

[Assembly Bill 1157](#) (Nazarian)

Date: February 25, 2015 (Introduced)

Program: Property Tax

Sponsor: [California Assessors' Association](#) (CAA)

RTC Sections 401.17, 441, and 1153.5

Effective January 1, 2016

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**Summary:** Extends for five years property tax law provisions related to commercial air carriers<sup>1</sup> that detail certificated aircraft<sup>2</sup> assessment methodology and allow centralized administrative procedures at the local level using a "lead county" system.

**Purpose:** To extend aircraft valuation methodology provisions and streamlined administrative procedures for counties and airlines that will otherwise sunset.

**Fiscal Impact Summary:** The revenue consequence of extending the sunset date versus allowing these laws to expire is unknown.

**Existing Law:** The law permits assessors and commercial air carriers to use a streamlined administrative procedure. In addition, the law details the assessment methodology to value certificated aircraft. These provisions are as follows.

**Centralized System - One Return/One Audit.**<sup>3</sup> The law allows commercial air carriers operating in multiple airport locations in California to file a single consolidated property statement (tax return) with a designated "lead" county. The law outlines the lead county selection process for each air carrier. The selected county notifies the air carrier it will serve as the lead county,<sup>4</sup> and each air carrier files its annual tax return with that lead county. The tax return details necessary information about the air carrier's property holdings (both certificated aircraft and other business personal property and fixtures)<sup>5</sup> that are subject to property tax in California. The lead county transmits return information related to non-aircraft personal property and fixtures to other relevant counties where the air carrier operates. The law requires an audit team directed by the lead county to audit the air carriers. When the statutes sunset on December 31, 2015, air carriers must file returns with each individual county. In addition, each county will be required to audit the air carrier, if the air carrier's assessment qualifies as a mandatory audit in that county.

**Lead County Calculates Fleet Value.**<sup>6</sup> The lead county calculates the total unallocated fleet value of the air carrier's certificated aircraft for each make, model, and series as the law specifies.<sup>7</sup> The lead county transmits the calculated fleet value to the other counties. To assess the aircraft, each county determines its allocated portion of the calculated fleet value based on the flight data for its particular county. The allocation process limits each county's assessment to reflect the aircraft's physical presence in that county. The law repeals these provisions on December 31, 2015.

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<sup>1</sup> Commercial air carriers include both passenger airlines and freight delivery services.

<sup>2</sup> Certificated aircraft includes certificated aircraft per Revenue and Taxation Code (RTC) [Section 1150](#) and scheduled air taxi operators per RTC [Section 1154](#) (a) and (b).

<sup>3</sup> RTC [Section 441\(m\)](#).

<sup>4</sup> RTC [Section 1153.5](#).

<sup>5</sup> Business personal property subject to property tax includes items such as unlicensed surface vehicles, ground and cargo handling equipment, ramp equipment, machinery and other equipment, spare parts, rotables, computers, furniture, fuel and other supplies.

<sup>6</sup> RTC [Section 1153.5](#).

<sup>7</sup> RTC [Section 401.17](#).

**Fleet Valuation Methodology.**<sup>8</sup> The law provides that preallocated fair market value will be the lesser of:

- A historical cost less depreciation basis with no individual aircraft value exceeding the original price paid, or
- Wholesale prices listed in the [Airliner Price Guide](#), a commercially published value guide, less 10%.<sup>9</sup>

The resulting value is rebuttably presumed to be correct. After the 2015-16 fiscal year, these provisions are no longer effective. Assessors will assess aircraft at the general "fair market value" property tax definition using any valid approach to value.<sup>10</sup>

**Proposed Law:** This bill extends the current commercial air carrier administrative procedure and the aircraft valuation methodology provision to the 2021-22 fiscal year and extends the repeal date to December 31, 2021.

**In General: Business Personal Property.** Personal property used in a trade or business is generally taxable. The law requires property owners to annually report their cost on a business property statement.<sup>11</sup> Proposition 13's valuation limitations do not apply to business personal property. Instead, the law requires the assessor to redetermine value each lien date (January 1) at the property's current fair market value. Mass appraisal techniques generally are necessary given the enormity of this task.

The assessor generally determines the fair market value of most business personal property and fixtures using the property's acquisition cost. The assessor multiplies acquisition cost by a price index (an inflation trending factor based on acquisition year) to estimate reproduction cost new. Next, the assessor multiplies reproduction cost new by a percent good factor (from BOE-issued<sup>12</sup> percent good tables) to estimate depreciated reproduction cost (reproduction cost new less depreciation). The assessor uses the reproduction cost new less depreciation value as the property's taxable value for the fiscal year. The tax rate applied to the value is the same as the rate on real property, which is 1% plus voter approved indebtedness in the locality. The BOE's [Assessors' Handbook Section 504 Assessment of Personal Property](#) provides more detailed guidance.

**Certificated Aircraft.** Certificated aircraft is subject to property taxation when in revenue service in California. Generally, certificated aircraft are commercial aircraft operated by air carriers for passenger or freight service. Certificated aircraft are valued under a "fleet" concept. This means that the assessed value is not the value of any single aircraft owned by an air carrier, but rather the value of *all* aircraft of each type that is flown into the state. Aircraft regularly fly in and out of California and the various California counties having major airports; typically no single or particular aircraft remains located in the state on a permanent basis. Under the "fleet" concept, aircraft types that have gained situs in California by their entry into revenue service in this state are valued as a fleet with only an allocated portion of the entire fleet's value ultimately taxed to reflect actual presence in California's counties.<sup>13</sup> Under the federal due process and commerce clauses, personal property taxes on these aircraft must be fairly apportioned.

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<sup>8</sup> RTC [Section 401.17](#).

<sup>9</sup> Generally, the "Used Price of Average Aircraft Wholesale" listed guide value less 10% for a fleet discount.

<sup>10</sup> RTC [Section 110](#) defines "fair market value" as the amount of cash ... 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..."

<sup>11</sup> RTC [Section 441](#).

<sup>12</sup> Assessors' Handbook [Section 581 Equipment and Fixtures Index, Percent Good and Valuation Factors](#)

<sup>13</sup> Article 6 (RTC Sections [1150 to 1156](#)) enacted in 1968 after the BOE requested the Legislature determine an apportionment method that would be uniform. Assembly Revenue and Taxation Committee, Volume 4, Number 22, *A Study of Aircraft Assessment in California* (January, 1968).

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**The Fleet Concept - Example.** An individual air carrier, Blue Sky Airlines, operates the following aircraft types in its overall fleet: Boeing 737-300s and 737-500s; Boeing 747-400s; and Boeing 767-200s and 767-300s. Each of these aircraft types (Boeing 737, 747, 767) is considered to be a fleet type. Thus, Blue Sky Airlines may have a fleet of 100 Boeing 737-500s, but only 30 of those aircraft make any contact in Sacramento County during the year. For purposes of property taxation in Sacramento County, the full cash value of all 100 of Blue Sky Airline's Boeing 737-500 aircraft is determined and then the computed allocation ratio is applied to that value.

**Valuation and Allocation.** For fiscal years 2005-06 to 2015-16,<sup>14</sup> the law details the assessor's assessment methodology for determining the market value of commercial air carrier-owned certificated aircraft.<sup>15</sup> The law provides an allocation formula to determine the frequency and the amount of time that an air carrier's aircraft makes contact and maintains situs within a county.<sup>16</sup> A BOE regulation provides further explanation of the allocation procedure.<sup>17</sup> The allocation ratio is made up of two components: a ground and flight time factor, which accounts for 75% of the ratio, and an arrivals-and-departures factor, which accounts for 25% of the ratio. The sum of these two factors yields the allocation ratio, which is applied to the full cash value of a fleet of a particular aircraft type operated by an air carrier and, thus, the assessed value calculation for that aircraft type. The sum of the assessed allocated values for each make and model used by an air carrier results in the total assessed value of the aircraft for that air carrier for a particular county.

**Background: Settlement Agreement.** Prior to January 1, 1999, California law did not provide any specific assessment methodology for valuing certificated aircraft, or for valuing the carrier's taxable possessory interest in the publicly owned airport in which they operated. In 1997-98, a group of counties and air carrier industry representatives met to resolve property tax issues on air carrier-owned and used property. The end result was a written settlement agreement to dispose of outstanding litigation and appeals over the valuation of airport possessory interest assessments and certificated aircraft. The Legislature codified the settlement agreement in a three-piece package:

**Aircraft Valuation Methodology and Monetary Settlement.** [AB 1807](#) (Stats. 1998, Ch. 86; Takasugi) outlined the valuation procedures<sup>18</sup> for certificated aircraft for a six year period, and included the settlement agreement's \$50 million tax credit provisions on future tax liabilities,<sup>19</sup> as well as extensive uncodified legislative findings and declarations.

**Airport Possessory Interests.** [AB 2318](#) (Stats. 1998, Ch. 85; Knox) specified the assessment methodology for valuing the air carrier's taxable possessory interest in publicly owned airports.<sup>20</sup>

**Tax Credits.** [SB 30](#) (Stats. 1998, Ch. 87; Kopp) added general purpose provisions to allow counties and taxpayers to enter into written settlement agreements granting taxpayers tax credits.<sup>21</sup>

**Centralized System and Valuation Refinements.** Beginning in 2006, [AB 964](#) (Stats. 2005, Ch. 699; J. Horton) established the current centralized administrative procedure for air carriers and counties using the lead county system. AB 964 also added a new valuation methodology and specified that the lead county would calculate total unallocated fleet value. The new methodology refined and built upon the first valuation methodology.

<sup>14</sup> For fiscal years 1997-98 to 2003-04, assessors used another detailed methodology outlined in RTC [Section 401.15](#).

<sup>15</sup> RTC [Section 401.17](#).

<sup>16</sup> RTC [Section 1152](#).

<sup>17</sup> Property Tax [Rule 202](#), subdivision (c).

<sup>18</sup> RTC [Section 401.15](#).

<sup>19</sup> RTC [Section 5096.3](#).

<sup>20</sup> RTC [Section 107.9](#).

<sup>21</sup> RTC [Section 5103](#).

- **Aircraft Types.** Specifically, it recognized the need to distinguish between different aircraft types: passenger aircraft (main-line jets or regional jets) and freighter aircraft (production or converted).
- **Variable Components.** It added previously lacking detail for the variable components. To calculate a reproduction cost new less depreciation value indicator (i.e., the historical cost basis) each variable component was addressed; specifically: (1) acquisition cost, (2) price index, (3) percent good factor, and (4) economic obsolescence.
- **Airliner Price Guide.** The use of values referenced in the *Airliner Price Guide*, (APG) a “blue book” value guide for aircraft was set at wholesale price and recognized that air carriers generally receive a fleet discount not reflected in guide's listed prices.
- **Economic Obsolescence Adjustment.** It added detailed procedures to make economic obsolescence adjustments to capture significant market value changes (such as 9/11) due to severe airline industry economic condition changes.

Another written settlement agreement between counties and airlines accompanied AB 964. The agreement provided airlines with tax credits worth \$25 million. Additionally, the parties agreed not to pursue embedded software issues<sup>22</sup> until after the 2010-11 fiscal year.

In 2009, [AB 311](#) (Ma), as introduced, would have made the valuation methodology and centralized provisions permanent and, as amended, would have extended the effective date. However, Governor Schwarzenegger [vetoed](#) AB 311 because one airline disagreed with extending the valuation methodology as is, and the timing of the sunset allowed another year for all the parties to reach consensus before the provisions expired.

In 2010, [AB 384](#) (Stats. 2010, Ch. 228; Ma) extended these provisions to the 2015-16 fiscal year and extended the repeal date provisions to December 31, 2015. In addition, AB 384 changed the valuation provisions as follows:

- **Rebuttable Presumption of Correctness.** Expressly provided that the fair market value of certificated aircraft determined using the specified assessment methodology only enjoys a *rebuttable* presumption of correctness. Previously, the methodology-produced value was deemed to be the aircraft's fair market value.
- **Evidence for Rebutting Presumption.** Specified that the preallocated aircraft fair market value produced using the delineated methodology may be rebutted by evidence including, but not limited to, appraisals, invoices, and expert testimony.
- **Original Cost - Maximum Value for Original Owner.** Provided that the value of an individual aircraft assessed to the original owner of that aircraft is not to exceed its original cost from the manufacturer.

The maximum value cap provision was added to appease the airline that opposed AB 311 in the prior year.

In 2005, [AB 964](#) (J. Horton) initially proposed transferring assessment responsibility for commercial air carriers from the local county assessor to the BOE. Those provisions were amended out of the bill on May 26, 2005. In 2003, [SB 593](#) (Ackerman) also proposed transferring these assessments to the BOE. The Senate Appropriations Committee held the bill in committee. In 2004, the [California Performance Review Report](#)<sup>23</sup> recommended to Governor Schwarzenegger that the BOE assess commercial airline-owned aircraft to address certain inefficiencies, which were subsequently mitigated in 2005 by AB 964's new centralized lead county system.

<sup>22</sup> A computer program that is not a basic operational program under RTC [Section 995](#) and [995.2](#).

<sup>23</sup> [GG19](#) – Centralize for Efficiency the Assessment of Commercial Aircraft and [CAA response](#).

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**Related Legislation.** This year, [SB 661](#) (Hill) proposes to transfer assessment jurisdiction for commercial air carrier personal property, including certificated aircraft, to the BOE. The bill does not specify a valuation methodology for certificated aircraft.

### Commentary:

1. **Certificated aircraft valuation is complex and contentious.** A codified valuation methodology helps reduce conflict. Extending the provisions for five more years provides a period of stability and allows periodic methodology re-evaluation and adjustment. While the methodology has not eliminated conflict, it has narrowed its scope.<sup>24</sup>
  - **Trended Cost.** Before 1998, assessors based aircraft values on trended costs pursuant to RTC 110 fair market value standard and [Assessors' Handbook](#) guidelines on personal property assessments.
  - **Blue Book – Average Wholesale and Retail Prices.** Between 1998 and 2004, assessors based aircraft values on the average wholesale and retail APG value pursuant to RTC 401.15.
  - **Blue Book – Wholesale Prices Less 10%.** Between 2005 and present, assessors based aircraft values at the lower of (1) trended cost or (2) wholesale APG value less 10% pursuant to RTC 401.17.
2. **Lead-county fleet value calculation ensures statewide consistency in the base valuation of the fleet.** Extending the centralized procedure's sunset date ensures continued uniform certificated aircraft assessments for each carrier statewide. Before the centralized procedures, air carriers contended that although counties used the same assessment methodology, the fleet value calculations differed. Counties countered that the value discrepancies could be traced to (1) differences in the air-carrier-reported-information provided to different counties and (2) audit-related changes resulting from an individual county audit.
3. **The lead county system promotes administrative efficiency for both air carriers and counties.**
  - **One Return.** This eliminates any airline-reporting discrepancies to counties. Since air carriers report all information to a single county, which is then distributed, all counties receive the same information. This also reduces airline tax return compliance costs by eliminating duplicative reporting. Non-aircraft personal property must still be identified by tax rate area to ensure that local jurisdictions receive their share of property tax revenue for property located within their boundaries.
  - **One Audit.** This limits the airline to a single audit by one multi-county audit team and reduces auditing costs incurred by both counties and air carriers for duplicative audits.
4. **Rebuttable Presumption of Correctness.** The annual fair market value determined using the proposed methodology only enjoys a rebuttable presumption of correctness. Thus, either the assessor or the air carriers could rebut the presumption.
  - If the assessor deviates from the methodology, the assessor would lose the presumption of correctness before the appeals board should the air carrier appeal the assessment.
  - If the assessor uses the methodology and the taxpayer appeals those assessments, the taxpayer must provide sufficient evidence to overcome the presumption of correctness.

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<sup>24</sup> Beginning in August 2013, some airlines filed numerous appeals, lawsuits and claims for refunds related to economic obsolescence calculations under RTC Section 401.17(a)(1)(C) and (D), which this bill, as introduced, does not propose to modify. Counties report that they have prevailed and their assessments have been upheld in cases before the local assessment appeals board. Airlines report that there are 45 pending lawsuits.

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5. **What happens if the provisions sunset?** Administration returns to the pre-2006 system without unallocated fleet value calculations by a lead county. Without centralization, each county would calculate the total aircraft fleet value and audit each airline that lands in their county if the assessment qualifies as a mandatory audit. The valuation method returns to pre-1999 "fair market value" standard without a delineated methodology specific to certificated aircraft.
- **Property Statements.** Airlines would file separate property statements with every county. Prior to 2006, air carriers' submitted duplicative aircraft fleet information to every county for every location in which they operated. The one-stop reporting to a single lead-county reduced the carriers' administrative burdens.
  - **Value Method.** Assessors could use any valid method (cost, income, comparable sales, published market value guides) to determine fair market value, as defined in RTC Section 110.
  - **Uniformity.** The California Assessors' Association Aircraft Advisory subcommittee could continue to recommend valuation methodologies for all assessors to ensure statewide uniformity. Nonetheless, individual assessors still may use different valuation methods, such as trended cost basis or market/comparable sales basis using the *Airliner Pricing Guide*.
  - **Audits.** Counties would need to perform, and airlines would endure, multiple audits.
  - **Presumption of Correctness.** Only the assessor would enjoy the presumption of correctness in any appeal. The burden of proof would rest with the airline challenging assessed values.
6. **A codified valuation methodology addresses appraisal process variables.** Codifying a valuation methodology reduces conflict by specifying which of the many variables to use in the valuation process, such as:
- Cost basis (i.e., trended cost, reproduction/replacement cost new less depreciation, historical cost less depreciation)
  - Trending. (The inflation rate benchmark selected to trend historical cost to current cost or eliminating any trending factor.)
  - Depreciation schedule (i.e., life term selected and method selected such as straight-line depreciation, declining-balance method, or booked depreciation)
  - Minimum value (i.e., floor percentage or remove any floor)
  - Functional and economic obsolescence adjustments
  - Embedded software adjustments
  - Nontaxable intangible adjustments
  - Maintenance costs, capitalized addition costs
  - Market basis:
    - Commercial blue book selected (APG, Avitas, or Avmarkinc)
    - Edition Selected (Winter or Spring)
  - Blue book application:
    - Retail or Wholesale Price, Average, Weighted Average
    - Fleet Discount (amount, if any, applied)
7. **This bill will provide more certainty and predictability in the valuation of aircraft for both assessors and commercial air carriers.** Absent a codified methodology, there is no guarantee that the values determined by each individual county assessor would be the same, higher, or lower than they would be without this bill.

**Administrative Costs:** The BOE would incur some absorbable costs to update various publications and the BOE's website.

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**Revenue Impact:**

**Background, Methodology, and Assumptions.** The law requires the assessor to value certificated aircraft annually at fair market value. Absent a codified methodology, there is no guarantee that the values determined by each individual county assessor would be the same, higher, or lower than they would be without this bill.

**Summary.** This bill maintains the status quo. The revenue consequence of extending the sunset date versus allowing these laws to expire is unknown. The revenue realized under the existing valuation methodology might be different from the revenue derived from the methodology used prior to 1998 or some other methodology. Extending the existing valuation methodology, which includes a rebuttable presumption of correctness, may be a reasonable method to determine fair market value of certificated aircraft given the uncertainty that would otherwise exist.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.