COUNTY OF LOS ANGELES

OFFICE OF THE COUNTY COUNSEL

648 KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET
LOS ANGELES, CALIFORNIA 90012-2713

TELEPHONE
(213) 974-0809
FACSIMILE
(213) 617-7182
TDD
(213) 633-0901

JOHN F. KRATTLI
County Counsel

May 20, 2014

Mr. Rick Bennion
State Board of Equalization
450 N Street, MIC:80
P.O. Box 942879
Sacramento, CA 94279-0080

Re: Opposition to Amendment to Property Tax Rule 133

Dear Mr. Bennion:

This is to provide comments by the Los Angeles County Assessor's Office ("LACAO") opposing the proposed amendment to Property Tax Rule 133, calendared to be considered by the California State Board of Equalization ("Board") on May 22, 2014.

I. Introduction

Newly enacted Revenue and Taxation Code section 242 exempts from property taxation tangible personal property that has space flight capacity. Space Exploration Technologies Corporation ("SpaceX"), headquartered in Hawthorne, California, is a private company that constructs rockets that deliver satellites into space as well as spacecraft that carry cargo to the International Space Station. A description by SpaceX of its business is attached as exhibit A. The main competition of SpaceX for launch services is United Launch Alliance ("ULA"). An overview of ULA's business is attached as exhibit B.

SpaceX and its competitor United Launch Alliance, urge an amendment of Rule 133 to define "space flight property" as exempt from property taxation. The intent of the proposed amendment to Rule 133 is to provide industry a basis for arguing for a retroactive exemption of space flight property for all open assessment years. Section 242 takes effect for the 2014 and later assessment years, and the open assessment years are for years prior to 2014.

II. The Proposed Amendment Fails the Necessity Standard of Gov. Code § 11346.2(b)(1)

California law recognizes a business inventory exemption to the property tax. (Rev. & Tax. code 129 and 219.) Section 129 states that "business inventories" shall include goods intended for sale or lease in the ordinary course of business.

California law provides that all property is subject property taxation unless otherwise exempt pursuant to constitutional authority. (Cal.Const., art. XIII, section 1.) The California Constitution authorizes the Legislature to exempt personal property from taxation upon two-thirds membership of each house concurring. (Cal.Const., art. XIII, section 2.)

The Legislature in section 242 determined that space flight property is prospectively exempt, but did not enact the exemption retroactively. It is within the Legislature's prerogative to determine whether a category of personal property should be exempt from property taxation, and when that exemption first applies.

In the pending rulemaking process, Board staff writes ". . . By 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. . . ." (Initial Statement of Reasons for the proposed amendment ["Initial Statement"], page 3.)

An initial statement in support of proposed rulemaking shall provide "A statement of the specific purpose of each adoption, amendment, or repeal, the problem the agency intends to address, and the rationale for the determination by the agency that each adoption, amendment, or repeal is reasonably necessary to carry out the purpose and address the problem for which it is proposed. . . . (Cal. Gov. 11346.2(b)(1).)

The purported necessity for the proposed amendment is stated at page 6 of the Initial Statement: "At the conclusion of the Board's discussion of Formal Issue Paper 14-002 during the February 25, 2014, Property Tax Committee meeting, the Board determined that there is an issue (or problem within the meaning of Gov. Code, § 11346.2(b)(1)) because Property Tax Rule 133 does not address the application of the business inventory exemption to space flight property, and that it is reasonably necessary to amend Property Tax Rule 133, as recommended by staff, for the specific purpose of addressing that issue."

The prerogative to declare property exempt from taxation is a legislative prerogative. The Board relies on its legal counsel's opinion as the statement of necessity for why an amendment to Rule 133 is required, and as a description of the amendment's specific purpose. The Board states that it agrees with the staff's recommendation to initiate rulemaking "[b]ecause the issue of the qualification of space flight property as exempt business inventory is one that has potential statewide significance and is interpretative of and consistent with existent statutes, [. . .]."

The Board's stated purpose for the proposed action is to declare space flight property as business inventory that is exempt from property tax assessment, and to amend Rule 133 to set forth that interpretation. The Rule, however, did not previously address space flight property, and newly enacted Rev. & Tax. code section 242 makes that change prospectively only. **Amending Rule 133 so as to provide an argument for the retroactive exemption of space flight property from assessment exceeds the authority of the Board**. As previously cited, Board staff acknowledges that Rule 133 did not previously address space flight property. The purpose of broaching the subject now, a mere month after the Legislature has addressed the issue, is to enact an unauthorized retroactive exemption.

It is for the Legislature to decide whether to exempt personal property from assessment. The Board's proposed action to interpret section 129 to arguably provide a retroactive exemption where the Legislature itself declined to do so, fails the "necessity" standard that is required of rulemaking.

The proposed amendment is also substantively wrong. Federal policy is to "acquire space transportation services from United States commercial providers whenever such services are required in the course of its activities. To the maximum extent practicable, the Federal Government shall plan missions to accommodate the space transportation services capabilities of United States commercial providers." (51 USC § 50131(a).)

The term "space transportation services" is defined in federal statute 51 USC § 50131(4):

> **(4) Space transportation services**. The term "space transportation services" means the preparation of a space transportation vehicle and its payloads for transportation to, from, or within outer space, or in suborbital trajectory, **and the conduct of transporting a payload** to, from, or within outer

> space, or in suborbital trajectory. (Emphasis added.)

A commercial provider of space transportation services does not deliver space flight property to the government as a proxy for the provider's customer, for the government to then transport the property to space. The provider instead merely ***contracts*** with a federal launch range for the use of the range and for flight safety system property and services. (14 CFR 417.103; 417.302(d)(2)(i).) If anything, the government in this context is an agent of the commercial provider!! A commercial provider of space transportation services is required to reimburse the government for the use of space-related facilities and is presumably also subject to a possessory interest assessment on that use. (51 USC §50504.)

A federal license is required to launch cargo into space. (51 USC §50904(a).) Customers contract with launch service providers for the delivery of their space-bound asset. As a condition of a launch services contract, the launch provider and the customer are required to enter into a reciprocal waiver of liability with regard to personal injury and damage to the payload. (51 USC §50914(b)(1).) The launch service provider is in addition required to carry up to $500 million in insurance to protect third parties. (51 USC § 50914.)

The notion that a launch service provider is a retailer of tangible personal property to its customer, and that its space flight property is non-assessable business inventory is unsupported by substantial evidence, particularly when the Board's proposed regulatory action is viewed in the context of the relevant federal legal authorities.

III. The Proposed Amendment is Inconsistent with Section 129.

SpaceX and ULA are in the transportation business, the transporting of cargo into space. They are not retailers of personal property, instead they provide space launch services. California law does not impose sales tax on the performance of services. (*Navistar Internat. Transportation Corp. v. State Bd. of Equalization* (1994) 8 Cal.4th 868, 874; 18 Cal.Code of Regs. § 1500 [". . . The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the **true objects of the contract**; that is, is the real object sought by the buyer the service per se or the property produced by the service.". . . .].)

The Board's reliance on sales tax doctrine as the rationale for granting industry a retroactive property tax exemption is sophistry. The true object of a launch contract is for the conduct of the transportation of a payload into space.

The customers of the launch industry, such as the government in obtaining resupply of the International Space Station, or the National Reconnaisance Office in placing satellites in orbit, have no interest in taking possession or title to the launch equipment that is employed in performing the professional service of delivering cargo to space.

The Board's argument that SpaceX or ULA are retailers of tangible personal property for consideration mischaracterizes the taxpayers' business. A launch service provider is responsible for the service that is provided. (*Martin Marietta Corp. v. International Telecommunications Satellite Organization* (4th Cir. 1993) 991 F.2d 94.) And though it is true that the federal government oversees launch operations on a federal launch range, the launch licensee is ultimately responsible for the success of the engagement.

The Board's reliance on *Transworld Systems, Inc. v. County of Sonoma* (2000) 78 Cal.App.4th 713 does not support its analysis. The issue in *Transworld* was whether business forms mailed out by a third party service to debtors on behalf of a collection agency were eligible for the business inventory exemption. The court found that it did not matter that the collection agency did not take possession of the forms, holding that "the critical consideration is whether the goods are transferred away from the business **pursuant to sale**. . . ." (*Id.*, p. 717; emphasis.) Here, the commercial provider contracts with the government for the use of a federal facility and public safety related operations and support. This does not, however, limit in anyway the commercial provider's ultimate responsibility for the success or failure of its launch operations.

Here, the Board opines that the yielding of control of a launch vehicle to the federal safety officer is in effect a constructive sale of the vehicle to the launch customer. The analysis fails. The customer never takes delivery of the vehicle. The launch service company is responsible for the mission well beyond the time that the mission is complete. (14 CFR 417.25; 417.129.) Moreover, the Board's own rules provide that "[p]roperty 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 . . . ." Launch engineering is a profession, and true object of the arrangement is for the customer to obtain professional delivery of its asset.

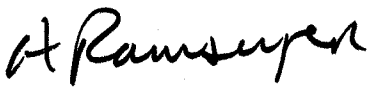
The *Transworld* court expressly states "Regulations must be construed in a manner consistent with the legislative purpose, and may not conflict with the statute." (*Id.*, p. 717.) The Board's proposed amendment of Rule 133 conflicts with a reasonable definition of "business inventory." It is inconsistent with the Legislature's plain intent to only exempt space flight property prospectively. In addition, the proposed amendment does not satisfy the required elements for

rulemaking of necessity and consistency. In light of this we respectfully urge that the proposed amendment not be adopted.

Thank you for your consideration of our comments.

Respectfully submitted,

JOHN F. KRATTLI
County Counsel

By 

ALBERT RAMSEYER
Principal Deputy County Counsel
Government Services Division

Attorneys for the Los Angeles
County Assessor's Office

SpaceX designs, manufactures and launches advanced rockets and spacecraft. The company was founded in 2002 to revolutionize space technology, with the ultimate goal of enabling people to live on other planets.

QUICK FACTS ABOUT SPACEX:

FOUNDED	VEHICLES	MANIFEST	EMPLOYEES
2002	3	40+	3,000+

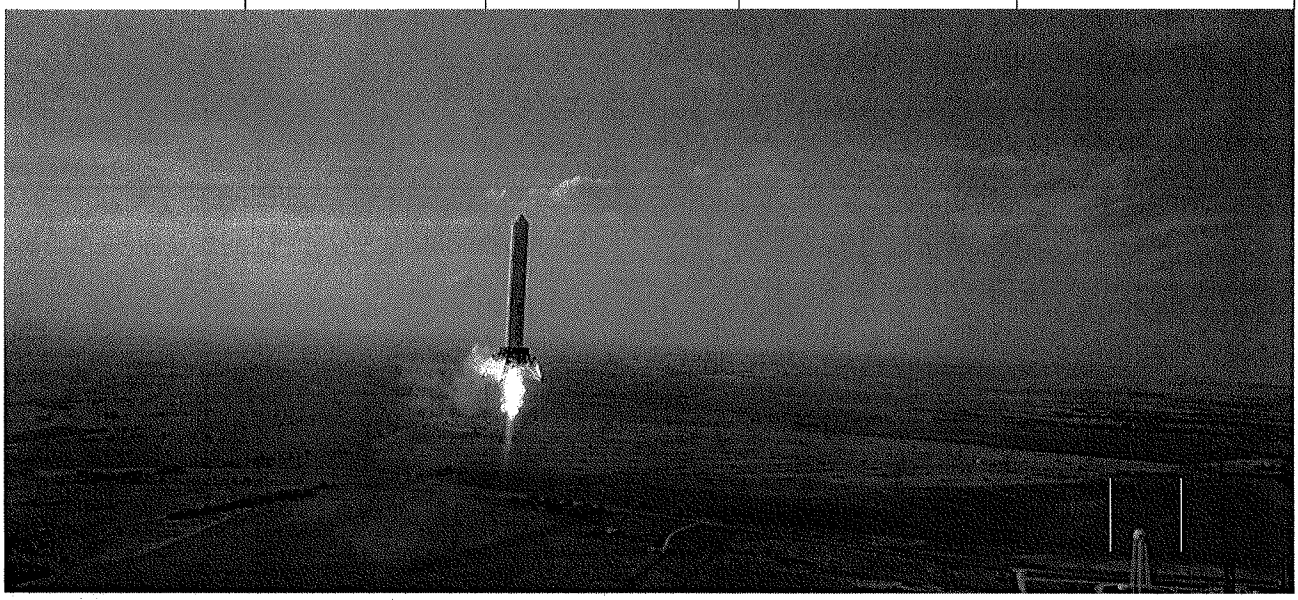
VIEW MORE SPACEX VIDEOS (HTTP://WWW.YOUTUBE.COM/SPACEX)

MAKING HISTORY

Ex. A-1

SpaceX has gained worldwide attention for a series of historic milestones. It is the only private company ever to return a spacecraft from low-Earth orbit, which it first accomplished in December 2010. The company made history again in May 2012 when its Dragon spacecraft attached to the International Space Station, exchanged cargo payloads, and returned safely to Earth — a technically challenging feat previously accomplished only by governments. Since then Dragon has delivered cargo to and from the space station multiple times, providing regular cargo resupply missions for NASA.

2013 | 2012 | 2010 | 2009 | 2008



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MARCH 2013

GRASSHOPPER COMPLETES HIGHEST LEAP TO DATE

Grasshopper achieves 325m leap--higher than the Chrysler building.

'12

SEPTEMBER 2012

GRASSHOPPER'S FIRST HOP

First in a series of successful tests of SpaceX's reusability technology.

MAY 2012

DRAGON V

Dragon becomes th
history to visit the sp

ADVANCING THE FUTURE

Under a $1.6 billion contract with NASA, SpaceX will fly numerous cargo resupply missions to the ISS, for a total of at least 12 —and in the near future, SpaceX will carry crew as well. Dragon was designed from the outset to carry astronauts and now, under a $440 million agreement with NASA, SpaceX is making modifications to make Dragon crew-ready.SpaceX is the world's fastest-growing provider of launch services. Profitable and cash-flow positive, the company has nearly 50 launches on its manifest, representing close to $5 billion in contracts. These include commercial satellite launches as well as NASA missions.

Currently under development is the Falcon Heavy, which will be the world's most powerful rocket. All the while, SpaceX continues to work toward one of its key goals—developing reusable rockets, a feat that will transform space exploration by delivering highly reliable vehicles at radically reduced costs.

CONTACT SPACEX

SPACEX HEADQUARTERS
1 Rocket Rd
Hawthorne, CA 90250

310-363-6000

SPACEX WASHINGTON D.C.
1030 15th Street N.W.
Suite 220E
Washington, DC 20005-1503

(202) 649-2700

MEDIA INQUIRIES
media@spacex.com
(mailto:media@spacex.com)

SALES INQUIRIES
sales@spacex.com
(mailto:sales@spacex.com)

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SpaceX is a private company owned by management and employees, with minority investments from Founders Fund, Draper Fisher Jurvetson, and Valor Equity Partners. The company has more than 3,000 employees at its headquarters in Hawthorne, California; launch facilities at Cape Canaveral Air Force Station, Florida, and Vandenberg Air Force Base, California; a rocket-development facility in McGregor, Texas; and offices in Houston, Texas; Chantilly, Virginia; and Washington, DC. See our SpaceX Supplier/Contractor Policy here (/news/2013/07/29/spacex-suppliercontractor-policy).

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Quick Facts

- ULA is a 50-50 joint venture between Lockheed Martin and The Boeing Company formed in 2006 to provide reliable, cost-efficient access to space for U.S. government missions.
- United Launch Alliance brings together two of the launch industry's most experienced and successful teams—Atlas and Delta—that have supported America's presence in space for more than 50 years.

- ULA program management, engineering, test, and mission support functions are headquartered in Denver, Colo. Manufacturing, assembly and integration operations are located at Decatur, Ala., and Harlingen, Texas. Launch operations are located at Cape Canaveral Air Force Station, Fla., and Vandenberg Air Force Base, Calif.
- The United Launch Alliance team consists of approximately 3,600 employees working at sites across the country. Job category functions include program management, engineering, test, manufacturing, launch site operations, mission and business support.
- Atlas and Delta expendable launch vehicles carry payloads to space ranging from weather, telecommunications and national security satellites that protect and improve life on Earth, to deep space and interplanetary exploration missions that further our knowledge of the universe.
- Launch customers include the Department of Defense, NASA, the National Reconnaissance Office, the U.S. Air Force and other organizations.
- Atlas and Delta represent more than 100 years of combined launch experience.
- Over more than 50 years, Atlas and Delta have launched approximately 1,300 missions.
- ULA employs more rocket scientists than any other company in the world.

- About ULA(/about-ula.aspx)
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Ex. B