

# Cal-Tax Digest

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## Guest Commentary



### Property Taxes and Intangibles: Where We Are Now

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The treatment of intangibles in the property taxation arena has always been troublesome, primarily because of the difficulty with the manner of segregating intangible assets and rights from tangible taxable property. This difficulty, with which taxpayers and assessors alike have struggled for many years, is embodied in the California Supreme Court's 1948 decision in *Roehm v. County of Orange* which held that intangible assets and rights be "reflected" in the assessment of property.

For many years, the meaning of the term "reflected" in *Roehm* plagued property taxpayers, preventing them from excluding non-taxable intangibles from the real property. However, over the past decade, the logjam created by *Roehm* was finally broken. During that time, nearly a dozen appellate court decisions were issued, legislation was promulgated, and State Board of Equalization publications came out explaining the term "reflected" and, more importantly, establishing specific standards for the proper handling of various intangible assets and rights in the property tax context.

The California Court of Appeal was the first to address the issue directly. In the 1993 case of *GTE Sprint Communications Corp. v. County of Alameda*, the First District of the Court of Appeal, while acknowledging that intangibles be "reflected" in assessing properties, nevertheless held that intangible assets that were identified by a property taxpayer had to be valued and removed by the taxing agency if a going concern valuation method (income approach) was used to value the property.

Almost simultaneously, the Fourth District Court of Appeal issued two decisions describing how to segregate intangible assets and rights from the value of taxable property. First, in *County of Orange v. Orange County Assessment Appeals*

*Board* the appellate court held that using a cost approach method was a valid means for directly determining the value of the tangible taxable property alone. Then, in *Service America Corp. v. County of San Diego*, the fourth appellate district held that that portion of income attributable to intangible assets and rights had to be excluded, and that only income generated by real property be used to determine assessed value when an income approach method was used to value the property.

Finally, the Third District Court of Appeal in *Shubat v. Sutter County Assessment Appeals Board*, following the lead of *GTE Sprint*, ruled that it was appropriate to deduct the appraised value of specifically identified intangible assets and rights from the value of a going business concern in order to arrive at the assessed value of the remaining tangible taxable property.

Relying upon these appellate court precedents, the California Legislature took up the issue of property taxes and intangibles, passing what became known as the “Maddy Bill” in 1995. Codified as Revenue and Taxation Code sections 110(c) through (f) and 212(c), these legislative provisions put many of the issues resolved by the 1993 appellate court decisions into statutory form. Unfortunately, the statutes created some confusion by including a provision carried over from *Roehm*, namely that the presence of intangibles be assumed in order to put property to beneficial and productive use.

Fortunately, in 1998 the State Board of Equalization promulgated Assessor’s Handbook Section 502 entitled “Advanced Appraisal.” A portion of Chapter 6 in that handbook described in great detail the correct manner for handling intangible assets and rights. Most importantly, the “Advanced Appraisal” manual spelled out, at page 152, the requirement that value associated with intangibles be excluded from a property’s assessed value:

“[Revenue and Taxation Code] sections 110(e) and 212(c) do **not** authorize adding an increment to the value of taxable property to reflect the value of intangible assets and rights necessary to put the taxable property to beneficial or productive use. Instead, those sections indicate that, in valuing taxable property, it is appropriate to assume the presence of the intangible assets and rights which are necessary to put taxable property to beneficial or productive use. For example, a business which owns taxable property may need working capital and other intangible assets in order to productively use its tangible property. Although the presence of the intangible assets is assumed in the valuation of the tangible property, this does **not** mean that their values are included in that valuation.” (Emphasis added)

This requirement was confirmed in the most recent Court of Appeal decision on intangibles, *Mola Development Corp. v. County of Orange*, which was issued by the Fourth District in 2000, where the appellate court stated:

“For purposes of its value to California law, the *Sweepster* opinion is faulty mainly in this regard: it *included* the value of a clear intangible in the value of the real property .... The correct

approach is actually the opposite, given our Constitution's mandate to value just the property. \* \* \* But that is the result of the fact that we are only dealing with real property tax valuations. If you buy real property plus an intangible, you are only taxed on the value of the property."

It is also noteworthy that the 12<sup>th</sup> Edition of the Appraisal Institute's leading treatise on property valuation, *The Appraisal of Real Estate*, published in 2001, also now counsels appraisers to segregate from real estate value all value associated with intangible assets and rights.

The groundwork by the Court of Appeal, Legislature and State Board of Equalization appears to have taken hold. For example, a Letter to Assessors setting forth "Guidelines for the Assessment of Billboard Properties," issued by the State Board of Equalization in December 2002 (LTA No. 2002/078), requires the exclusion of intangible asset value from the value of taxable billboard properties. LTA No. 2002/078 also states that the cost approach is the preferred method for determining assessed value because, as explained in State Board of Equalization's "Advanced Appraisal" manual, the cost method does not capture the value of intangible assets and rights.

The proper treatment of intangible assets and rights by taxing authorities in recent years is a bright spot for property taxpayers. However, more work remains to be done. For example, the few appellate court decisions which appear to condone assessment of intangibles need to be distinguished and further explained. Those efforts, as well as efforts to protect the gains taxpayers have made in the past decade, must continue as part of the ongoing effort to "level the playing field" for California taxpayers.