



51st Annual  
WICHITA PROPERTY TAX  
CONFERENCE

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# Legal Update

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# TAX RATE CASES



## County of Santa Clara v. Superior Court

87 Cal. App. 5th 347 (2023 – California Court of Appeal)

**Procedural Posture:** County appealed Superior Court’s denial of its demurrer. Court of Appeal reversed and issued peremptory writ of mandate directing Superior Court to vacate its ruling and sustain the demurrer without leave to amend. California Supreme Court later denied taxpayers’ petition for review.

### **Issue:**

Does applying a higher debt service tax rate on privately-owned, centrally assessed utilities than on locally-assessed properties violate Art. XIII, Sec. 19 of the California Constitution, which requires centrally assessed property to “be subject to taxation to the same extent and in the same manner as other property?”



# County of Santa Clara v. Superior Court

87 Cal. App. 5th 347 (2023 – California Court of Appeal)

## Facts:

1. Telecommunications taxpayers in this case make similar claims to those made by the railroads in *BNSF Railway Company v. County of Alameda*, 7 F.4th 875 (9th Cir. 2021) (a win for railroads under the 4-R Act) but do not get the same outcome.
2. A group of privately owned public utilities sued the County of Santa Clara alleging that the higher tax rates imposed on utility property as compared to non-utility property violated Art. XIII, Sec. 19 of the California Constitution which requires centrally assessed property to “be subject to taxation to the same extent and in the same manner as other property.”
3. The rate differential is due to the calculation of the debt service component.
  - Centrally assessed property’s debt service component “is based on the change in absolute dollars of the county’s debt service rate, not changes in the percentage that other taxpayers are paying.” Cal. R&TC § 100(b).
  - Locally assessed property’s debt service component is “the amount needed as a percentage of property values to produce enough revenue to make payments for the interest and principal on all voter-approved bonded indebtedness issued by any of the various local entities in the tax rate area to which the property is assigned.” Cal. R&TC § 93.
1. For tax years 2014-15 and 2015-16, the debt-service component tax rate for utility property was 1.04% and 1.09% respectively, while the rate for other property was 0.202%.

County	2019-20 BNSF Unitary Rate	2019-20 Ave. Countywide Rate
Alameda	2.5187%	1.241%
Contra Costa	1.6865%	1.148%
Fresno	1.370408%	1.181%
Kern	1.611299%	1.24%
Kings	1.326084%	1.087%
Madera	1.203169%	1.089%
Merced	1.4109014%	1.088%
Orange	1.28173%	1.064%
Plumas	1.11652%	1.089%
Riverside	1.76133%	1.164%
San Bernardino	1.3645%	1.144%
San Diego	1.62331%	1.142%
San Joaquin	1.6922%	1.145%
Stanislaus	1.38011%	1.103%
Tulare	1.4002%	1.113%



## County of Santa Clara v. Superior Court (cont' d)

87 Cal. App. 5th 347 (2023 – California Court of Appeal)

### Holding:

1. The Court held that the California Supreme Court's previous interpretation of Art. XIII, Sec. 19 in *ITT World* was dicta.
  - In *ITT World*, the California Supreme Court held: "By requiring that public utility property be 'subject to taxation to the same extent and in the same manner as other property,' article XIII, section 19 does not impose a requirement of equal valuation between public utility and other property, but simply specifies that public utility property, after it has been placed on the local tax rolls, be levied on at the same *rate* as locally assessed property." *ITT World Commc'ns, Inc. v. City and Cnty. of San Francisco*, 37 Cal.3d 859 (1985).
2. The Court's analyzed the legislative history of Art. XIII, Sec. 19 and concluded that its purpose was to authorize, not limit, property tax on utility properties.
  - "To the same extent as" means "after such utility property is assessed by the SBOE, it shall be subject to ad valorem taxation at its full market value, rather than via the previous method of gross receipts in-lieu taxation that failed to capture its full value adequately and contributed to the local tax burden."
  - "In the same manner" means "after the utility property is assessed by the SBOE, it shall be subject to taxation by local jurisdictions just as other property is, rather than by the state, as it had been previously."
3. Property tax rates applied to utility property may differ from non-utility property without violating the California Constitution.



# Idaho Power Co. v. Idaho State Tax Comm' n, (2023 - Idaho Supreme Court)





## Idaho Power Co. v. Idaho State Tax Comm' n, (2023 – Idaho Supreme Court)

**Procedural Posture:** Remanded to Idaho District Court.

**Issues:**

1. Is the State Board of Equalization required to equalize the assessments of centrally assessed property with the assessment to value ratio associated with either railroad properties or other commercial and industrial properties assessed in the state?



# Idaho Power Co. v. Idaho State Tax Commission, (2023 – Idaho Supreme Court)

Idaho Power Company	
Operating Property	
Assessed at	100%
4-R Adjustment	-
Assmt in relation to Value	100%

Idaho Const. Art. VII, Sec. 5 states  
"[a]ll taxes shall be uniform upon the  
same class of subjects."

4-R Claim	
Railroad Companies	
Operating Property	
Assessed as	100%
4-R Adjustment	-12%
Assmt in relation to Value	88%

Alternate Claim - State Const.	
Other Commercial Entities	
Real and Personal Property	
Assessed as	88%
4-R Adjustment	-
Assmt in relation to Value	88%





## Idaho Power Co. v. Idaho State Tax Comm' n, (2023 – Idaho Supreme Court)

“However, the broader question presented by this case is whether the federal act also preempts the Commission from following Idaho’s constitutional requirement to tax the Companies uniformly compared to the railroads. We conclude no such broad preemption exists.”

*Idaho Power Co., v. Idaho State Tax Comm’n*, p. 7, Case No. 49126 (May 17, 2023).



# INTANGIBLE CASES



# Petrogas Pacific LLC v. Xczar, (2022 – Washington Court of Appeals)





## Petrogas Pacific LLC v. Xczar, (2022 – Washington Court of Appeals)

**Procedural Posture:** Final - Washington Supreme Court denied review on July 12, 2023.

### **Issues:**

1. Can intangible characteristics of the subject properties be considered in valuation assessments?
2. Can a land lease be considered in determining the value of the subject properties?



## Petrogas Pacific LLC v. Xczar, (2022 – Washington Court of Appeals)

- Purchased Liquefied Petroleum Gas (LPG) Terminal in 2014
- Purchased adjacent Warf in 2016
- **Intangible characteristics** - (The Terminal and Warf are close to Asian markets. There are few LPG facilities on the West Coast. The Terminal and Warf would be used in concert with other Petrogas assets.)
- **Lease** – (The Warf is built on aquatic lands and subject to aquatic lease to only allow 48 ships to dock annually.)



## Petrogas Pacific LLC v. Xczar, (2022 – Washington Court of Appeals)

1. **Can intangible characteristics of the subject properties be considered in valuation assessments? [Yes]**
2. **Can a land lease be considered in determining the value of the subject properties? [Yes]**
  - Intangible Property is exempt from property taxation – RCW 84.36.070(1).
  - **Intangible characteristics** – are not considered to be intangible property. RCW 84.36.070(3) provides that intangible property does not include characteristics such as zoning, location, view, geographic features, easements, covenants, proximity to markets, etc.
  - **Lease** – WAC 458-50-160(4)(b) provides that other factors that contribute to value include grants of licenses, permits and franchises by a government agency that affect the use of the property. The Court concluded that the lease affected the highest and best use of the Warf and thus should be considered.



## Olympic & Georgia Partners, LLC v. County of Los Angeles

90 Cal. App. 5th 100 (2023 – California Court of Appeal)

**Procedural Posture:** Taxpayer wins on all issues at appellate level, reducing assessment by \$150M. Review subsequently granted by CA Supreme Court.

**Issue:** In a hotel assessment, are a “subsidy”, “discount”, and enterprise assets considered non-taxable intangible assets?

### **Facts:**

Owner of hotel near Los Angeles’ downtown convention center challenged inclusion of certain intangibles in the hotel’s assessed value—

1. “Subsidy” valued at \$80M.
2. “Discount” or “key money” valued at \$36M.
3. Hotel enterprise assets valued at \$34M.



# Olympic & Georgia Partners, LLC v. County of Los Angeles (cont'd)

90 Cal. App. 5th 100 (2023 – California Court of Appeal)

## Holding:

The “Subsidy” is a non-taxable intangible asset.

- **Intangible Asset**. As a development incentive for building a hotel near the convention center, the City of Los Angeles agreed to rebate to the owner the entire transient occupancy tax (TOT) that the City’s collected from the hotel’s guests for 25 years (the “Subsidy”).
- **AAB**. Refused to deduct the value of the Subsidy from the assessment because it was an intangible asset “that runs with the land and is associated with ownership of the property.”
- **Trial Court**. Upheld AAB.
- **Court of Appeal Majority**. Reversed, holding that the \$80M Subsidy is a non-assessable intangible.
  - Relied on *Elk Hills Power, LLC v. Board of Equalization*, 57 Cal.4th 593 (2013), finding that the Subsidy is an intangible asset, capable of being valued and needed to foster development of hotel.
- **Court of Appeal Dissent**. The subsidy is taxable because it is directly tied to use of hotel rooms.
  - Distinguished *Elk Hills*, claiming it is not applicable to intangibles tied to use of the realty.
  - The Subsidy is equivalent to room revenue.





# Olympic & Georgia Partners, LLC v. County of Los Angeles (cont'd)

90 Cal. App. 5th 100 (2023 – California Court of Appeal)

## Holding:

Discount or “key money” is a non-taxable intangible asset.

- **Intangible Asset**. Upfront payment made by Marriott & Ritz-Carlton to “win” 50-year management contract (the “Discount”).
- **AAB**. Includable in assessed value as this payment was for the right to operate hotel.
- **Trial Court**. Upheld AAB.
- **Court of Appeal Majority**. Reversed, holding that \$36M discount was an intangible that must be deducted from the assessment.
  - Payment was not income to Olympic but a discount/cash rebate on the management contract.
- **Court of Appeal Dissent**. Discount is assessable as it is income generated by the real property.
  - Payment was for managers’ use of the property, which is akin to prepaid rent to operate hotel.



# Olympic & Georgia Partners, LLC v. County of Los Angeles (cont'd)

90 Cal. App. 5th 100 (2023 – California Court of Appeal)

## Holding:

Hotel enterprise assets are non-taxable intangible assets.

- **Intangible Asset**. Income derived from flag & franchise, food & beverage, and assembled workforce.
- **AAB**. No deduction for income attributable to fees for flag, franchise or assembled workforce as these are intangibles attributable to management company not to the hotel business.
- **Trial Court**. Reversed the AAB, holding that these are enterprise assets part of hotel business and must be deducted from the hotel assessment. Remanded to the AAB to determine and deduct such value.
- **Court of Appeal**. Upheld the trial court, rejecting the Rushmore method (*i.e.*, removal of the owner's franchise fee payment to the hotel operator removes all value of the franchise affiliation and the associated workforce).
  - Franchise fees paid for management contract do not account for hotel's enterprise intangibles.
  - "This argument is incorrect. If a franchise fee were so high as to account completely for all intangible benefits to a hotel owner, the owner would have no reason to agree to the franchise deal...[there] is no empirical support for the illogical premise that every franchise fee wipes out all intangible benefits a franchise agreement might offer to a hotel owner."
- **Court of Appeal Dissent**. None.



## Kingfisher Wind, LLC v. Wehmuller

521 p.3d 786 (2022 – Oklahoma Supreme Court)

**Procedural Posture:** Taxpayer appealed assessments to district court. Case proceeded to a bench trial, and district court ruled in favor of the taxpayer. Counties appealed. This is an issue of first impression for the Oklahoma Supreme Court.

**Issue:** Are Production Tax Credits (PTCs) exempt intangible personal property for ad valorem tax purposes in Oklahoma?

**Facts:**

1. Kingfisher Wind owns a wind farm partially in Canadian County and partially in Kingfisher County.
2. Kingfisher Wind appealed their 2016 assessments to the respective County Board of Equalization, who both upheld the respective Assessor's increases in the assessed values, creating a combined assessed value of \$458M. Kingfisher appealed, arguing the assessments illegally included the value of their PTCs and that without the PTCs, the value of the property was only \$169M. The trial court agreed, and the Assessors appealed.



## Kingfisher Wind, LLC v. Wehmuller (cont' d)

521 p.3d 786 (2022 – Oklahoma Supreme Court)

### Holding:

1. Intangible personal property is not subject to ad valorem tax under the Oklahoma Constitution.
  - Oklahoma Constitution, art. 10 § 6A provides: “Beginning January 1, 2013, intangible personal property shall not be subject to ad valorem tax or any other tax in lieu of ad valorem tax within this State.”
2. Neither the constitution nor the Ad Valorem Tax Code defines “intangible personal property”, “intangible property”, or “tangible property.”
  - The Court adopted the definitions set forth in *Global Life and Accident Ins. Co. v. Okla. Tax Com’n* (a use tax case)—
    - “‘Tangible personal property’ refers to rights in tangible things of the world over which possession may be taken.”
    - “‘Intangible personal property’ encompasses property rights which – though represented by tangible objects (e.g., stock certificates, bonds and notes) – are essentially incorporeal in that they have limited intrinsic value and ultimately can only be claimed or enforced by a legal action.”
3. PTCs are not tangible physical things; they are “incorporeal” with “limited intrinsic value” and “ultimately can only be claimed or enforced by legal action.”
4. Although they have both tangible and intangible aspects, may be “intrinsically tied to”/ “intertwined with” a business or real estate, enhance the value of the real property and have a direct impact on the fair market value of the real property, have value for IRS tax purposes, PTCs are intangible personal property, and thus, are not subject to property tax under current Oklahoma law.



## Mesquite Power, LLC v. Arizona Dept. of Revenue

523 P.3d 960 (2022 – Arizona Court of Appeals)

**Procedural Posture:** Department appealed from tax court’s judgment reducing the assessed value of the power plant to taxpayer’s \$105M opinion of value. Court of Appeals vacated tax court’s judgment and remanded it to the tax court to affirm the \$196M “statutory value” found by the Department.

**Issue:** Does the existence of a power purchase agreement (PPA) enhance the assessable value of the real and tangible personal property?



## Mesquite Power, LLC v. Arizona Dept. of Revenue (cont' d)

523 P.3d 960 (2022 – Arizona Court of Appeals)

### Facts:

1. The Mesquite power plant (“Mesquite”) is a natural gas-fired electric generation facility built in 2003. It is a “base load plant” in continuous operation that sells power on the open market as a “merchant plant.”
2. Mesquite was sold to Southwest Generation Operating Company (“Southwest”) in 2018 for \$556 million.
  - The sale included a PPA guaranteeing Southwest Public Power Resources Group (“SPPR”) access to 271MW through May 2021 and 475MW through 2046.
  - SPPR is obligated to make fixed annual payments of \$34M/yr. through 2021 and \$48M/yr. thereafter, as well as cover certain operation and maintenance costs.
  - The PPA was a deciding factor in Southwest’s purchase of Mesquite.
  - The PPA does not require power to come from Mesquite; the PPA is severable from Mesquite with SPPR’s approval.
3. In 2019, the Department assessed Mesquite at a “statutory value” of \$196M and presented expert testimony valuing the plant at \$432M.
4. Mesquite subsequently appealed, contending the assessment incorrectly considered the PPA in its valuation. Mesquite’s expert valued the plant at \$105M using a hypothetical cash flow that excluded the PPA and a weighted average cost of capital (WACC) calculation that included a “small company size risk premium” and a “company-specific risk factor”.
  - Without these risk premiums, Mesquite’s expert valuation would have been \$230M (*i.e.*, above the statutory value).



# Mesquite Power, LLC v. Arizona Dept. of Revenue (cont' d)

523 P.3d 960 (2022 – Arizona Court of Appeals)

## Holding:

1. Where intangible assets enhance real and tangible property's value, the appraisal must consider the effect intangible assets have on the taxable property's value.
2. The PPA has no independent value.
  - The PPA does not change the plant or its ability to produce the same electrical capacity.
  - The plant's electricity production generates value no matter how the electricity is sold or how it is purchased. The PPA provides evidence of the fair market value of the electricity generated by the plant.
  - Some contracts have inherent value, for example if bargained-for return is greater than the consideration that would be achieved on the open market, but Mesquite did not prove such favorable terms existed. Rather, Mesquite provided no explanation of the roughly \$450M gap between the \$556M purchase price and their \$102M opinion of value.
3. Notwithstanding the tax court's finding that the PPA is a "non-taxable, intangible asset that is separate and severable from the tangible property," the PPA enhances the value of the taxable property and therefore, should be included in the property tax valuation.
  - A willing buyer would consider the PPA's impact on the plant. Southwest testified that it "would never have bought the Mesquite's business without the [PPA]."
  - Severability of the PPA from plant does not determine whether the PPA enhances the plant's value. "An asset that may be removed from the property does not exempt it from taxation" (e.g., taxes on personal property).
  - In any event, the PPA was not severed from the plant, and tax valuations must be based on property's "current use," not its hypothetical use.
  - The PPA "enhances the value of [the] taxable property because it contributes to the plant's cash flows and current usages."



# VALUATION CASES





## Mesquite Power, LLC v. Arizona Dept. of Revenue (cont' d)

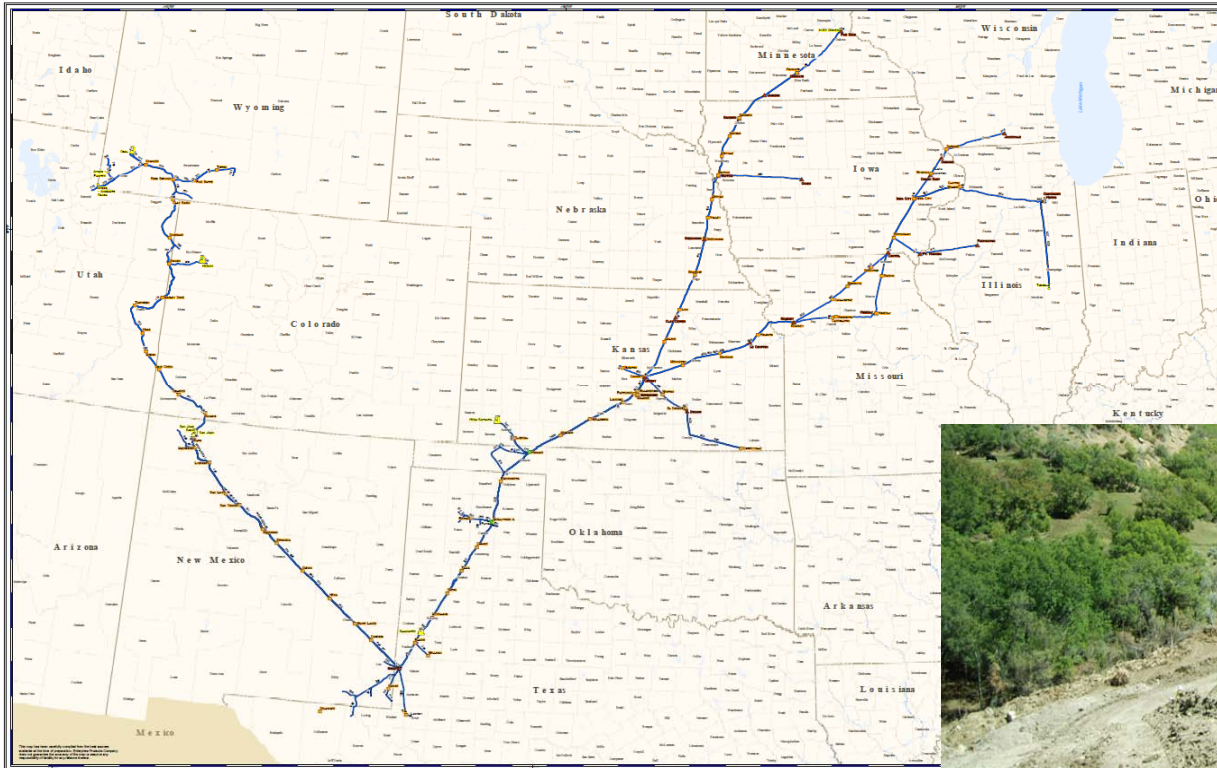
523 P.3d 960 (2022 – Arizona Court of Appeals)

# Holding:

4. A competent valuation approach must appraise the operating unit based on its current usage and must be derived by standard appraisal methods and techniques which are shown to be appropriate under the circumstances.
  - Mesquite constructed a hypothetical income model for the property as if the PPA did not exist. This is improper because it does not reflect the property’s “current usage.”
  - Further, court rejected Mesquite’s WACC, which added a “small company size premium” and a “company-specific risk factor” without presenting specific evidence that either risk premium existed and were not duplicative of one another.
    - These premiums roughly doubled the rate of return on equity.



# Mid America Pipeline Co., LLC v. Utah State Tax Comm'n, (2023 – Utah District Court)





## Mid America Pipeline Co., LLC v. Utah State Tax Commission, (2023 – Utah District Court)

**Procedural Posture:** Final Decision May 25, 2023 – was not appealed by the parties.

### **Issues:**

1. Should take or pay deficiency payments be include in the cash flow to capitalize in an income approach?
2. Should Deferred Income Tax (DIT) amounts be included in the cash flow to capitalized in an income approach?
3. Should a size premium be added to the CAPM Does the Department carry a burden of proof if it recommends a value higher than the original assessment?
4. How should growth be handled in the yield capitalization income approach?
5. What methods should be used when determining a cost of equity?
6. What is the standard for allocation formulas?



## Mid America Pipeline Co., LLC v. Utah State Tax Comm' n, (2023 – Utah District Court)

2. **Should Deferred Income Tax (DIT) amounts be included in the cash flow to capitalized in an income approach? [No]**
- DIT is an accounting entry that recognizes the temporary difference between using MACRS and SL GAAP depreciation accounting.
  - MACRS usually allows more depreciation in early years (less tax) and less depreciation in later years (more tax). Over the life of the asset total depreciation will be the same under either method.
  - For mature public utilities the amount of accelerated depreciation will typically be equally offset by replacement capital expenditures. (Thus, may assume CAPEX = Depreciation + DIT).
  - DIT is not part of rate base for regulated utilities.
  - Is there a present value benefit of the DIT variance in the variable years of a DCF income approach?



## Mid America Pipeline Co., LLC v. Utah State Tax Comm' n, (2023 – Utah District Court)

### 3. Should a size premium be added to the CAPM? **[No]**

- CAPM formula is:  $Ke = rf + b*(rm-rf) + [SP]$

Ke = cost of equity  
rf = risk free rate  
b = beta  
rm-rf = market risk premium  
SP = size premium

- The “Court finds that the company-specific risk is accounted for by the forecasted cash flows, and that any additional company-specific risk should be accounted for by the appropriate beta, or multiplier applied to the market risk calculation.” *Mid America*, ¶182.



## Mid America Pipeline Co., LLC v. Utah State Tax Comm'n, (2023 – Utah District Court)

### 4. How should growth be handled in the yield capitalization income approach?

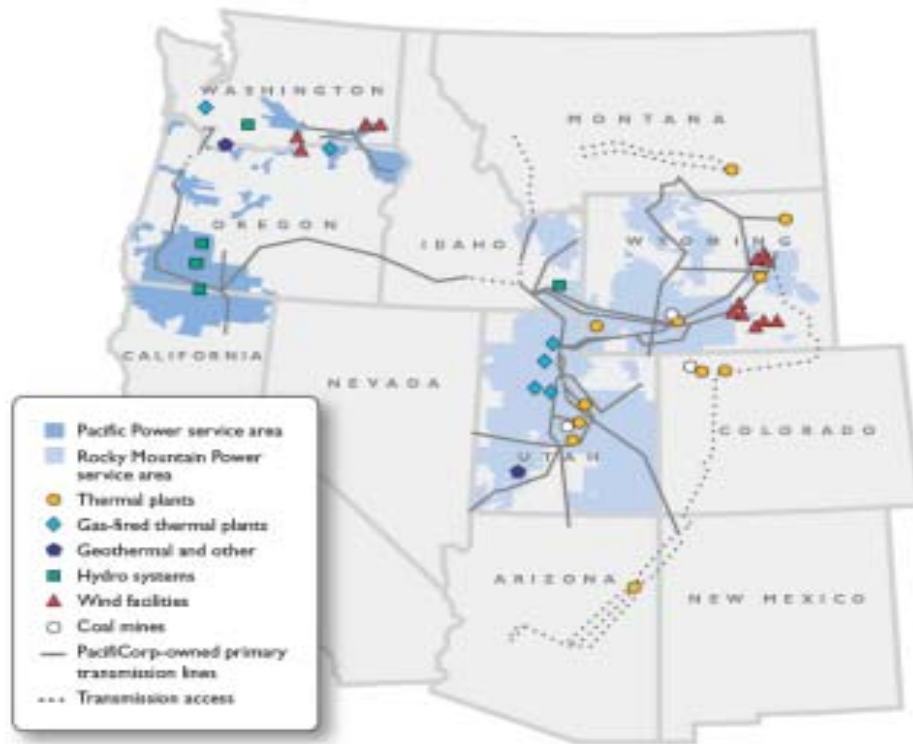
- Yield Capitalization formula is:  $Value = CF/k-g$

CF = cash flow  
k = capitalization rate  
g = growth

- Assumptions in the numerator (CF) and denominator (g) must match.
- Assumption to only value assets in existence – appraisers usually then assume that capital expenditures are equal to depreciation.
- The “Court is convinced that it is erroneous to assume that cash flow can grow forever with net investment in plant remaining flat.” *Mid America*, ¶229.



# PacifiCorp v. Department of Revenue, (2023 – Oregon Tax Court)





## PacifiCorp v. Department of Revenue, (2023 – Oregon Tax Court)

**Procedural Posture:** Final Opinion issued July 17, 2023.

### **Issues:**

1. Does the WSATA Handbook adopted by the Department as its administrative valuation rule govern the valuation methods that must be used for centrally assessed properties?
2. Does the Department carry a burden of proof if it recommends a value higher than the original assessment?
3. Should obsolescence be considered when using an HCLD cost approach for a regulated utility?
4. How should growth be handled in the yield capitalization income approach?
5. What methods should be used when determining a cost of equity?
6. What is the standard for allocation formulas?





# OTHER



## California' s ACA 11

(Assembly Constitutional Amendment 11)

**Current Status:** Awaiting hearing by state Assembly Rev. & Tax Committee and Assembly Elections Committee.

### Issues:

1. Constitutional amendment proposes to abolish the State Board of Equalization (BOE) and reassign its responsibilities to other state tax agencies effective January 1, 2027.
2. The BOE is a constitutionally established elected body that has existed for 140 years. Its duties include:
  - a. Annually assessing state-assessed properties.
  - b. Hearing assessment appeals on state-assessed properties.
  - c. Promulgating rules, regulations, and other guidance to govern the state-wide property tax system.
3. Under ACA 11, the BOE's responsibilities related to "assessment and collection of taxes" would transfer to the California Department of Tax and Fee Administration (CDTFA) and responsibilities related to "review, equalization, or adjustment of taxes" would transfer to the Office of Tax Appeals (OTA).
4. Both the CDTFA and the OTA are controlled by political appointees.
5. Transfer of duties could reduce transparency, accountability, and fairness in California's property tax system.