

Issue Paper Number **14-002**



BOARD OF EQUALIZATION  
**KEY AGENCY ISSUE**

- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

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## **Property Tax Rule 133, *Business Inventory Exemption***

### **I. Issue**

Whether the State Board of Equalization (Board) should initiate the rulemaking process to amend Property Tax Rule 133, *Business Inventory Exemption*, to clarify that the business inventory exemption applies to non-reusable, space transportation equipment (space flight property) fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch under federal law to a Range Safety Officer.

### **II. Alternative 1 - Staff Recommendation**

Staff recommends that the Board authorize publication of the proposed amendments to Rule 133, as set forth in Attachment A, to initiate the formal rulemaking process.

### **III. Other Alternatives Considered**

#### **Alternative 2 – Conduct Additional Interested Parties Meetings**

The Board could direct staff to initiate further interested party discussions on the proposed amendments to Rule 133 before proceeding with the official rulemaking process.

#### **Alternative 3 – Do Not Amend Rule 133**

The Board could deny authorization to amend Rule 133 as proposed.

## **IV. Background**

Under Government Code section 15606, subdivision (c), the Board is given the power and duty to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Additionally, Government Code section 15606, subdivision (f), authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures." In compliance with this duty, the Board adopted Rule 133 to provide guidance on the exemption of business inventories as mandated by Revenue and Taxation Code<sup>1</sup> sections 129 and 219.

Section 219 provides that, "For the 1980-81 fiscal year and fiscal years thereafter, business inventories are exempt from taxation and the assessor shall not assess business inventories." Section 129 contains the following definition of *business inventories*:

"Business inventories" shall include goods intended for sale or lease in the ordinary course of business and shall include raw materials and work in process with respect to such goods. "Business inventories" shall also include animals and crops held primarily for sale or lease, or animals used in the production of food or fiber and feed for such animals.

"Business inventories" shall not include any goods actually leased or rented on the lien date nor shall "business inventories" include business machinery or equipment or office furniture, machines or equipment, except when such property is held for sale or lease in the ordinary course of business. "Business inventories" shall not include any item held for lease which has been or is intended to be used by the lessor prior to or subsequent to the lease. "Business inventories" shall not include goods intended for sale or lease in the ordinary course of business which cannot be legally sold or leased in this state. If goods which cannot be legally sold or leased are not reported by the taxpayer pursuant to Section 441, it shall be conclusively presumed that the value of the goods when discovered is the value of the goods on the preceding lien date.

"Business inventories" shall also include goods held by a licensed contractor and not yet incorporated into real property.

## **V. Discussion**

In a letter dated December 24, 2013, the Board's Legal Department opined that the business inventory exemption applies to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner relinquishes ultimate control at launch, and that Rule 133 should be amended to specifically address space flight property governed by federal statutes and regulations. Revisions to Rule 133 were proposed to clarify that such space flight property qualifies for the business inventory exemption.

The United States regulates the export of certain goods and technologies broadly related to national defense, including space flight property, through a number of laws and regulations that involve multiple federal agencies including the Department of State, the military, NASA and the intelligence agencies. Chief among those laws and regulations are the Arms Export Control Act (AECA) (22 U.S.C. § 2778) and the International Traffic in Arms Regulations (ITAR) (22 C.F.R. parts 120-130). The December 24 letter explained that the space flight industry is heavily regulated by relevant federal statutes and regulations including the AECA and ITAR, creating a unique market in which the technical sale of goods

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<sup>1</sup> All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

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is constrained to make the transfer of title of space flight equipment extremely difficult, if not practically impossible. Such a situation was not contemplated by sections 129 and 219 which were enacted contemplating an open and free market, and not a market with barriers to sale placed by the federal government due to national security and foreign policy concerns. In such an environment, the relinquishment of control to federal authority at launch should qualify as a *sale* within the meaning of the business inventory exemption.

In Letter To Assessors 2014/004, *Property Tax Rule 133, Business Inventory Exemption*, dated January 8, 2014, interested parties were advised that a project had been initiated to propose revisions to Rule 133. Interested parties were given the opportunity to provide comments by January 31, 2014, and several submissions both in support of and in opposition to the proposed amendments were received and are summarized below. All comments received are included as attachments to this issue paper in Attachment B. At an interested parties meeting held on February 6, 2014, various comments in support of and in opposition to the proposed amendments were discussed.

*Comments in Support*

- *Capitol Strategies Group*. The proposed amendments are a proper exercise of the Board's authority to prescribe rules and regulations and will promote uniformity. The proposed amendments are faithful to Rule 133's spirit and intent and reflect the proper interpretation of the governing statute.
- *United Launch Alliance*. United Launch Alliance supports the proposed amendments and suggested several revisions to the language. As a result of the interested parties meeting, one revision was made to the amendments that staff believes is responsive to United Launch Alliance's suggestions.
- *Reliance Machine Products*. The proposed amendments are a proper exercise of the Board's authority to prescribe rules and regulations, will ensure the rule's equitable application throughout the state, and will contribute to maintaining a prosperous aerospace industry in California.
- *Wesco Aircraft*. The proposed amendments are a proper exercise of the Board's authority to prescribe rules and regulations, will ensure the rule's equitable application throughout the state, and will contribute to maintaining a robust aerospace sector in California.
- *Commercial Spaceflight Federation*. The proposed amendments are supported by the Commercial Spaceflight Federation, a trade organization with over 45 members, as a proper classification of space-related inventory which would help ensure California's space technology innovators stay in business in California.

*Comments in Opposition*

- *California Assessors' Association*. The California Assessors' Association requested a delay in the deadline for comments to the proposed amendments due to the noted progress of Assembly Bill 777 and concerns about a rulemaking process being opened concurrently with an active assessment appeal addressing the same issue.
- *Los Angeles County Assessor's Office*. The Los Angeles County Assessor's Office objects to the proposed rule on the grounds that the proposed rule exceeds the Board's authority, is inconsistent with the applicable governing statute, and conflicts with the Board's previous instructions regarding the business inventory exemption.

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- *Santa Clara County Assessor's Office.* The Santa Clara County Assessor's Office objects to the proposed rule for the same reasons expressed by the Los Angeles County Assessor's Office and also objects based on staff initiating a rulemaking process impacting the entire state based on what appears to be a single anonymous inquiry, on the possibility that spaceflight companies are creating reusable spaceflight property that would not properly be business inventory, and on not offering a compelling state interest for providing a company with an ongoing appeal matter a "very special benefit" exempting it from normal due process.

As noted above, on February 6, 2014, Board staff held an interested parties meeting in Sacramento to discuss the proposed revisions to the rule and to address issues presented by interested parties. Staff explained that it was responsible for initiating the informal discussion regarding a potential rulemaking process and that the formal rulemaking process cannot begin unless the Board authorizes such action. Because the issue of the qualification of spaceflight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existing statutes, it is the proper subject of potential rulemaking. Staff further explained that the proposed amendments to Rule 133 were more narrow than the exemption afforded by AB 777. Rule 133 applies only to business inventory, while AB 777 would exempt all spaceflight property whether inventory or not. Responses to additional objections raised by the Los Angeles County Assessor's Office and the Santa Clara Assessor's Office are provided below:

- ***The proposed amendments to Rule 133 do not exceed the Board's authority.*** Government Code section 15606, subdivision (c), authorizes the Board to "[p]rescribe rules and regulations to govern . . . assessors when assessing," and to promote uniformity of assessment throughout the state. Additionally, Government Code section 15606, subdivision (f), authorizes the Board to prescribe "rules, regulations, instructions, and forms relating to classifications of kinds of property and evaluation procedures."
- ***The proposed amendments to Rule 133 are not inconsistent with applicable statutes governing business inventories.*** Sections 129 and 219 exempt and define business inventories. Together, the statute exempts certain goods that are for *sale*. Although the California Uniform Commercial Code defines *sale* as the passage of title, the term *sale* has been more broadly defined in other tax contexts (e.g., for sales and use tax purposes). In fact, but for the fact that there is a specific exemption for sale of spaceflight property in the Sales and Use Tax Law,<sup>2</sup> such a transaction contemplated by the proposed Rule 133 amendments would have been subject to sales tax. The proposed Rule 133 amendments are very narrowly tailored to interpret sections 129 and 219 to include as business inventory only spaceflight property regulated by federal statutes and regulations and for which control is relinquished upon launch under federal law. Finally, section 129's prohibition against the inclusion as business inventory of goods that cannot be legally sold was intended to apply to goods that are sold in criminal activity. (See Letter To Assessor (LTA) 86/90.)
- ***The proposed amendments to Rule 133 are not counter to prior Board-issued advice.*** Rule 133 was enacted in 1968 to interpret section 129. Since that time, the Board has issued guidance on what property qualifies for the business inventory exemption, including LTAs discussing goods transferred with nonprofessional services (LTA 2000/59), goods transferred with professional services (LTA 80/69), and goods which cannot be legally sold (LTA 86/90). Further, in the past, the Board has amended Rule 133 to clarify the treatment of specific property. Specifically, Rule 133 was amended substantively in 2000 to allow oak wine barrels used in the wine manufacturing process to qualify for the business inventory exemption. No previous guidance,

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<sup>2</sup> Section 6380.

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however, has been issued regarding space flight property that is the subject of this proposed amendment.

- ***The initiation of the rulemaking process was not based on a single anonymous inquiry.*** Staff initiated discussion regarding a potential rulemaking process because the issue of the qualification of spaceflight property as exempt business inventory is one that has potential statewide significance, and such rulemaking would be interpretative of and consistent with existing statutes. Therefore, it is the proper subject of potential rulemaking.
- ***The proposed amendments to Rule 133 would not allow reusable property to qualify as business inventory.*** The proposed Rule 133 amendments do not contemplate that reusable spaceflight property would qualify as business inventory. As discussed below, additional revisions were made to the amendments to clarify this point.
- ***The proposed amendments to Rule 133 do not provide a special benefit to a particular taxpayer.*** The proposed Rule 133 amendments have potential statewide significance and comments were received from multiple taxpayers, including the Commercial Spaceflight Federation—a trade organization representing more than 45 members including many in California. The proposed amendments to Rule 133 do not offer a special benefit, but is rather the proper exercise of the Board's rulemaking authority to prescribe rules and regulations for a unique industry to facilitate uniformity. Further, in any potential controversy, a taxpayer must demonstrate that its property qualifies under the amendments to Rule 133.

As a result of the February 6, 2014 interested parties meeting, agreement was reached on two amendments to the proposed rule. As mentioned above, the first clarifies that only space flight property that may not be reused under federal law could qualify as business inventory. The second defines the phrase "control over which is relinquished by the owner upon launch" as the transfer of control to the Range Safety Officer pursuant to federal law. Both amendments are reflected in Attachment A.

On February 11, 2014, interested parties were provided a copy of the revised rule language (as shown in Attachment A). Subsequent comments received are contained in Attachment C.

Because all potential interested parties were notified, objections answered, and agreed upon revisions made to the proposed amendments, staff does not believe additional interested parties meetings can be expected to result in the receipt of additional new information or in any changes to staff's recommendation. Finally, any continuing objections or new information may be presented to and considered by the Board as part of the public hearing that is required as part of the formal rulemaking process.

## **VI. Alternative 1 - Staff Recommendation**

Authorize publication of revisions to Rule 133 to initiate the formal rulemaking process.

### **A. Description of Alternative 1**

Staff recommends that the Board authorize publication of amendments to Rule 133, as set forth in Attachment A, to initiate the formal rulemaking process.

### **B. Pros of Alternative 1**

Authorizing publication of amendments to Rule 133 and initiating the formal rulemaking process will expedite clarification of Rule 133 to help ensure that all county assessors are uniformly applying the provisions of the business inventory exemption to spaceflight property fabricated and used to

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transport satellites and cargo to locations in outer space and over which the owner must relinquish ultimate control under federal law to a Range Safety Officer at launch. Such amendments are consistent with the governing statutes and the Board's rulemaking authority as exercised in past amendments to Rule 133. Further, while previous Board guidance has generally discussed the business inventory exemption, the specific treatment of space flight property is not contained in any previous guidance issued by the Board. The proposed amendments to Rule 133 would clarify the treatment of such property.

**C. Cons of Alternative 1**

Interested parties raised a number of objections which are discussed and responded to in the Discussion section above.

**D. Statutory or Regulatory Change for Alternative 1**

Action by the Board to adopt revisions to Property Tax Rule 133 will amend title 18 of the California Code of Regulations, chapter 1, subchapter 3, section 133.

**E. Operational Impact of Alternative 1**

None

**F. Administrative Impact of Alternative 1**

**1. Cost Impact**

Development of Property Tax Rules is within the scope of the statutory duties of the Property and Special Taxes Department and will be absorbed by existing staff.

**2. Revenue Impact**

None

**G. Taxpayer/Customer Impact of Alternative 1**

County assessors will be provided with guidance in order to help ensure that the business inventory exemption is uniformly applied to all taxpayers relative to space flight property fabricated and used to transport satellites and cargo to locations in outer space and over which the owner must relinquish ultimate control at launch under federal law to a Range Safety Officer.

**H. Critical Time Frames of Alternative 1**

None

**VII. Alternative 2 – Initiate an Interested Parties Process**

**A. Description of Alternative 2**

Initiate an interested parties process to further consider amendments to Rule 133.

**B. Pros of Alternative 2**

Directing staff to initiate an interested parties process to discuss issues and draft revisions to Rule 133 may result in a broader consensus of the interested parties who participate in the process.

**C. Cons of Alternative 2**

Initiating an interested parties process will delay any eventual revisions to Rule 133. Further, since potential interested parties were notified, objections answered, and revisions made to the proposed amendments, a delay in authorization of the formal rulemaking process may yield no new information, and, if such additional information exists, it may still be presented and considered during the formal rulemaking process.

**D. Statutory or Regulatory Change for Alternative 2**

None

**E. Operational Impact of Alternative 2**

None

**F. Administrative Impact of Alternative 2**

**1. Cost Impact**

Conducting an interested parties process to discuss proposed changes to a Property Tax Rule is within the scope of the duties of the Property and Special Taxes Department and will be absorbed by existing staff.

**2. Revenue Impact**

None

**G. Taxpayer/Customer Impact of Alternative 2**

Taxpayers and other interested parties will be given the opportunity to provide additional input on any proposed revisions to Rule 133.

**H. Critical Time Frames of Alternative 2**

None

**VIII. Alternative 3 – Do Not Amend Rule 133**

**A. Description of Alternative 3**

Do not approve authorization to amend Rule 133 as proposed.

**B. Pros of Alternative 3**

The Board would not incur the workload associated with processing and publicizing the amended regulation.

**C. Cons of Alternative 3**

Rule 133 would not be clarified to include certain space flight property as qualifying business inventory.

**D. Statutory or Regulatory Change for Alternative 3**

None

**G. Operational Impact of Alternative 3**

None

**H. Administrative Impact of Alternative 3**

**1. Cost Impact**

None

**2. Revenue Impact**

None

**G. Taxpayer/Customer Impact of Alternative 3**

Without amendment to Rule 133, there may be confusion as to whether space flight property that is the subject of the amended rule qualifies as business inventory.

**H. Critical Time Frames of Alternative 3**

None

**Preparer/Reviewer Information**

Prepared by: Legal Department

Current as of: February 14, 2014

**RULE 133. BUSINESS INVENTORY EXEMPTION.**

*Authority Cited:* Section 15606, Government Code.  
*Reference:* Sections 129 and 219, Revenue and Taxation Code.

**(a) SCOPE OF EXEMPTION.**

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property, not reusable for space flight under federal law, listed in the International Traffic in Arms Regulations (22 CFR § 121.1) as a defense article on the United States Munitions List, the control over which is relinquished by the owner upon launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel by a space vehicle, satellite, space facility, or space station of any kind.

(ii) The phrase "control over which is relinquished by the owner upon launch" means the transfer of control to the Range Safety Officer pursuant to federal law.

**(b) EXCLUSIONS.** Property eligible for the "business inventories" exemption does not include:

(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased. Examples of property excluded from business inventories are office supplies, furniture, machines and equipment and manufacturing machinery, equipment and supplies such as dies, patterns, jigs, tooling or chemicals used to produce a chemical or physical reaction, and contractors' supplies, tools, concrete forms, and

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other items that will not be incorporated into and become a part of the property. Also ineligible are materials that a contractor is holding to incorporate into real property that will be retained for his own use.

(2) Property being used by its owner for any purpose not directly associated with the prospective sale or lease of that property.

(3) Property actually leased or rented on the lien date.

(4) Property which has been used by the holder prior to the lien date, even though held for lease on the lien date.

(5) Property intended to be used by the lessor after being leased or during intervals between leases even though held for lease on the lien date.

(6) Property in the hands of a lessor who, with intent to enjoy the benefits of the inventory exemption, had leased the property for a period that expired shortly before the lien date but who renewed, extended or renegotiated the lease shortly thereafter.

**(c) SERVICE ENTERPRISES.** Property held by a person in connection with a profession which is primarily a service activity such as medicine, law, architecture or accountancy is not "business inventories" held for sale or lease even though such property may be transferred to a patient or client incidental to the rendition of the professional service. Property held by enterprises rendering services of a nonprofessional type such as dry cleaners, beauty shop operators and swimming pool service companies is to be regarded as "business inventories" held for sale if such property is delivered as an item regularly included in the service.

**(d) REPAIRERS AND RECONDITIONERS.** Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and materials shall be regarded as holding said parts and materials as "business inventories."

**(e) AGRICULTURAL ENTERPRISES.** Animals, crops and feed held primarily for sale or lease in the ordinary course of business are included in the term "business inventories," as are animals used in the production of food or fiber and feed for such animals.

(1) "Animals used in the production of food and fiber" includes all animals customarily employed in the raising of crops or for the feeding, breeding and management of livestock, or for dairying, or any other confined animals whose products are normally used as food for human consumption or for the production of fiber useful to man. Excluded are animals held by an owner or lessee principally for sport, recreation or pleasure such as show animals, horses kept for racing or horses and other animals kept as pets.

(2) The term "crops" means all products grown, harvested, and held primarily for sale, including seeds held for sale or seeds to be used in the production of a crop which is to be held primarily for sale. It does not include growing crops exempted pursuant to Article XIII, section 3 (h), of the California Constitution or fruit trees, nut trees, and grapevines exempted by section 223 of the Revenue and Taxation Code.

(3) The term "food" means property normally considered as food for human consumption.

(4) Feed for animals held primarily for sale or lease or for animals used in the production of food or fiber constitutes "business inventories" subject to exemption. It includes every type of natural-grown or commercial product fed to animals except medicinal commodities intended to prevent or cure disease unless the medicinal commodities are purchased as a component part of feed for such animals.

*History:* Adopted November 20, 1968, effective December 21, 1968.  
Amended January 7, 1970, effective February 8, 1970.  
Amended January 6, 1971, effective February 18, 1971.  
Amended February 5, 1975, effective March 20, 1975.  
Amended August 20, 1980, effective November 14, 1980.  
Amended October 10, 1984, effective February 21, 1985.  
Amended January 5, 2000, effective July 26, 2000.  
Amended and effective April 6, 2001.

# **Comments from Interested Parties**



January 23, 2014

Ms. Sherrie Kinkle  
State Board of Equalization  
Property and Special Taxes Department  
450 N Street  
P.O. Box 942879  
Sacramento, California 94279-0064

**Re: Property Tax Rule 133, Business Inventory Exemption**

Dear Ms. Kinkle:

On behalf of my client, Space Exploration Technologies Corporation, or SpaceX, I am writing this letter in support of the Board of Equalization's proposed amendments to Property Tax Rule 133, *Business Inventory Exemption*. Board staff correctly concluded that the business inventory exemption should apply to space flight property, control over which is relinquished at launch.

Government Code Section 15606(c) authorizes the Board to "[p]rescribe rules and regulations to govern ... assessors when assessing." Moreover, the statute empowers the Board to provide "instructions to assessors designed to promote uniformity throughout the state," and the Board "may adapt the instructions to varying local circumstances and to differences in the character and conditions of property subject to taxation as in its judgment is necessary to attain this uniformity." (*Id.*, § 15606(e).) I applaud the Board's proper exercise of its authority and judgment in this circumstance.

Space flight property undoubtedly represents challenges for the property tax system due to government restrictions stemming from national security concerns and the nuances involved in properly assessing the property. The Board's careful revision of Rule 133 is an important step in promoting uniformity and correctly accounting for the intricacies and customs inherent in space-related endeavors and contracts, while remaining faithful to Rule 133's spirit and intent.

Once again, we believe that the Board's revision of the business inventory exemption reflects the proper interpretation of the governing statute.

Sincerely,



Dennis Loper



January 23, 2014

Ms. Sherrie Kinkle  
State Board of Equalization  
450 N. Street  
Sacramento, CA 94279-0064

RE: Proposed Revisions to Property Tax Rule 133

Dear Ms. Kinkle,

We appreciate the effort that the State Board of Equalization is making in helping space launch companies secure the business inventory exemption under Rule 133. United Launch Alliance has been launching space vehicles from Vandenberg since 2007. We are very concerned about the County of Los Angeles's efforts to tax the launch vehicles and parts as "supplies" rather than treating them as business inventory.

To that end, we have some suggested modifications to the language of Rule 133, which I have attached. The first change we would like to see is the removal of the phrase "as a defense vehicle". Our reasoning is twofold:

- First, it is redundant as space flight property is already defined as "a defense article" within 22CFR 121.1,
- Second, and more importantly, often the average person who reads the Rule in a literal sense does not perform the research necessary to vet out the true meaning of the language used such as going on to read, in detail, 22CFR121.1(a) Category IV and XV.

In this instance, we believe that taxpayers and county auditors alike will see the phrase "as a defense vehicle" and interpret this phrase as excluding commercial launch vehicles from the exemption as they will not look to 22CFR 121.1 (a) Category IV and XV. This could create another round of misunderstanding which could be avoided by relying on the language in 22 CFR 121.1.

We also believe the Rule should be broad enough to include future space vehicles and hope to prevent any future debate over what type of vehicle would qualify, so we made a few changes to the definition of "space flight".

Our last recommendation is to include a definition of the phrase "control over which is relinquished at launch" to prevent any debate over the intended meaning of this phrase.

If you would like to discuss our proposed modification, please feel free to contact me at 303-26-5183(direct) or via my email: [debra.k.reynolds-clark@ulalaunch.co](mailto:debra.k.reynolds-clark@ulalaunch.co),



I would like to be included as an interested party along with our outside legal counsel Joseph Vinatieri. We would like to attend the Feb 6 meeting of interested parties.

If you need to contact me via mail my address is:

United Launch Alliance, LLC  
c/o Debra Reynolds-Clark  
P.O. Box 5076  
Centennial, CO 80155

We appreciate your assistance with this matter.

Best Regards,

A handwritten signature in black ink that reads "Debra Reynolds-Clark". The signature is written in a cursive, flowing style.

Debra Reynolds-Clark  
Senior Tax Manager

## **RULE 133. BUSINESS INVENTORY EXEMPTION.**

*Authority Cited:* Section 15606, Government Code.

*Reference:* Sections 129 and 219, Revenue and Taxation Code.

### **(a) SCOPE OF EXEMPTION.**

(1) "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of or are themselves items of personalty held for sale or lease in the ordinary course of business.

(A) The phrase "ordinary course of business" does not constitute a limitation on the type of property which may be held for sale or lease, but it does require that the property be intended for sale or lease in accordance with the regular and usual practice and method of the business of the vendor or lessor.

(B) The phrase "goods intended for sale or lease" means property acquired, manufactured, produced, processed, raised or grown which is already the subject of a contract of sale or which is held and openly offered for sale or lease or will be so held and offered for sale or lease at the time it becomes a marketable product. Property which is ready for sale or lease must be displayed, advertised or otherwise brought to the attention of the potential purchasers or lessees by means normally employed by vendors or lessors of the product.

(2) "Business inventories" includes:

(A) Containers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein.

(B) New and used oak barrels used in the manufacturing process that physically incorporate the flavor- and aroma-enhancing chemical compounds of the oak into wine or brandy to be sold, when used for this purpose. However, an oak barrel is no longer business inventory once it loses the ability to impart the chemical compounds that enhance the flavor and aroma of the wine or brandy. An "oak barrel" used in the manufacturing process is defined as having a capacity of 212 gallons or less. Oak barrels not used in the manufacturing process but held for sale in the ordinary course of business are also considered business inventory.

(C) Materials such as lumber, cement, nails, steel beams, columns, girders, etc., held by a licensed contractor for incorporation into real property, providing the real property will not be retained for the licensed contractor's use.

(D) Crops and animals held primarily for sale or lease and animals used in the production of food or fiber and feed for animals in either category.

(E) Space flight property listed in the International Traffic in Arms Regulations (22 CFR section 121.1) ~~as a defense article~~ on the United States Munitions List, the control over which is relinquished by the owner upon launch. "Space flight" means any flight of a launch vehicle designed for suborbital, orbital, or interplanetary travel ~~by~~ a-involving any type of space vehicle, satellite, space facility, or space station of any kind.

i) For the purposes of (E) above, the phrase, "control over which is relinquished upon launch", is intended to mean the transfer of control to the Range Safety Officer pursuant to federal law.

# RELIANCE

MACHINE PRODUCTS, INC.

4265 Solar Way • Fremont, CA 94538 • 510.438.6760 • Fax 510.438.6770

January 29, 2014

Ms. Sherrie Kinkle  
State Board of Equalization  
Property and Special Taxes Department  
450 N Street  
P.O. Box 942879  
Sacramento, CA 94279-0064

Re: Property Tax Rule 133, Business Inventory Exemption

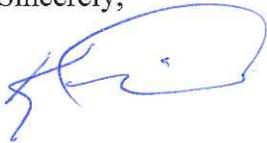
Dear Ms. Kinkle:

On behalf of Reliance Machine Products, I would like to express our support of the Board of Equalization's recent decision that space flight property should be categorized as exempt business inventory. The proposed amendments to Property Tax Rule 133 ensure the rule's equitable application throughout the state. This action is consistent with the authority vested in the Board under Government Code Section 15606(c), and will contribute to maintaining a prosperous aerospace industry in California.

We understand that commercial space launch is an evolving and challenging issue for the property tax system. While launch providers sell services, they relinquish control over space flight property upon launch. Therefore, as a California aerospace supplier, we support the important distinction that launch vehicles should not be subject to property tax. This tax, if improperly applied, would have a negative impact on the entire industry.

Thank you again.

Sincerely,



Kelly Hill  
President and Chief Executive Officer  
Reliance Machine Products, Inc.  
4265 Solar Way  
Fremont, California 94538



January 30, 2014

Ms. Sherrie Kinkle  
State Board of Equalization  
Property and Special Taxes Department  
450 N Street  
P.O. Box 942879  
Sacramento, CA 94279-0064

Re: Property Tax Rule 133, Business Inventory Exemption

Dear Ms. Kinkle:

On behalf of Wesco Aircraft Hardware Corp., I wish to express our strong support of the Board of Equalization's recent conclusion that space flight property should be categorized as exempt business inventory. The proposed amendments to Property Tax Rule 133 properly ensure the rule's uniform application throughout the state. This action is consistent with the authority vested in the Board under Government Code Section 15606(c), and will contribute to maintaining a robust aerospace sector in California.

We recognize that commercial space launch is an emerging and challenging issue for the property tax system. While launch providers sell services, they relinquish control over space flight property upon launch. Therefore, as a proud California aerospace supplier, we applaud this important clarification that launch vehicles should not be subject to property tax. This tax, if improperly applied, would have added significant burden to the entire industry.

Thank you again.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Hal Weinstein', is written over a light blue horizontal line.

Hal Weinstein  
Executive Vice President



Hal Weinstein | Executive Vice President | 27727 Avenue Scott, Valencia, California, US 91355  
Office: 661-775-7279 | Email: [Hal.Weinstein@wescoair.com](mailto:Hal.Weinstein@wescoair.com) | Web: [www.wescoair.com](http://www.wescoair.com)



444 N. Capitol St. NW, Suite 837  
Washington, DC 20001  
31 January 2014

Ms. Sherrie Kinkle  
CA State Board of Equalization  
450 N. Street  
Sacramento, CA 94279-0064

Dear Ms. Kinkle,

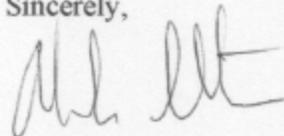
On behalf of the Commercial Spaceflight Federation, a trade organization with over 45 company members in the commercial spaceflight business, including many in California, I am pleased to see that the State Board of Equalization is making an effort to ensure that space launch vehicles and parts are properly classified as business inventory for the purposes of California tax provisions.

Commercial spaceflight promises to expand the nation's space capabilities to enable new and improved missions for commerce, science, defense and exploration. By using technical and business developments pioneered by NASA and a number of high-tech industries, commercial space is now offering spaceflight services at affordable prices and new services that have never been possible before. A large amount of this commercial space activity currently takes place in California.

California aerospace firms are not only creating the most advanced space vehicles, they are also significantly contributing to the state's economy and local communities. In 2009, California aerospace companies generated \$27 billion in revenue, ranging from the sale of aircraft parts to space satellite research and development. California's significant contribution in aerospace represents 15% of the overall U.S. aerospace industry.

A ruling to properly classify space-related inventory would help ensure that California's space technology innovators stay in business in California, and we support your effort to do so.

Sincerely,



Alexander Saltman  
Executive Director



# CALIFORNIA ASSESSORS' ASSOCIATION

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San Joaquin County
- Education**  
**LESLIE DAVIS**  
Calaveras County
- \*Past President**

January 24, 2014

David Gau  
Deputy Director  
Property and Special Taxes Department  
State Board of Equalization  
450 N Street Sacramento, California  
PO Box 942879, Sacramento, California 94279-0064

Re: Proposed Revisions to Property Tax Rule 133

Dear Deputy Director Gau:

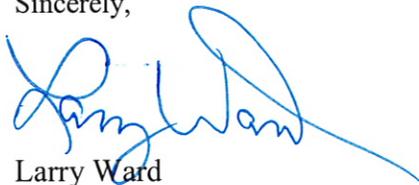
The California Assessors' Association requests that the date for comments regarding the proposed revisions to Property Tax Rule 133, as described in LTA no. 2014/004, be moved forward to April 30, 2014. This extension is requested due to the noted progress of Assembly Bill 777 (Muratsuchi), as well as concerns about a rulemaking process being opened concurrently with an active assessment appeal addressing the same issues.

While we are not privy to the details of how the process to revise Rule 133 was started, it seems likely that it was in response to the apparent stalling of AB 777 in the Legislature several months ago. However, it now appears that the bill is making new progress. It was just voted out of committee unanimously on January 23<sup>rd</sup>, and is very likely to be in the Senate by the end of the month. We understand there is significant support for the bill, including a positive outlook from the Governor's office.

Additionally, Los Angeles County has four years of pending assessment appeals cases concerning the type of property described in LRA 2014/004. In the past, the rulemaking process has been held back when there is related litigation, and this is a similar situation.

With these conditions in mind, it would be in the best interests of all parties to provide additional time for initial comments, and request that the deadline be extended until April 30, 2014.

Sincerely,



Larry Ward  
President, California Assessors' Association  
Riverside County Assessor-County Clerk-Recorder

cc: CAA Executive Committee



**OFFICE OF THE ASSESSOR  
COUNTY OF LOS ANGELES**

500 WEST TEMPLE STREET, ROOM 320  
LOS ANGELES, CALIFORNIA 90012-2770

(213) 974-3101

assessor.lacounty.gov

**SHARON MOLLER**  
CHIEF DEPUTY ASSESSOR

January 27, 2014

Ms. Sherrie Kinkle  
California State Board of Equalization  
Property and Special Taxes Department  
450 N Street, MIC:72  
Sacramento, CA 94279-0064

Dear Ms. Kinkle:

**PROPOSED REVISIONS TO PROPERTY TAX RULE 133**

This is to provide comments by the Los Angeles County Office of the Assessor (LACOA) regarding the proposed amendment to Property Tax Rule 133.

The LACOA objects to the proposed amendment on at least three grounds. The proposed rule exceeds the authority of the California State Board of Equalization (BOE), is inconsistent with the applicable statute governing business inventories, and conflicts with the BOE's previous instruction regarding the exemption.

The proposed amended rule exceeds the authority of the BOE. California Government Code section 15606(c), authorizes the BOE to enact rules and regulations "governing assessors when assessing." Implicit in this rulemaking authority is that the BOE will not usurp authority otherwise delegated to the legislature by the California Constitution.

The California Constitution empowers the legislature to classify personal property for differential assessment or exemption. (Cal.Const., art. XIII, § 2.) The BOE by its proposed rulemaking seeks to classify "space flight property" as exempt business inventory, but the property in question is not at all inventory. Participants in the civilian space launch industry sell a service (space transportation), and we understand that they do not sell the space launch equipment to their customers in the undertaking of their service. The proposed amendment seeking to classify space flight equipment as business inventory property is a transparent results-oriented effort to exempt such property from property tax. Unfortunately, the BOE's rulemaking power does not extend to classifying property as exempt unless it is consistent with existing law. The proposed rulemaking is not within the authority of existing law and impinges upon the legislature's constitutional authority to determine what categories of personal property are exempt from assessment.

The proposed amended rule is also inconsistent with Revenue and Taxation (R&T) Code section 129. This statute provides comprehensive guidance regarding the scope of the business inventory exemption:

"Business inventories" shall include goods intended for sale or lease in the ordinary course of business and shall include raw materials and work in process with respect to such goods. [ . . . ]

"Business inventories" shall not include any goods actually leased or rented on the lien date **nor shall "business inventories" include business machinery or equipment** or office furniture, machines or equipment, **except when such property is held for sale or lease in the ordinary course of business.** "Business inventories" shall not include any item held for lease which has been or is intended to be used by the lessor prior to or subsequent to the lease. **"Business inventories" shall not include goods intended for sale or lease in the ordinary course of business which cannot be legally sold or leased in this state.** If goods which cannot be legally sold or leased are not reported by the taxpayer pursuant to Section 441, it shall be conclusively presumed that the value of the goods when discovered is the value of the goods on the preceding lien date. . . . (Emphasis added.)

The space flight equipment that is the subject of the proposed rulemaking is machinery and equipment, and to the best of LACOA's knowledge is not offered for sale or lease in the ordinary course of business. Indeed, staff counsel's advice letter suggests that the property that is the subject of the proposed rule cannot be sold in the ordinary course of business pursuant to federal law. (Mr. Moon's letter of December 24, 2013, p. 4, 2<sup>nd</sup> full paragraph), ". . . it is clear that the governing federal statutes and regulations heavily regulate the space flight industry, creating a unique market in which the technical sale of goods is constrained to make the transfer of title of space flight equipment extremely difficult, if not practically impossible. . . ."

Notwithstanding the foregoing, BOE staff is undeterred stating, "Sections 219 and 129 were enacted in the late 1960's contemplating an open and free market, and not a market with barriers to sale placed by the federal government due to national security and foreign policy concerns. [Fn. omitted.] In our view, when SpaceX's business is viewed in light of the heavily regulated market in which it operates, the required relinquishment of control of its Equipment by SpaceX to federal authority at launch should qualify as a 'sale' within the meaning of the business inventory exemption."

The BOE can only take this position by ignoring the plain meaning of the term "sale." A sale is the transfer of title of property to a purchaser for a price. Industry participants do not sell title of their flight equipment to their customers in the ordinary course of business, let alone for consideration. The business inventory exemption is not applicable to this property type as revealed by the unambiguous text of R&T Code section 129. Staff's effort to shoehorn this property type into an exempt category is statutorily unauthorized. Section 129 is clear what the result must be when the property type at issue cannot be legally sold or transferred. "Business inventories" shall not include goods intended for sale or lease in the ordinary course of business which cannot be legally sold or leased in this state."

Ms. Sherrie Kinkle  
January 27, 2014  
Page 3

Finally, the BOE's proposed rule amendment is contrary to previous advice provided by BOE staff to county assessors. The BOE has previously advised that machinery and equipment that is held for use by a taxpayer does not qualify for the business inventory exemption. (LTA 80/69, p. 3, q. 2.) Further, goods transferred in connection with professional services are not eligible for exemption. (Id., p. 7, q. D.1.)

As discussed above, the property in question does not transfer to third parties, and BOE staff essentially concedes this point by reference to federal law. But even if the space flight property were deemed to transfer to an industry customer, it still would not qualify for exemption as the transfer would be incidental to a profession. (Id., "Examples of profession or professional service [include]: law, ministry, medicine, military service, engineering, chemistry, industrial designing, accountancy, economics, etc.")

The BOE's proposed rulemaking would establish a troubling precedent. Certificated air carrier property is ostensibly transferred to federal air control supervision for purposes of landings and takeoffs, and commercial aviation is subject to extensive federal regulation. Applying the BOE's proposed logic, the operation of this commercial flight equipment property is subject to extensive government controls and could be argued to satisfy the statutory requirement of "goods intended for sale or lease in the ordinary course of business" consistent with the BOE's apparent proposal of an "extensive federal regulation" exception to the business inventory statutory test. Such an extension of the exemption is unauthorized and illogical.

To summarize, the BOE's proposed amendment to Rule 133 usurps the legislature's constitutional prerogative to determine what classifications of personal property are exempt from property tax. The BOE's proposed classification of civilian flight equipment is contrary to the express terms of R&T Code section 129, and also creates a precedent that potentially puts in question the assessment of conventional certificated air carrier flight equipment. Further, the proposed amended rule is contrary to previous longstanding advice that the BOE has communicated to assessors further emphasizing the results-oriented approach of the proposed amendment to Rule 133.

The LACOA respectfully submits that the Rule 133 proposed rulemaking is contrary to law. The proponents efforts are directed to the wrong body, and their advocacy would be more appropriately redirected to the legislature.

Thank you for your consideration of our office's position.

Sincerely,



SHARON MOLLER

AR:AC

# Office of the Assessor

County of Santa Clara

County Government Center, East Wing  
70 West Hedding Street, 5th Floor  
San Jose, CA 95110-1770  
(408) 299-5588 FAX (408) 297-9526  
E-mail: [assessor@asr.sccgov.org](mailto:assessor@asr.sccgov.org)  
Website: [www.sccassessor.org](http://www.sccassessor.org)



---

Lawrence E. Stone, Assessor

February 3, 2014

Sherrie Kinkle  
California State Board of Equalization  
Property and Special Taxes Department  
450 N. Street, MIC:72  
Sacramento, CA 94279-0064

Re: Proposed Revision to Property Tax Rule 133

Dear Ms. Kinkle:

I write to oppose staff's suggested revision to Property Tax Rule 133, which exempts space flight equipment as business inventory. In addition, I want to strongly echo the comments submitted by the Los Angeles County Assessor's Office in their letter to the State Board of Equalization (BOE) dated January 27, 2014. Finally, I write to express a number of other concerns with this proposal.

### **INITIATION OF RULE-MAKING PROCESS SETS BAD PRECEDENT**

I strongly object to the BOE staff initiating a rule-making process, which would impact the entire state, based on what appears to be a single anonymous inquiry sent to the BOE legal staff. Historically, staff has limited their authority to initiate changes in rules to non-controversial issues. Changing this practice and allowing a single company to effectively initiate the rule-making sets a very bad precedent for the BOE.

My Assistant Assessor initiated a formal California Public Records Act (CPRA) request on January 9, for a copy of the letter that initiated the proposed ruling. The BOE's legal staff did not provide the requested information on the basis that the letter contained confidential information pursuant to a loose interpretation of Government Code Section 15619. The CPRA is strongly worded in favor of the production of records for the purpose of open government and transparency. If a single letter from an anonymous company can trigger a rule-making process, then I believe it is the BOE's responsibility to release the requested documents in their entirety. This action is especially troubling as assessors and the BOE routinely share confidential information.

### **RULE IS INCONSISTENT WITH REVENUE & TAXATION CODE SECTION 129**

The proposed rule is inconsistent with Revenue & Taxation Code Section 129 which defines "business inventories" as all tangible personal property, whether raw materials, work in process or finished goods, that will become a part of or are themselves items of personalty held for sale

Assessor's Office Mission: To produce an annual assessment roll including all assessable property in accordance with legal mandates in a timely, accurate, and efficient manner; and to provide current assessment-related information to the public and governmental agencies in a timely and responsive way-

or lease in the ordinary course of business. The space flight equipment that is the subject of the proposed ruling is machinery and equipment, and is not offered for sale or lease in the ordinary course of business. The code section thereby explicitly disqualifies space flight equipment from being classified as business inventory.

The Assessor's Handbook reiterates the law's intent when it directs assessors to consider the key phrases "ordinary course of business and goods intended for sale or lease." It goes on to state that these phrases "must apply for the property to qualify for the business inventory exemption." The Handbook provides an example: "If a copier leasing company holding machines for lease uses one of the machines prior to the lien date or intends to use the copier after the lien date, that copier is no longer part of the goods intended for sale or lease and would not qualify for the business inventory exemption even if it is held for lease on the lien date."

#### **SPACE JUNK OR REUSABLE SPACESHIP**

In the "anonymous" company's letter to the BOE Legal Department, the author claims that after the delivery of the equipment's payload, it is generally burned up in space or becomes space junk. Yet SpaceX, the leading proponent of this tax break, notes on its company website that their spacecraft (called "Dragon") delivered cargo to and from space multiple times, and was able to return safely to earth. The website also states that the company has been providing regular cargo resupply missions to NASA. There is serious contradiction between what SpaceX is advertising on its website and the information provided by the company in the letter to the BOE. Either companies like SpaceX are creating an inventory of space junk or, more likely, are manufacturing a fleet of space vehicles that they intend to use much as UPS and FedEx use aircraft to deliver packages.

#### **PROPOSAL EXCEEDS BOE AUTHORITY**

The State Assembly has passed to the State Senate AB 777 which was introduced with the clear, singular purpose to exempt the same space equipment that the proposed rule seeks to exempt. The legislature has initiated that change in policy as they would like to provide this tax break to SpaceX and similar companies. While I oppose AB 777, the Constitution grants the State Legislature the authority to provide such exemptions. The proposed change exceeds the BOE's authority, and since the matter is currently before the State Senate, there is no need to test the boundaries of the BOE's constitutional authority. Doing so would certainly invite the California Assessors' Association to file a 538 action challenging the BOE authority.

#### **NO URGENCY FOR INTERVENTION IN AN APPEAL**

As the BOE is aware, the issue in dispute concerns a single company that has appropriately sought redress through the assessment appeals process. Intervening on behalf of a single taxpayer before the matter is adjudicated at the local assessment appeals board sets a very bad precedent. Moreover, neither the BOE nor the taxpayer has offered a compelling state interest for providing this company with a very special benefit exempting it from the normal due process afforded all other taxpayers.

Sherrie Kinkle  
February 3, 2014  
Page three

In summary, the proposed ruling is contrary to law and to previous advice provided by the BOE to county assessors. Allowing the revision to occur will set a bad precedent and encourage other companies to seek the same exemption. I urge the BOE staff to halt further discussion of this ill-conceived proposal.

Sincerely,

A handwritten signature in black ink, appearing to read "Lawrence E. Stone". The signature is written in a cursive style with a large initial "L".

Lawrence E. Stone  
Assessor

Cc: Members of the California Assessors' Association  
Brian Donnelly, Los Angeles County Assessor's Office  
Dean Kinnee, Board of Equalization  
Rob Grossglauser and Gregg Cook, Government Affairs Consulting

LES:dhl

**Additional Comments  
Received  
after the  
Interested Parties  
Meeting**



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**SHARON MOLLER**  
CHIEF DEPUTY ASSESSOR

February 13, 2014

Ms. Sherrie Kinkle  
State Board of Equalization  
450 N Street, MIC:72  
Sacramento, CA 94279-0064

Dear Ms. Kinkle:

**COMMENTS TO THE REVISED PROPOSED AMENDMENT OF PROPERTY TAX RULE 133**

This is to provide the comments of the Los Angeles County Office of the Assessor to the proposed amendment of Rule 133, and are made in advance of the Property Tax Committee meeting scheduled for February 25, 2014.

We continue to insist that the effort by the Board of Equalization (Board) to amend Rule 133 to exempt space flight property as non-assessable business inventory is inconsistent with Revenue and Taxation Code Section 129. (Please see our letter of January 27, 2014, comments of which have been reiterated herein.) The Board's rulemaking must be consistent with statute (Gov. Code § 11342.2).

The proposed rule purports to override, for purposes of the space launch industry, the statutory definition of business inventory as "property intended for sale or lease in the ordinary course of business." The Board, however, does not have legal authority to redefine categories of business property as exempt from assessment. The authority to exempt personal property from assessment resides in the legislature and the proposal should be redirected to that body.

California law requires regulations to be consistent with statute and with an agency's rulemaking authority. The proposed amendment apparently seeks to define the transfer of control of certain property to a Range Safety Officer as the functional equivalent of the sale or lease of property in the ordinary course of business. This is a non sequitur, and does not meet the "consistency" standard for rulemaking. (See Govt. Code 11349(d).) The operation of property subject to government regulation is entirely distinct from a transfer of property to a third party for their own beneficial use.

We further object to the proposed language of the rule amendment because it is unclear. What exactly is "space flight property"? Does this include ground-based flight controls? The

Ms. Sherrie Kinkle  
February 13, 2014  
Page 2

tax administrator should not be put in the position of having to guess what the proposed text means.

The general references to "federal law" in the proposed amendment are also vague. We respectfully request that the proposed amendment identify where in federal law the distinction is found between property that is and is not "reusable for space flight," a distinction that will be important in administering the proposed amended rule. The same observation holds true with regard to the "transfer of control to the Range Safety Officer. . . ." Where is this reference found in federal law? The Board's proposed amendment is apparently predicated upon the notion that a transfer of control of operations to a Range Safety Officer in a space launch is equivalent to the "sale or lease of property in the ordinary course of business." We respectfully request that the Board identify the federal law which serves as the basis for this proposed distinction.

One final point. We would advise the Board that we understand that with regard to spacecraft systems and related items the ITAR list is under review and, according to the trade press, the list is expected to be amended in spring or early summer with regard to this type of property.

We thank the Board and its Property Tax Committee for its consideration of these comments.

Sincerely,

A handwritten signature in cursive script, appearing to read "Sharon Moller".

SHARON MOLLER

AR:AC

February 13, 2014

I write on behalf of Santa Clara County to let you know that in the short window provided, we have quickly reviewed the proposed changes to the rule. We remain opposed for the reasons outlined in our letter of February 3, 2014. Fundamentally, only property that is “intended for sale or lease” can constitutionally be exempted from assessment. SpaceX’s website (and its founder, Elon Musk) has repeatedly made clear that its intention is to build and operate a fleet of space capsules much like any other cargo transportation company. As noted in a January 29 Reuters article about the passage of AB 777, the competing effort to provide this tax break, SpaceX “along with Virginia-based Orbital Sciences Corp, have NASA contracts worth a combined \$3.5 billion for a total of 20 cargo flights to the International Space Station...SpaceX is preparing for its third cargo run to the space station on Feb. 22. Other private space exploration companies have also set up shop in California, including Virgin Galactic...”

**Larry Stone**  
Assessor

**BEWLEY LASSLEBEN & MILLER LLP**  
*Established 1888*

13215 E. PENN STREET, SUITE 510, WHITTIER, CA 90602-1797 562.698.9771

JOSEPH A. VINATIERI, ESQ.

CALIFORNIA STATE AND LOCAL TAX GROUP

JOSEPH A. VINATIERI      JEFFREY S. BAIRD  
JASON C. DEMILLE      PATRICIA VERDUGO  
RICHARD L. DEWBERRY

February 13, 2014

Sent Via Email (Sherrie.Kinkle@boe.ca.gov) and U.S. Mail

Sherrie Kinkle  
Tax Administrator  
County-Assessed Properties Division  
State Board of Equalization  
PO Box 942879  
Sacramento, California 94279-0064

Re: Property Tax Rule 133

Dear Sherrie:

This letter is written to follow up you email of February 11, 2014 as well as the recently held Interested Parties meeting on February 6, 2014. The undersigned is outside tax counsel for United Launch Alliance, LLC (“ULA”). ULA provides, inter alia, the launch vehicle as found in Category IV – Launch Vehicles, Guided Missiles, Ballistic Missiles, Rockets, etc. on the United States Munitions List, Section 121.1 of ITAR (22 CFR 121.1). We appreciated the opportunity to present comments at the meeting and want to follow up on those comments.

First, it is important to understand that Rule 133 affects more than one party. The space industry continues to evolve and we suspect that there are other parties who are also affected by the rulemaking process of Rule 133 that aren’t even aware of the applicability of the Rule to their particular situation. We appreciate the fact that the Board is taking a leadership role in this matter which bodes well for the growth of the space industry in California and the jobs the industry provides.

Second, there was much discussion regarding transfer of title as the final attribute of a sale. However, as we discussed at the meeting, under the Sales and Use Tax Law, transfer of possession and/or control can be utilized as a surrogate for title. Pursuant to federal law, the actions of the Range Officer, with no recourse from the launch provider, show the ultimate in control vested in that Range Officer. This is made clear in (E)(ii) of the proposed language.

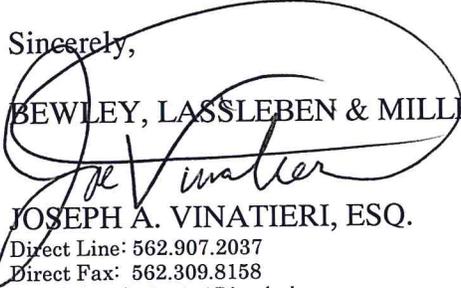
There was criticism at the Interested Parties meeting regarding whether the State Board of Equalization has the power to amend Rule 133. There can be no question that this Board possesses said power as that rulemaking authority is found in the Government Code. We applaud the staff and Board for utilizing said power and responsibility.

Letter to Sherrie Kinkle  
February 13, 2014  
Page 2 of 2

Thank you for the opportunity to provide our comments and to further California's long standing reputation as an aerospace and space leader.

Sincerely,

BEWLEY, LASSLEBEN & MILLER

  
JOSEPH A. VINATIERI, ESQ.

Direct Line: 562.907.2037

Direct Fax: 562.309.8158

*e-mail: [joseph.vinatieri@bewleylaw.com](mailto:joseph.vinatieri@bewleylaw.com)*

JAV:dm

cc: Debra Reynolds-Clark, Senior Tax Manager, United Launch Alliance  
Dean Kinnee, Property Tax Department, State Board of Equalization



February 13, 2014

Sent Via Email ([Sherrie.Kinkle@boe.ca.gov](mailto:Sherrie.Kinkle@boe.ca.gov)) and UA Mail

Sherrie Kinkle  
Tax Administrator  
County-Assessed Properties Division  
State Board of Equalization  
PO Box 942879  
Sacramento, CA 94279-0064

CC: Joseph Vinatieri

RE: Property Tax Rule 133

Dear Sherrie,

This letter is a follow up to the recently held Interested Parties meeting on February 6, 2014. We appreciated the opportunity to participate in that meeting and would like to provide some additional concerns/comments regarding the revised draft of Rule 133.

I would first like to take the opportunity to thank you and your staff for spearheading this rule change. As you may know, United Launch Alliance, LLC is a joint venture between the Boeing Company and Lockheed Martin and our business is placing payloads such as NROL satellites into orbit through the use of the rockets we build under Category IV of Sec 121.1 of ITAR as "Launch vehicles." The payloads, which we do not take title, would qualify under Category XV, "Spacecraft Systems and Associated Equipment." We launch all of our polar orbits launch vehicles out of three space complexes located on the Vandenberg Air Force Base in Santa Barbara County. ULA was formed in 2006, and prior to that Boeing and Lockheed launched rockets from the same three space complexes. We are materially affected if Rule 133 and the pending Assembly Bill 777 do not pass, perhaps to the same degree as other California launch providers. We appreciate your efforts in clarifying Rule 133 and are relieved to know that this is not a special interest bill, but an industry bill and that our comments will be considered equally.

In practice, over the last 15 years, many of the California Counties performed regular personal property tax audits of the space manufacturing facilities of Boeing, Lockheed and ULA and have historically treated the launch vehicles, whether during the manufacturing process or when in ending inventory and on the pad for launch as "inventory." Please note that this occurred under the same type of government contract as is in question today where the "title" does not pass through an invoice, but through transfer of control/possession. It would appear that a precedent has already been firmly established and that a new interpretation after 15 years of practice is unfair as the taxpayer was not placed on notice of the change in "interpretation."



In regard to Rule 133, we are concerned as to how the law will be interpreted in future audits. Careful wording and clear definitions are required in this revision to avoid future interpretation issues. I am sure when they originally drafted Rule 133 they considered our launch vehicles and every piece of tangible personal property in the manufacturing process as “inventory,” but it wasn’t clearly worded.

Our concerns are: 1) use of the term “defense article,” 2) the lack of clear definition of the term “space vehicle,” and 3) under E(i) an explanation of why the term “not reusable under federal law” is required and what federal code is being referenced.

As we stated in our letter to you dated January 23, 2014, we are concerned that use of the term “defense vehicle” in the language, as opposed to simply relying on the language contained in ITAR section 121.1, will create audit issues in the future. I envision arguing with future auditors as to whether a commercial launch vehicle is a “defense article” rather than just letting it be defined as a defense article through the language in 121.1. Is there some fundamental premise I am missing as to why this needs to be in the language of the Rule? We can live with this language if there is a good reason for the redundancy.

We are adamant that there needs to be further clarification of the language used in Rule 133E(1). It appears that **E(i)** is attempting to further narrow what qualifies under this exemption. To that point, the term “launch vehicle” has been omitted and instead the term “space vehicle” was used, but not defined. From a technical perspective, Category IV of 121.1 defines “Launch Vehicle” and Category XV defines “Spacecraft,” however I do not see any reference to or definition of what constitutes a “space vehicle”. ULA’s technical, legal and contract personnel have pointed out that often a “space vehicle” references a satellite, cargo container or human capsule, not the launch vehicle itself. A causal verbal agreement or gentlemen’s understanding that a “space vehicle” includes a “launch vehicle” is not sufficient. If the exempted property is “**space flight** property” and the term “space flight” only covers the flight of a “space vehicle,” satellite, etc and does not include the flight of a “launch vehicle” then proposes Rule 133 will only exempt the payload and not the rocket from a technical perspective. We feel that the Rule either needs to define the term “space vehicle” to include the “launch vehicle” or add the term “launch vehicle” to (i) as follows:

- (i) “Space flight” means any flight designed for suborbital, orbital, or interplanetary travel by a space vehicle, launch vehicle, space facility, or space station of any kind”

Additionally can you shed some light on what is the intent and meaning of the phrase “not reusable under federal law”? Clearly we understand the exclusion for a “reusable” item, but why include “under federal law” in this rule? Is this to allow the exemption for spacecraft or launch vehicles that return to earth and are not allowed to fly until it is “recertified?” Is this language intended to include space flight property (whatever that is defined as) that returns to earth and is refurbished and recertified in this exemption? At what point in the refurbishment/recertification process would the property be considered exempt? It would help us all if we understand what “federal law” you are referring to, specifically what Federal code section and/ or regulations.

We appreciate the fact that you did include our recommended language for E (ii) of this rule.



We find these Rule changes to be even more important than the passage of the Assembly Bill as the Assembly Bill is not retroactive. This would allow the Counties to assess the inventory as business supplies for all open years, up until the year the bill. These assessments will be litigated and in the end, the property tax law will treat “change of control” and or “transfer of possession” as surrogate for title passage, as that is where California sales tax law ended up.

Furthermore, the counties themselves employ the “transfer of possession” in asserting real property taxes on Possessory Interests. With a Possessory Interest, there is no change of title involved, but only a transfer of control, possession or use, and yet the counties are able to tax the Possessory Interest in a manner similar to the taxation of real property where title passed and recorded. As Possessory Interests are granted by the government, why should the Counties be the only ones with an exception to the “title passage rules” for government contracts/agreements? Aren’t these proposed Rule 133 changes just extending the same logic to the space industries’ government contracts as was previously extended to the Counties, allowing them to tax government property when “control and use is transferred” to a private party via a Possessory Interest?

Please let me know if there is anything ULA can do to help you in your efforts to see this passed.

If you need to contact me, my email is: [debra.k.reynolds-clark@uallaunch.com](mailto:debra.k.reynolds-clark@uallaunch.com) or

:

United Launch Alliance, LLC  
c/o Debra Reynolds-Clark  
MS-C2000  
P.O. Box 3788  
Centennial, CO 80155

Telephone Number: 303-269-5183 (direct)

We appreciate your assistance with this matter.

Best Regards,

A handwritten signature in black ink that reads "Debra Reynolds-Clark". The signature is written in a cursive, flowing style.

Debra Reynolds-Clark  
SR. Tax Manager



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February 13, 2014

**By Electronic Mail**

Ms. Sherrie Kinkle  
State Board of Equalization  
Property and Special Taxes Department  
450 N Street  
P.O. Box 942879  
Sacramento, California 94279-0064

**Re: Property Tax Rule 133, Business Inventory Exemption**

Dear Ms. Kinkle:

On behalf of our client, Space Exploration Technologies Corporation, or SpaceX, we are providing some suggested modifications to the proposed language of Rule 133 that was sent to us on February 11, 2014. Our modifications are to subsections (a)(2)(E) and (a)(2)(E)(ii) as provided below.

(E) Space flight property, ~~not reusable for space flight under federal law,~~ listed in the International Traffic in Arms Regulations (22 CFR § 121.1) as a defense article on the United States Munitions List, not demonstrated to be operationally reusable and actually reused for space flight and the control over which is relinquished by the owner upon at any point after launch.

(i) "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel by a space vehicle, satellite, space facility, or space station of any kind.

(ii) The phrase "control over which is relinquished by the owner ~~upon at any point after launch~~" means the transfer of control to ~~the~~ Range Safety Officer pursuant to federal law for Space flight termination purposes.

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We have suggested these changes for two reasons. First, as to subsection (a)(2)(E), the aerospace industry has a long way to go before reusability is actually achieved. This has never been achieved on launch vehicles in the history of spaceflight, and there will be numerous iterations and possible failures and successes during the process. It is unreasonable for California to tax a mere possibility, particularly given the technological innovation that is being attempted by California companies. We believe that our changes to this subsection reflect the current state of the technology—which is fully aspirational at this time—and the associated uncertainty and will ensure that California will only tax the space flight property when it is proven that the property is actually operational and reused. California should support (not tax) highly advanced Research and Development activities that are performed in California, activities of which encourage further R&D activities, increase jobs, and improve the economy in California.

Second, as to subsection (a)(2)(E)(ii), the Federal Ranges are in the process of developing technology whereby the function of the Range Safety Officer will become automated through technology known as the Automated Flight Termination System (AFTS). Thus, the Officer will no longer be required, but the Range Safety regulations regarding flight termination will remain in force. Our suggested modifications reflect this change in Range Safety and are in the best interest of all parties. If our suggested changes are not currently made, the Board will be forced to once again amend the regulation when the flight termination system is automated and an Officer is no longer used.

Should you have any questions or concerns, please feel free to contact me at (213) 457-8310. Thank you for your time and consideration.

Very truly yours,

  
Mardiros H. Dakessian

MHD:cg