, although the cost and market approaches may be correlated with the income approach where applicable.

Railroad property and oil and natural gas pipeline property are valued on a unitary basis but the assessed value is determined by formula for each type of property (R15-4-206, Arizona Administrative Code).

Railroads (42-14355, ARS): The Arizona Department of Revenue values railroad operating property in the state. The assessment includes franchises, intangible values, right-of-way, roadbed, rolling stock, buildings and telecommunication lines, all other real and personal property (42-14354, ARS). The value of railroad property is determined by multiplying the base value by the value change factor and multiplying that result by the allocation factor.

The base value is the full cash value of the railroad system in the preceding calendar year. If the railroad was not valued in the prior year, the base value is the acquisition cost of the railroad. If the railroad is transferred to a new owner, the base value is transferred to the new owner.

The valuation change factor is the sum of the income change factor (change in earnings divided by change in capitalization rate) weighted by 50%, the profitability change factor (average of the gross profit margin factor and return on investment factor) weighted by 20%, the efficiency change factor (quotient of current year's earnings divided by gross revenue and that amount divided by previous year's quotient) weighted by 15%, and the property change factor (dividing system cost as of the previous December 31 by the system cost of the previous December 31) weighted by 15%.⁴

IDAHO

Article VI, section 3, of the Idaho Constitution requires that property be defined and classified by law. The classes of property are real property, personal property, and operating property.

Operating property includes real and personal property of public utilities, railroads, or private railcar fleets, operated wholly or partly in Idaho.

⁴A different valuation change factor formula is applied to the base values of oil and gas pipelines.

Public utilities include electrical companies, pipeline companies, natural gas distribution companies, power producers, or telephone corporations. Public utilities do not include energy cogenerators, mobile telephone services, pager services, except when the services are an integral part of services provided by a telephone corporation. Public utilities also do not include businesses providing solely on a resale basis, any telephone or telecommunication service which is purchased from a telephone corporation (63-201, Idaho Statutes).

Operating property is assessed by the Idaho State Tax Commission⁵ (63-405, IS). The commission identifies property to be included as operating property for assessment purposes. Nonoperating property is assessed by the county assessor (63-402, IS).

The market value of operating property for assessment purposes is the system value of the property when considered as a unit. Most intangible personal property is exempt from taxation.

Intangible personal property includes stock and bonds, deposits in financial institutions, goodwill, customer lists, contracts and contract rights, patents, trademarks, custom computer program copyrights, trade secrets, franchises, licenses, and possessory rights-of-way. Exempt intangible value does not include values attributable to availability of a skilled work force, condition of surrounding property, geographic features, location, rights-of-way accompanied by title, view, zoning, and attributes or characteristics of real properties. (Rule 615.02, 35.01.03, Idaho Administrative Code)

The owner of operating property may elect one of three methods for excluding exempt intangible personal property from the taxable value of the property:

- exclusion of intangible personal property from the system-level value;
- exclusion of intangible personal property from the system value allocated to the state; or
- exclusion of intangible personal property by valuation of only tangible personal property and nonexempt intangible personal property using valuation models that do not impound or include values of exempt intangible personal property. (63-602L, IS)

Rule 405 (35.01.03, IAC) provides that unit method of valuation is preferred for valuing operating property when the individual assets function collectively, are operated under one ownership and one management, are interdependent, and the property would be expected to trade in the marketplace as a unit. Under the unit method, the value of the tangible and intangible property is equal to the value of the going concern. The three approaches to value may be considered for all property. Market value is determined through procedures, methods, and techniques accepted by nationally recognized appraisal and valuation organizations.

⁵The Idaho State Tax Commission is constitutionally established under Article VII of the Idaho Constitution. It is a four-member commission appointed by the governor. No more than two members may be of the same political party.

Income approach: The yield capitalization of income is used for estimating value under the income approach. The rules prohibit the use of direct capitalization of income for estimating value.

Cost approach: Under the cost approach, replacement cost, reproduction cost, or original or historical cost may be considered. Construction work in progress may be considered in the cost approach. The appraiser must attempt to measure obsolescence, if any exists. If obsolescence is found to exist, it may be considered in the cost approach.

Market approach: Under the market approach, the sales comparison approach or the stock and debt approach may be considered.

NEW MEXICO

Article VIII, section 1, of the New Mexico Constitution provides for the taxation of tangible property. Taxes are levied upon tangible property in proportion to its value and is uniform on property of the same class. It also provides that different methods of valuation may be enacted to determine the value of different kinds of property.

New Mexico has two classes of property -- residential and nonresidential -- but all property is taxed at one-third of its assessed value. Intangible property is not subject to valuation. Intangible property includes, but is not limited to, shares of stock, bonds, bills, notes, checks, drafts, bills of exchange, certificates of deposit, letters of credit and negotiable instruments. (3.6.1.7, New Mexico Administrative Code)

Centrally assessed property is valued under Chapter 7, article 36, New Mexico Statutes Annotated. Statutory provisions ("special method") govern the valuation of most types of centrally assessed property.

Special Method of Valuation -- Pipelines (7-36-27, NMSA): The New Mexico Department of Taxation and Revenue values pipelines and direct customer distribution pipelines at cost, less depreciation. Straight line depreciation over the useful life of the property, as determined by the Federal Energy Regulatory Commission, is used. The department may take into account functional or economic obsolescence. The value of property may not be less than 20% of the cost of tangible property before depreciation. Construction work in progress is valued at 50% of the amount expended as of December 31 of preceding calendar year. Real property used in the pipeline or public utility business, but that are not defined in 7-26-27, NMSA, are valued separately.

Special Method of Valuation -- Electric Plant (7-36-29, NMSA): The department values electric generation, transmission, and distribution (electric plant) at cost, less depreciation (net

book value).⁶ The electric plant does not include land, land rights buildings and improvements, construction work in progress, materials and supplies, and licensed vehicles, which are valued separately. The value of the electric plant may not be less than 20% of the cost of tangible property before depreciation. Construction work in progress is valued at 50% of the amount expended as of December 31 of preceding calendar year.

The assessment of this type of property is limited to property within the state. The value of electric plant property is allocated to governmental units in which the property is located.

If, however, a regulated utility protests the valuation of the property, the department will conduct a unit valuation assessment.⁷

Special Method of Valuation -- Property of a Communications System: Owners of communication property may elect to be valued at cost less depreciation and other justifiable factors; e.g., wear and tear of property not covered by depreciation and functional and economic obsolescence) or by the unitary method. The election is effective for 3 years. A communications system includes the transmission and reception of information by the use of electronic, magnetic, or optical means or any combination of those means. It includes microwave transmission and reception and two-way cable television systems (3.65.37, NMAC).⁸

Under the cost election, the value of communications system property may not be less than 20% of the cost of tangible property before depreciation. Construction work in progress is valued at 50% of the amount expended as of December 31 of preceding calendar year.

The value of communications property is allocated to governmental units in which the property is located.

Under the unitary method of valuation, the department uses one or more methods to appraise telecommunications property: capitalization of earnings, market value of stock and debt, or cost less depreciation and obsolescence.

The capitalization of earnings is determined by dividing net operating income (based on the preceding 5 years' net operating income of the communications business in all states by the capitalization rate for the particular company). The capitalization rate is determined by the band of investment method or any other method that is consistent with generally accepted appraisal techniques. (3.6.5.37, NMAC)

⁶The New Mexico Department of Taxation and Revenue must consider functional and economic obsolescence and other relevant factors.

⁷Martin, *op. cit.*, p. 5.

⁸State Assessed Properties Bureau, New Mexico Department of Taxation and Revenue, General and Special Reporting Instructions, available at <http://www.tax.newmexico.gov/About-Us/Property-Tax-Division/State-Assessed-Properties-Bureau/Pages/General-and-Special-Reporting-Instructions.aspx>.

The market value of stock and debt is computed on the basis of the average of the monthly high and low market prices for the preceding tax year. If the stock is not traded or is not traded in sufficient volume to indicate value, the department may rely on price earnings ratio, or other methods consistent with generally accepted appraisal techniques. (3.6.5.37, NMAC)

The market value of debt is determined on the basis of the published quotations for each of the obligation and liabilities of the business.

From the system value determined by the stock and debt approach, the value of non-communications property that is not used in the communications operation and the value of intangible property used in the operation is subtracted.

Cost, less depreciation and obsolescence, is computed for communications plant in service in all states. Construction work in progress is 50% of the amount expended (3.6.5.37, NMAC).

Special Method of Valuation -- Operating Railroad Property (7-36-31, NMSA): The department uses one or more methods to appraise railroad property under the unitary method of valuation: capitalization of earnings, market value of stock and debt, or cost less depreciation and obsolescence. The indicators of value are determined in a manner similar to communications property. Original cost less depreciation is used under the cost approach (3.6.5.38, NMAC). Construction work in progress is valued at 50% of cost.

OREGON

Article IX, section 1, of the Oregon Constitution provides that: "The Legislative Assembly shall, and the people through the initiative may, provide by law uniform rules of assessment and taxation. All taxes shall be levied and collected under general laws operating uniformly throughout the State."

Section 307.030, Oregon Revised Statutes, provides that real property and tangible personal property is subject to assessment and taxation. Intangible property is exempt from taxation except for property centrally assessed under 308.505 to 308.665, ORS. However, in 2001, the Oregon Legislature exempted licenses granted by the Federal Communications Commission from property taxation. (307.126, Oregon Revised Statutes)

Section 307.020, ORS, provides that "intangible personal property" or "intangibles" includes but is not limited to:

- money at interest, bonds, notes, claims, demands and all other evidences of indebtedness, secured or unsecured, including notes, bonds or certificates secured by mortgages;
- shares of stock in corporations, joint stock companies or associations;

- media constituting business records, computer software, files, records of accounts, title records, surveys, designs, credit references, and data contained therein. "Media" includes, but is not limited to, paper, film, punch cards, magnetic tape, and disk storage;
- goodwill; customer lists; contracts and contract rights; patents, trademarks, and copyrights; assembled labor force; and trade secrets.

The Oregon Department of Revenue centrally assesses companies maintaining certain businesses, companies performing certain services, and companies selling certain commodities, "whether in domestic or interstate commerce or in any combination of domestic or interstate commerce . . ." (308.515, ORS)

The department assesses property used for: railroad transportation; air transportation; water transportation used in inland waters of the state; communications; heating, gas, or electricity; and pipelines, among other types of property.

For the purposes of central assessment, "property" means real property, tangible personal property, and intangible personal property, except for money at interest, bonds, notes, claims, demands of other evidence of indebtedness, secured or unsecured.

Centrally assessed companies report their assets (current assets; property, plant, and equipment; and intangibles) at book cost; liabilities and equity, and other information.

The department has adopted the *2009 Western States Association of Tax Administrators Appraisal Handbook: Unit Valuation of Centrally Assessed Properties* as the official valuation guide for property assessed under ORS 308.505 to 308.665 for ad valorem tax purposes (150-308.655, Oregon Administrative Rules).

Communications includes telephone communication and "data transmission services by whatever means provided" (Section 308.505(3), ORS). In 2008, the Oregon Department of Revenue adopted a rule (OAR 150-308.515(1)(h)) which provided that cable companies and internet service providers are communications service providers for purposes of central assessment. The Oregon Court of Appeals invalidated the rule (*Oregon Cable Telecommunication v. Department of Revenue*, 237 Or App 628, 240 P3d 1122 (2010)) because the department failed to follow the correct rule making procedures.⁹

In the tax year 2009-2010, the department centrally assessed the property of cable television and internet service providers. Comcast Corporation, "a family of companies that provides cable television services, internet access, and voice over internet", challenged the central assessment of its cable television business and its internet access business in the Oregon Tax Court, Regular

⁹*Comcast Corporation v. Department of Revenue*, p. 3, 2011 Ore. Tax LEXIS 321.

Division.¹⁰ An affiliate of Comcast involved in the voice over internet business had already been centrally assessed.

The Tax Court concluded that the cable television business does not fit within the meaning of "data transmission services by whatever means provided" because Comcast does not transmit data created by the customer, but rather transmits its own data or data to which it has obtained the right to make transmission to a third party.¹¹

The court also concluded that the internet service is a form of data transmission service. However, the court said that section 308.510(4), ORS, requires:

that where the department finds an integrated use of assets in more than one business and at least one such business is subject to central assessment, the department must also determine the primary use of the property.¹²

The upshot of the court's decision was that because the primary use of Comcast's properties is in the cable television business does not subject any of the properties (i.e., cable television or internet access property) to central assessment.

The department has appealed the decision to the Oregon Supreme Court.¹³

UTAH

Article XIII, section 2, of the Utah Constitution provides that all tangible property is assessed at a uniform and equal rate in proportion to its fair market value, to be ascertained as provided by law, and is taxed at a uniform and equal rate. The constitution also provides that the Legislature may exempt intangible property.

However, if intangible property is subject to tax, the property tax may not exceed .005 of its fair market value. In addition, if intangible property is taxed under the property tax, the income from that property may not also be taxed.

¹⁰*Ibid.*, p. 1.

¹¹*Ibid.*, p. 7.

¹²*Ibid.*, p. 9.

¹³Qwest Corporation petitioned (date unknown) the Utah State Tax Commission to amend "Rule 62" to clarify that cable television companies are centrally assessed telecommunications property: . . . cable companies and other similar properties which are utilized to facilitate two-way communication. Retrieved from <http://tax.utah.gov/commission/proposed/qwest/r884-24p-62-memorandum.pdf>. The rule has not been revised.

Article XIII, section 6, creates the Utah State Tax Commission. The commission consists of four members, not more than two of whom may belong to the same political party. The Governor appoints the commission with the approval of the Senate. The commission administers and supervises the state's tax laws. The constitution directs the commission to assess mines and public utilities and may conduct original assessment of property as may be provided law. It is required to adjust and equalize the valuation and assessment of property among the counties.

The provisions related to the taxation of property are contained in Title 59, chapter 2, of the Utah Code.

Section 59-2-201, UC, describes property assessed by the commission. It includes all property that operates as a unit across county lines, if the values must be apportioned among more than one county or state; all property of public utilities; all operating property of an airline, air charter service, and air contract service; geothermal fluids and geothermal resources; and mines and mining claims.

Public utilities include, among other types of property, the operating property of railroads, gas corporations, oil or gas pipeline companies, coal slurry pipeline companies, electrical corporations, and telephone corporations (including local exchange carriers, local access providers, long distance carriers, cellular telephone or personal communications service providers and pagers).¹⁴

Utah exempts intangible personal property from taxation. Under 59-2-101, UC, "intangible property" means property that is capable of private ownership separate from tangible property, including:

- money, credits, bonds, and stocks;
- representative property;
- franchises, licenses, trade names, copyrights, and patents;
- a low-income housing tax credit;
- goodwill; or
- a renewable energy tax credit or incentive.

Under Utah law, goodwill includes acquired goodwill that is reported as goodwill on the taxpayer's books and records and that are maintained for financial reporting purposes. It also includes the ability of a business to generate income that exceeds a normal rate of return on assets resulting from such factors as superior management skills, reputation, customer relationships, patronage, or other similar factors or obtain an economic or competitive advantage resulting from any of these factors.

Goodwill does not include certain attributes of real property, such as zoning, location, covenants,

¹⁴Utah State Tax Commission, Rules, R884-24P-62, Valuation of State Assessed Unitary Properties Pursuant to Utah Code Ann., Section 59-2-201.

proximity to raw materials or markets, or the condition of surrounding property. It also does not include the enhancement value specifically attributable to the interrelation of tangible property working as a unit.

The administrative rules for valuing centrally assessed property are contained in R884-24P-62. Valuation of State Assessed Unitary Properties Pursuant to 59-2-201, UCA.

The purpose of the rule is to:

- specify consistent mass appraisal methodologies to be used by the Property Tax Division (Division) in the valuation of tangible property assessable by the Commission; and
- identify preferred valuation methodologies to be considered by any party making an appraisal of an individual unitary property.

The rules provide that unitary properties are assessed at fair market value based on generally accepted appraisal theory as provided by rule. The rules specify "the assemblage or enhanced value attributable to the tangible property should be included in the assessed value. See *Beaver County v. WilTel, Inc.*, 995 P.2d 602 (Utah 2000). The value attributable to intangible property must, when possible, be identified and removed from value when using any valuation method and before that value is used in the reconciliation process."

The rules state that the preferred methods of valuation are the cost approach and a yield capitalization indicator.

Other generally accepted appraisal methods may also be used when it can be demonstrated that the methods are necessary to more accurately estimate fair market value. However, the rules state that direct capitalization and the stock and debt method typically capture the value of intangible property at higher levels than other methods. To the extent intangible property cannot be identified and removed, relatively less weight is given to these methods in the reconciliation process.

The rules describe the various appraisal methods, including the various cost, income, and market indicators to valuation.

In the reconciliation process, the appraiser takes into account the availability, quantity, and quality of data, as well as the strength and weakness of each value indicator. Weighting percentages used to correlate the value approaches generally vary by industry, and may vary by company if evidence exists to support a different weighting. The Property Assessment Division is required to disclose in writing the weighting percentages used in the reconciliation for the final assessment. It must explain in writing any departure from the prior year's weighting.

The rules also provide for "property specific considerations". For example, the historical cost less depreciation is the preferred method of valuing rate regulated utilities because it represents

an approximation of the basis upon which the investor can earn a return. On the other hand, the rules state that the cost indicator should be given little or no weight for railroads because there is no observable relationship between cost and fair market value.

Third Time a Charm

In 1995, the Property Tax Division of the Utah State Tax Commission centrally assessed the property of Wiltel, Inc., a provider of long-distance telecommunications services. The division assessed Wiltel's Utah taxable property at \$39.6 million based on a nationwide correlated system value of \$1.45 billion¹⁵ and an allocation factor of 2.83%.¹⁶

Wiltel appealed the assessment to the commission, asserting that it was indistinguishable from locally assessed resellers of telecommunications services and should be locally assessed using the cost approach employed for locally assessed property. It also asserted that the assessment included nontaxable intangibles.

Beaver County and other Utah counties challenged the State Tax Commission's determination that intangible property, intangible value, and intangibles are synonymous for tax purposes under 59-2-1101(2)(g) (now 59-2-1101(3)(a)(vii)), which exempts intangible property from taxation.

At the time Wiltel was centrally assessed, 59-2-102(19), UCA, provided that "property":

means property which is subject to assessment and taxation according to its value, but does not include moneys, credits, bonds, stocks, representative property, franchises, goodwill, copyrights, patents or other intangibles.

The counties also objected to the Property Tax Division's correlated unit value and submitted its own appraisal to the State Tax Commission, estimating that Wiltel's system value was \$2.34 billion.¹⁷

The division argued that Wiltel had failed to establish that locally assessed resellers of telecommunications services were similarly situated to Wiltel, that the cost approach would undervalue Wiltel's property, and that the cost approach would discriminate against other centrally assessed taxpayers.¹⁸ It also argued that the intangible exemption is restricted to intangible property and intangible assets that cannot be characterized as property are not tax exempt.

¹⁵In January 1995, LDDS and other companies acquired Wiltel for a stipulated price of \$2.5 billion.

¹⁶Beaver County v. Wiltel, Inc., 995 P.2d 602 (Utah 2000).

¹⁷*Ibid.*, ¶ 6.

¹⁸*Ibid.*, ¶ 4.

The commission ruled that Witel is a centrally assessed company and disagreed with the division that intangible property, intangible assets, and intangible value are distinguishable and determined that, however categorized, intangibles are not taxable under Utah law. It also said that "there is a distinction . . . between intangible property and the inherent features of a particular parcel of real property" and the value ascribed to such features is subject to property tax."¹⁹

The commission directed the parties to identify and quantify the intangibles and remove them from the assessment. The division came back with a Utah allocation of taxable property of \$37.2 million, while Witel's calculation was \$15.7 million, based on a different determination of the system value of intangible property and a lower allocation factor using net book value.²⁰

In its final decision, the commission concluded that "separately valuing intangibles and deducting them for a unit valuation is impractical." The commission found that neither the replacement cost new less depreciation nor the historical cost adjusted for entrepreneurial profit adequately accounted for goodwill or "for the enhanced value of assets in place and operating as a unit."²¹

The commission attempted to resolve the matter of removing the intangibles and capturing the enhanced value of tangible property operating as a unit by using a yield capitalization approach minus any growth factor and a time-adjusted historical cost indicator. The commission discouraged the use of the direct capitalization method and the stock and debt method indicators because of the tendency each has to impound intangibles at higher levels.²²

The commission ultimately directed the parties to submit their valuations using the methods prescribed and weighting each indicator by 50%. In a third round of valuation, the commission ruled in favor of the division's determination of value of Witel's Utah property at \$30.6 million, based on a system value of \$1.08 billion and an allocation factor of 2.83%.²³

On appeal to the Utah Supreme Court, Witel sought review of the Utah State Tax Commission decision subjecting WilTel's property to central assessment on a unitary basis (asserting a right to equal protection under the U.S. Constitution and uniform operation of law under the Utah Constitution); employing cost and yield capitalization to value its tangible property; and using gross book value rather than net book value to apportion Witel's taxable property in Utah.

¹⁹*Ibid.*, ¶ 6.

²⁰*Ibid.*, ¶ 7.

²¹*Ibid.*, ¶ 9.

²²*Ibid.*, ¶ 10.

²³*Ibid.*, ¶ 12.

The Property Assessment Division and the counties sought review of the commission's ruling that intangible property includes nonproperty intangible assets.

The Utah Supreme Court reaffirmed "that central assessment by the unitary method bears a constitutionally sufficient rational relationship to the legitimate state purpose of assuring that each property is 'accountable for its pro rata share of the burden of local government.'"²⁴

The Court also ruled that Wiltel was an asset-based carrier and was not singled out and taxed inconsistently with other asset-based carriers (such as AT&T, MCI, or Sprint).²⁵

The Court affirmed the Utah State Tax Commission's ruling that all intangibles are tax exempt, based on the definition of property,²⁶ including the vague phrase "other intangibles". It also concluded that "the statutory and constitutional fair market value requirements recognize some element of value that is not attributable to either intangibles or simple cost and that this enhanced value is taxable."²⁷

Finally, the Court upheld the commission's valuation methods, after noting that "[i]t was only after the parties proved the impracticality of determining and deducting the value of intangibles, category by category, the commission stepped in with the cost/yield capitalization method."²⁸ It also upheld the Property Tax Division's allocation factor using gross book value, based on testimony that "the Division's method is used by most appraisers in most states."²⁹

Utah Legislature Revises Definition of Property

In the 1998 General Session, the Utah Legislature revised the definition of property under 59-2-102 (House Bill No. 370):

(28)(a) "Property" means property that is subject to assessment and taxation according to its value.

(b) "Property" does not include intangible property as defined in this section.

The legislation removed the description of intangible property and eliminated the phrase "or other intangibles" (see former definition of property, p. 13). The legislation also provided a

²⁴*Ibid.*, ¶ 22.

²⁵*Ibid.*, ¶ 26.

²⁶*Ibid.*, ¶ 29.

²⁷*Ibid.*, ¶ 40.

²⁸*Ibid.*, ¶ 44.

²⁹*Ibid.*, ¶ 48.

separate definition of intangible property described above (p. 11). In 2006, the Legislature added "goodwill" to the definition of intangible property (2006 Utah Laws 249).

SUMMARY

The survey of the five states shows a variety of methods in valuing centrally assessed property, with methods sometimes varying by type of property.

Arizona and New Mexico have established different statutory procedures for valuing property operating as a unit within the state.

Arizona uses a cost approach for valuing the property of electric and gas utilities located within the state and a separate cost approach for valuing electric generation facilities. The valuation of generation property depends on whether the generation property is new or "vintage".

On the other hand, railroad property and pipeline property are valued as a unit using a base period amount adjusted by value change factors. Montana has a similar method for valuing railroads.

Telecommunications property and airlines are valued on a unitary basis using the cost approach. Real property of telecommunications companies is valued at market value.

New Mexico also has specific statutory provisions for valuing unitary property. The cost approach is used for pipeline property and electric utilities. Telecommunications property, at the election of the taxpayer, may be valued at cost, less depreciation, or by the unitary method. Railroad property is valued on a unitary basis.

Idaho, Oregon, and Utah use the unit value method for valuing property operating in more than one county of the state or in more than one state. Idaho rules prohibit the Idaho State Tax Commission from using direct capitalization of income, while the rules in Utah discourage direct capitalization of income and the stock and debt approach because these methods "typically capture intangible property at higher levels than other methods." Utah rules also provide that the "assemblage or enhanced value attributable to the tangible property should be included in the assessed value."

Idaho and Utah exempt intangible personal property from taxation. Oregon also exempts intangible personal property except for intangible personal property of a taxpayer subject to unit valuation.

Each state surveyed expresses in one form or another that standard appraisal methods or appraisal methods accepted by nationally recognized appraisal and valuation organizations (without specific reference) will be used in valuing property. Oregon (as has Montana) has adopted the WSATA handbook as the official valuation guide.

Given the disparate valuation methods used in each of the states surveyed, it is difficult to ascertain whether one state's uniform standards are the same as another state's standards.

PANEL DISCUSSION

If the Revenue and Transportation Interim Committee decides to proceed with a panel discussion, some of the questions it may want to consider asking may include:

- How do state appraisers identify the unit to be valued?
- What are the advantages and disadvantages of each method for a particular indicator of value (e.g., direct capitalization of income versus yield capitalization of income)?
- What are the approaches used to account for exempt intangible personal property and does one approach or another tend to be better than others?
- What steps are involved in correlating values from different indicators of value?
- Are there common appraisal practices used by states and how do they vary by statutory provisions?
- What are the trends in valuation disputes and do they tend to be resolved in favor of the taxpayer or the state?

Committee members would have to evaluate the information in the context of Montana's constitutional and statutory framework.

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