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BEFORE THE UTAH STATE TAX COMMISSION

In Re:

**Utah Taxpayers Association,
and
Milford Wind Corridor , LLC**

**Petition to Amend Rule
R884-24P-62.
“Valuation of State Assessed Unitary
Properties Pursuant to Utah Code
Ann. Section 59-2-201.”**

Pursuant to Utah Admin. Code R861-1A-2.G. (Petitions for Exercise of Rulemaking Power), Petitioners, the Utah Taxpayers Association (“Utah Taxpayers Association”) and Milford Wind Corridor, LLC (“Milford Wind”) (herein collectively referred to as “Petitioners”) hereby petition the Utah State Tax Commission (“Tax Commission”) to “exercise its power to adopt a rule,” amending current Utah Admin. Code R884-24P-62 “Valuation of State Assessed Unitary Properties Pursuant to Utah Code Ann. Section 59-2-201” as hereinafter specified.

To facilitate the Tax Commission’s evaluation of Petitioners’ present request, this petition includes a “rule analysis” of the proposed amendment to Utah Admin. Code Rule R884-24P-62 (“Rule 62”) in conformity with Utah Code Ann. § 63-46a-4(6) (prescribing that a “rule analysis” of proposed rules be submitted by the Tax Commission to the Division of Administrative Rules); and further requests that the Tax Commission “hold a public hearing on [the] proposed amendment to [the] rule,” pursuant to Utah Code Ann. § 63-46a-5.

I. STANDING OF PETITIONERS UTAH TAXPAYERS ASSOCIATION, AND MILFORD WIND

Utah Admin. Code R861-1A-2.G. vests the Tax Commission with “wide discretion” to exercise its rulemaking authority pursuant to the Utah Administrative Rulemaking Act, Utah Code Ann. § 63-46a-1 *et seq.* Rule R861-1A-2.G. further provides that “any party who would be substantially and directly affected by such rule” may petition the Tax Commission to exercise its rulemaking authority.

Petitioners seeking to have the Tax Commission amend Rule 62 are the Utah Taxpayers Association and Milford Wind. Each petitioner would be “substantially and directly affected” by an amended Rule 62.

The Utah Taxpayers Association is a nonprofit, nonpartisan association of approximately 2,500 members, which include business and individual Utah taxpayers. The Utah Taxpayers Association has traditionally worked to ensure fair taxation of all Utah taxpayers through such measures as promoting adherence to the rule of law, insisting on the uniform application of tax laws and strict observance of procedural safeguards against overreaching taxation. The Utah Taxpayers Association, on behalf of its members, thus has

an interest in ensuring that the Tax Commission's rules are appropriate, efficient, effective, and in conformity with statutory and constitutional law.

Milford Wind is an affiliate of UPC Wind Partners, LLC ("UPC Wind"). UPC Wind is an American owned company that is pursuing wind power projects in the North American market. UPC Wind and affiliated companies are in the process of developing over 3,600 megawatts of electrical energy generating capacity from wind power projects in several markets.

The above-named entities have formed a coalition to petition the Tax Commission to amend Rule 62 because application of the rule, as presently written, fails to recognize unique and material aspects of wind power projects that legally should be taken into account in order to appropriately determine "fair market value" for property tax purposes; and, accordingly, would substantially and directly deter the development, construction and operation of such projects in Utah.

Milford Wind has obtained a Conditional Use Permit from Beaver County for its Milford Wind Corridor Project ("Milford Wind Project"). The Milford Wind Project is an approximately 300 megawatt wind farm that Milford Wind proposes to develop, finance, construct, own and operate in Beaver and Millard Counties, Utah. The location was chosen because the Milford valley (north of the City of Milford) constitutes a long, narrow wind exchange corridor between two very large and distinct desert basins.

The Milford Wind Project will consist of two phases (or more), with the first phase constituting approximately 200 megawatts of electric generating capacity, and the second phase approximately 100 megawatts of electric generating capacity. The project will

necessarily include the construction of a power transmission line and an interconnection for the delivery of the generated electricity. The target commercial operation date is late 2008. The estimated construction cost of the first phase is approximately [REDACTED], a substantial portion of which will be for the purchase of wind turbine generators and towers.

The first phase wind turbines will be located in Beaver County, while some of the second phase turbines may be located in Millard County. The first phase is expected to involve eighty 2.5 megawatt wind turbine generators. The project also includes an approximately 90 mile power transmission line, which will traverse portions of Beaver and Millard County, together with an interconnection to the Intermountain Power Project substation in Delta, Utah. Power from Phase I will then be transmitted for use by the Southern California Public Power Authority.

The Bureau of Land Management has commenced a review of the proposed wind farm project and transmission line under the National Environmental Policy Act (NEPA) (42 U.S.C. 4321 et seq.). This process will be open to public comments. More details on the NEPA process as well as other aspects of the Milford Wind Corridor project are published on the project website, <http://www.milfordwind.com/permitting.php>

II. TAX COMMISSION JURISDICTION

Utah Code Ann. § 59-2-201(1)(a) vests the Tax Commission with the responsibility to assess "all property which operates as a unit across county lines, if the values must be apportioned among more than one county or state." Pursuant to this statute, the Milford Wind Project would appropriately be "state assessed property." As explained above, based on current plans, the first phase wind turbines are expected to be located in Beaver County,

north of the city of Milford, while some of the second phase turbines are expected to be located in Millard County. More important for jurisdiction purposes, the Milford Wind Project necessarily includes an approximately 90 mile power transmission line, which will traverse portions of Beaver and Millard County, to carry the wind-generated electricity to the Intermountain Power Project substation just northwest of Delta, Utah in Millard County. The functioning business assets and operations are integrated as a "unit" that operate "across county lines," even though other wind projects in the state may not so operate.

III. RULE 62 ANALYSIS

Utah Code Ann. § 63-46a-4, Rulemaking Procedure, prescribes the requirements the Tax Commission must follow in proposing an administrative rule. Subsection 63-46a-4(6) thereof includes a "rule analysis" as one of the prerequisite criteria for proposed rule submission to the Division of Administrative Rules. To aid the Tax Commission in the required submission, this petition addresses the statutory criteria in the sequence presented in Subsection 63-46a-4(6) to the extent applicable.

A. SUMMARY OF RULE R884-24P-62, THE PROPOSED AMENDMENTS TO THE RULE, AND THE NECESSITY FOR "PROPERTY SPECIFIC CONSIDERATIONS" FOR WIND PROJECTS

1. SUMMARY OF REASONS TO AMEND RULE R884-24P-62

Rule 62, as presently written, has historically aided the Tax Commission to meet its constitutional and statutory obligation to assess tangible property according to the constitutional "fair market value" standard. However, Rule 62 was never meant as a "one size fits all" application for all tangible property. Specifically, Subpart F of Rule 62 recognizes that for certain types of property the Rule 62 methodology needs to be adapted

for “Property Specific Considerations.” Such Subpart F specific considerations have not previously addressed wind power projects for the obvious reason that wind power projects have been heretofore non-existent in Utah. However, in 2007 and beyond there is and appears will be an increasing need and likelihood of wind power project construction in the United States, which will include Utah so long as it provides tax treatment that is fair and competitive with other states.

While Utah’s property tax is levied upon the “fair market value” of the property, not upon a direct correlation of megawatt hour production, these concepts are interrelated. A “willing buyer” of the Utah property would obviously be concerned about the property’s megawatt output, which is the end product sold to the project’s customers. That concept is reflected in the income approach under the proposed amendment to Rule 62. As a practical matter, if levied property taxes in Utah are not competitive with similar taxes in other state jurisdictions, a prospective purchaser of wind power projects would be encouraged to invest somewhere other than Utah.

Phase I of the Milford Wind Project will produce an initial property tax payment of approximately [REDACTED], gradually declining over the project’s twenty-year life. This projected tax payment in its initial year would be one of the highest for all UPC Wind’s projects nationwide. That is an important point to stress because competitive costs and expenses are one factor, although not the only factor, prospective purchasers of or investors in wind power projects would evaluate. Since investment in wind power, in part, depends upon competitive market alternatives, Subpart F of Rule 62 “Property Specific Considerations” should appropriately be amended to recognize and include such unique and

material economic considerations in valuing wind power projects. Specifically, Rule 62 should be amended so that wind projects can be valued at “fair market value” exclusive of intangibles that are impounded through government incentive subsidies and infused in the wind power project industry. Such intangibles provide and will likely continue to be an essential, if not exclusive, impetus for the development and construction of wind power projects in the United States and Utah. Without government incentive subsidies, many wind projects would not be constructed because of their initial high capital costs, as compared to conventional fossil fuel projects (coal and/or natural gas plants). These points are explained hereinafter.

2. PROPOSED AMENDMENTS TO RULE R884-24P-62

Petitioners’ proposed amendment to Subpart F of Rule 62 takes into consideration certain unique aspects of wind generation projects. The proposed changes to Subpart F of Rule 62 are underlined as follows:

F. Property Specific Considerations. Because of unique characteristics of properties and industries, modifications or alternatives to the general value indicators may be required for specific industries.

1. Cost Regulated Utilities.

a) HCLD is the preferred cost indicator of value for cost regulated utilities because it represents an approximation of the basis upon which the investor can earn a return. HCLD is calculated by taking the historic cost less depreciation as reflected in the utility's net plant accounts, and then:

- (1) subtracting intangible property;
- (2) subtracting any items not included in the utility's rate base (e.g., deferred income taxes and, if appropriate, acquisition adjustments); and
- (3) adding any taxable items not included in the utility's net plant account or rate base.

b) Deferred Income Taxes, also referred to as DFIT, is an accounting entry that reflects the difference between the use of accelerated depreciation for income tax purposes and the use of straight-line depreciation for financial statements. For traditional rate base regulated companies, regulators generally exclude deferred income taxes from rate base, recognizing it as ratepayer contributed capital. Where rate base is reduced by deferred income taxes for rate base regulated companies, they shall be removed from HCLD.

c) Items excluded from rate base under F.1.a)(2) or b) should not be subtracted from HCLD to the extent it can be shown that regulators would likely permit the rate base of a potential purchaser to include a premium over existing rate base.

2. Railroads.

a) The cost indicator should generally be given little or no weight because there is no observable relationship between cost and fair market value.

3. Wind Power Generating Plants.

a) The cost indicator should generally be given no weight because there is no observable relationship between cost and fair market value.

b) The income indicator should be the primary indicator of value for wind power generating projects. A projected revenue and expense model based on discounting expected operating revenues before interest, taxes, depreciation and amortization (EBITDA) over the anticipated useful economic life of the project should be used. A discounted projected revenue and expense methodology is preferable to the yield or direct capitalization methods described in Subpart E. The appropriate discount rate should reflect the cost of capital and debt on the project. All intangibles should be removed from the discounted projected revenues and expenses in determining the value of the project and its operations, including without limitation, all federal, state and local monetary and project incentives; renewable energy credits; production tax credits; environmental (green) subsidies, payments and incentives; accelerated depreciation and amortization deductions and credits; and tax expensing deductions and credits.

B. THE PURPOSE FOR AMENDING PRESENT RULE R884-24P-62, AS APPLIED TO WIND POWER PROJECTS

An unqualified application of present Rule 62 to wind power projects would not arrive at “fair market value” because the value of such projects would impound non-taxable intangibles and ignore unique development, construction and operational factors that conventional fossil fuel power projects do not face.

1. UNIQUE PHYSICAL ASPECTS OF WIND POWER PROJECTS

There are both advantages and disadvantages to wind power projects. A primary advantage to wind power projects is that the operating costs are substantially lower than other conventional sources of electricity, such as coal or gas. Unlike traditional polluting sources of energy, wind power has no fuel cost component, thereby serving as a natural hedge against volatile and generally increasing fuel prices. For most markets in the United States, such prices constitute a significant portion of monthly electricity bills. Another significant advantage to wind power is that wind projects emit no greenhouse gases, nor other damaging environmental pollutants. Neither do they deplete natural resources.

Significant disadvantages likewise exist for wind power projects. While wind power projects do not deplete natural resources, they are wholly dependent upon an unstable, uncertain, and largely unpredictable resource – wind. For example, the annual capacity factor for a coal fired electric plant can often exceed 90%, because it can draw upon a stable coal source and operate at or near its full capacity for the vast majority of time. In comparison, it is not unusual for the annual capacity factor for a wind project to be less than 30%, because it is dependent upon the viability and volatility of the wind.

Extremely high capital costs for construction of reliable wind turbines is another significant disadvantage to wind power projects. For example, the projected capital cost of the Milford Wind project, first phase, is [REDACTED]. A wind power project may incur initial capital costs over four times higher than conventional fossil fuel (coal and gas fired) plants to achieve equivalent electricity output.

2. UNIQUE FINANCIAL ASPECTS FOR CONSTRUCTION OF WIND POWER PROJECTS

Section 45 of the Internal Revenue Code of 1986, as amended, grants a “renewable electricity production credit” for any taxable year – (i) 1.5 cents x (ii) kilowatts hours of electricity produced by the taxpayer for qualified energy resources for ten years, and sold by the taxpayer to an unrelated person during the taxable year. Section 168 of the Internal Revenue Code authorizes a five-year rapid depreciation schedule (5 year MACRS) for much of the equipment that uses wind to generate electricity.

Similarly, under state law, environmental attributes, often in the form of “renewable energy credits” and/or incentive payments, are provided for “green” type projects, like wind power. The concept is to provide direct monetary incentives for the construction and operation of non-polluting sources of energy rather than levying penalties, fees, or similar additional charges against coal and gas fired facilities. Particularly in the northeast, payments and incentives for renewable energy projects may be as valuable as the electricity itself.

Utah has joined the ranks of states promoting alternate energy sources. The 2007 session of the Utah Legislature unanimously passed S.B. 223, enrolled on February 28, 2007, which extends the life of a credit previously available under Utah Code Ann. § 59-7-

614 that otherwise expired on December 31, 2006. Governor Huntsman signed the bill on March 14, 2007. The bill becomes law on January 1, 2008. As provided in the new legislation, Utah Code Ann. § 59-7-614(2)(c)(i), [page 13 of S.B. 223 Enrolled, beginning on line 558]:

558 (c) (i) For taxable years beginning on or after January 1,
2007, a business entity that
559 owns a commercial energy system situated in Utah
using wind, geothermal electricity, or
560 biomass equipment capable of producing a total of
660 or more kilowatts of electricity is
561 entitled to a refundable tax credit as provided in this
Subsection (2)(c) if:

562 (A) the commercial energy system supplies all or part
of the energy required by
563 commercial units owned or used by the business
entity; or
564 (B) the business entity sells all or part of the
energy produced by the commercial
565 energy system as a commercial enterprise.
566 (ii) (A) A business entity is entitled to a tax credit
under this section equal to the
567 product of:
568 (I) 0.35 cents; and
569 (II) the kilowatt hours of electricity produced and
either used or sold during the taxable
570 year.
571 (B) (I) The credit calculated under Subsection
(2)(c)(ii)(A) may be claimed for
572 production occurring during a period of 48 months
beginning with the month in which the
573 commercial energy system is placed in commercial
service.¹

¹ S.B. 223 Enrolled is 112 pages long. A complete copy is available at the Utah Legislature website, <http://www.le.state.ut.us/session/2007/bills>.

From the foregoing summary of state and federal subsidies, the essential point to highlight is that without government incentives and subsidies (both federal and state), wind power projects would not be economically feasible.

3. INADEQUACY OF RULE 62 AS APPLIED TO WIND POWER PROJECTS

a. Tax Credits and Subsidies

The overriding problem with current Rule 62, if applied to wind power projects as written, is that there is neither a specific directive nor methodology for “subtracting intangible property,” as there is, for instance, for “cost regulated utilities” under Subpart F. As described above, the enabling financial impetus for construction of wind power projects is the available governmental incentives and subsidies – both federal and state. To reiterate, without such subsidies, wind power projects would not be financed or built. Government subsidies stimulate the market entry, construction and operation of wind power facilities, just as Congress and state legislatures intend. Yet such subsidies artificially distort the fair market value of wind power machinery, equipment and related tangible property by inflating their purchase price. That is why a cost approach cannot be used for valuing wind power projects.

This conclusion is demonstrable by analysis of the cost approach. Under a cost approach, value is determined using “cost new” or purchase price, less depreciation and obsolescence, both physical and economic. By far, the most difficult of these factors to identify and quantify is obsolescence, especially economic obsolescence because it is dependent upon multiple considerations. As explained in one textbook, “Economic obsolescence (sometimes called ‘external obsolescence’) is the loss in value or usefulness

of a property caused by factors external to the property, such as increased cost of raw materials, labor, or utilities (without an offsetting increase in product price); reduced demand for the product; increased competition; environmental or other regulations; or similar factors.” American Society of Appraisers, *Valuing Machinery and Equipment*, Cost Approach, p. 109 (2000)(emphasis added.)

Without question, federal and state subsidies extended to wind power projects are intended to, and in fact do, stimulate demand, and therefore the purchase price for machinery and equipment used in wind power projects. If the government subsidies expire, are withdrawn or repealed, demand for wind power projects would plummet, likely rendering the machinery and equipment unique to wind power projects essentially worthless.

It is, therefore, problematic to identify, isolate and separately value the machinery and equipment (tangible property) used in wind power projects by simply subtracting the government subsidies, and claiming the residual value is fair market value of the tangible property. Such a mechanistic approach would not adequately measure the external obsolescence or reduced demand that must be factored into a credible cost analysis. That is why there are no “comparable” properties that can be used to value wind power projects. The price or cost Milford Wind (or other wind power companies) must pay for wind turbine generators necessarily includes the government subsidy – an intangible – that cannot legally be taxed. The legally required exclusion of such credits and subsidies as an intangible thus impacts the fair market value of the taxable, tangible property as an external or economic obsolescence factor. Put another way, the inclusion of tax credits in the assessment of wind

power projects under a cost approach is unlawful because such credits are intangibles exempt for taxation. They inflate the purchase price of tangible property. The legally required exclusion of such intangibles would operate as an external obsolescence factor that would, in turn, significantly lower the demand, and therefore the fair market value of the residual tangible property to a willing purchaser.

“Intangible property” is exempt from taxation in Utah, and is statutorily defined as “property that is capable of ownership separate from tangible property . . .” Utah Code Ann. § 59-2-102(19). The non exclusive list of intangible property in the Utah Code includes “credits,” and “federal low income housing tax credit,” Utah Code Ann. § 59-2-102 (19)(a)(ii) and (20). Moreover, as the Utah Supreme Court has held, the terms "intangible property," "intangible asset," and "intangibles" are synonymous, and all intangibles are tax exempt. *Beaver County v. WilTel, Inc.* 995 P.2d 602 (Utah 2000).

In this instance, tax credit incentives and environmental incentive payments extended to construct and operate wind power plants are independent of the physical, tangible property. They are akin to a “federal low income housing credit,” which is expressly recognized in the Utah Code as an intangible that must be subtracted from the value of tangible, taxable property. Utah Code Ann. § 59-2-102(18)(b). Attached to this Petition as Appendix “D” is a memorandum explaining in some detail why federal and state tax incentives and other government subsidies related to wind power projects in the United States are intangibles.

In summary, government subsidies are intangibles because they are paid to stimulate government-favored policy – in this instance, “green” power, and less dependence on fossil

fuels. Government subsidies may be measured by how much “green” power is generated, but they are not revenue derived from the operation of the physical, tangible property, nor the sale of power generated to plant customers. The memorandum concludes, “There are no credible arguments that federal and state tax subsidies to wind power projects are taxable, tangible property.” Appendix D at 7.

b. Projected Project Revenues

Another consideration for the proper valuation of wind power projects is to use an income methodology of discounting expected operating revenue before interest, taxes, depreciation, and amortization (EBITDA) over the expected useful life of the project. Wind power projects generally allow for pro forma modeling because they have a discrete technological expected useful life and reasonably predictable revenue streams and operating expenses over the expected life of the project. Inasmuch as the fuel source is wind, the most volatile element of a power plant’s operating costs (the cost of fuel) is eliminated.

The application of the suggested EBITDA present value calculation based on discounting pro forma operating revenues before interest, taxes, depreciation, and amortization for the Milford Wind project, [REDACTED], begins at an assessed value of approximately [REDACTED] for the first year of operation, and declines to approximately [REDACTED] in its twentieth year, spanning the project’s estimated useful life. Such assessed values would result in approximately [REDACTED] in taxes to the counties in the first year of project’s operation and approximately [REDACTED] in taxes in the twentieth year. This decline in value, and hence tax revenue, is somewhat analogous to an annuity, which, at the time of purchase, would obviously be worth more than if same annuity were

purchased at a later date when the longevity of its income stream would have declined. While normal operating repairs and maintenance of the Milford Wind assets may periodically require some replacement parts, it is expected the wind turbines and generators will largely be operative for at least their full engineered life. The suggested projected operating revenue valuation model [REDACTED] is limited to existing assets that are placed in service when the project begins operation. It does not include replacement assets because such would not exist on the initial lien date.

C. CONSTITUTIONAL AND STATUTORY AUTHORITY FOR THE PROPOSED AMENDMENT TO RULE 62

As explained above, the proposed rule change is necessitated by decisions of the Utah Supreme Court and Utah statutes that clarify and determine the scope of constitutional state taxation. The Utah Constitution authorizes taxation only of "all tangible property in the state, not exempt under the laws of the United States, or under this Constitution." Utah Const. art. XIII, § 2(1). Utah Supreme Court decisions interpreting this language expressly hold that intangibles, including intangible assets that would be sold with tangible property, are not taxable. In affirming the Tax Commission in *Beaver County v. Wiltel, Inc.* 995 P. 2d 602, 610 (Utah 2000), the Court stated: "The Commission correctly ruled that the terms 'intangible property,' 'intangible asset,' and 'intangibles' are synonymous, and all intangibles are tax-exempt." Utah Code Ann. § 59-2-102(18), which defines "Intangible property" as "(a) property that is capable of ownership separate from tangible property, including [but not limited to]: . . . (ii) credits or (b) a low-income housing tax credit [as a representative sample of tax credits]" must be interpreted consistent with the constitutional standard.

D. ANTICIPATED COSTS OR SAVINGS

It is impossible to predict the cost or savings to the counties or state if the Tax Commission amends Rule 62 as requested because it is unknown whether Rule 62 has been or will be interpreted and implemented consistent with constitutional imperatives explained above. More important, no matter the potential cost to the state, Utah is bound by the Utah Constitution as interpreted by the Utah Supreme Court. The Tax Commission's administrative rules must properly reflect such binding judicial precedents.

E. COMPLIANCE FOR AFFECTED PERSONS

It is anticipated that there will be no additional costs to affected persons, including taxpayers and Tax Commission employees, because taxpayers doing business in Utah must already file appropriate tax reports to reflect fair market value of their property. The proposed rule would likely avoid additional costs of unnecessary litigation over constitutional principles that the Supreme Court has already established, although such savings are impossible to quantify.²

² Sections 63-46a-4(6)(e) through (l), attached as Appendix B, concern the Tax Commission's duties in promulgating a rule, such as the time and place for a hearing, and agency designee, that are not relevant to this petition, and are thus, not included here.

IV. CONCLUSION

For the foregoing reasons, Petitioners recommend and request that the Tax Commission amend Rule 62 in conformity with the principles explained herein and the procedure outlined in Utah Code Ann. § 63-46a-4.

V. ATTACHMENTS

Appendix A: Proposed Rule 62

Appendix B: Utah Rulemaking Act



Appendix D: Memorandum on Intangibles

DATED this 17th day of August, 2007

A handwritten signature in cursive script, appearing to read "Maxwell A. Miller".

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APPENDIX "D"

MEMORANDUM

TO: UTAH STATE TAX COMMISSION

FROM: UTAH TAXPAYERS ASSOCIATION, MILFORD WIND CORRIDOR, LLC

RE: MEMORANDUM IN SUPPORT OF "PETITION TO AMEND RULE 884-24P-62" excluding state and federal production tax credits as intangibles from assessment of wind power property

DATE: August 17, 2007

This memorandum discusses and explains why state and federal production tax credits extended to wind power projects, in this instance to the Milford Wind Project planned for construction and operation in Beaver County and Millard County (the "Counties"), are "intangibles" that are exempt from ad valorem taxation under Utah constitutional and statutory law. Petitioners Utah Taxpayers Association and Milford Wind Corridor, LLC ("Milford Wind") submit this memorandum in support of their "Petition to Amend Rule R884-24P-62," which, when promulgated, will exclude from property tax assessment state and federal production tax credits granted for wind power projects as intangibles.

FACTUAL BACKGROUND

Petitioners' proposed amendment to Rule 62 seeks exclusion of wind power project federal and state tax credits and "green" government subsidies as intangibles, which are not taxable under Utah law. The Tax Commission has historically used Rule 62 to assess property that "operates as a unit across county lines." Utah Code Ann. § 59-2-201(1)(a). Such property would, accordingly, include the wind power project Milford Wind contemplates financing, building and operating in Beaver County and Millard County as "centrally assessed" or "state assessed" property.

As explained in the Petition, the Milford Wind Project will consist of two phases (or more), with the first two phases constituting approximately 300 megawatts (MW) of electric generating capacity. The target commercial operation date is late 2008. The estimated construction cost of the first phase is approximately [REDACTED], a substantial portion of which will be for wind turbine generators and towers. Using proposed Rule 62, as discussed in the Petition: (i) the federal and state production tax credits would be excluded as "intangibles" from the discounted projected revenue and expense methodology used to value Phase I of the Project, and (ii) the assessed valuation of Phase I of the Milford Wind Project (with no attempt to value Phase II) would approximate [REDACTED] for the project's first year. Since the assessed value of the project will decline over its expected useful life of twenty years, the expected value in the twentieth year will be [REDACTED]

The fundamental purpose of the proposed amendment to Rule 62 is to adapt the rule's application "so that wind projects can be valued at 'fair market value' exclusive of intangibles that are impounded through government incentive subsidies and infused in the wind power project enterprise. Such intangibles provide and will likely continue to be an essential, if not exclusive, impetus for the development and construction of wind power projects in the United States and Utah. Without government incentive subsidies, many wind projects would not be constructed because of their initial high capital costs, as compared to conventional fossil fuel projects (coal and/or natural gas plants)." Petition at 6. [REDACTED] provides a discounted projected revenue and expense valuation that excludes the federal and state tax and other government subsidies from the projected Milford Wind Project's capitalized revenue as intangibles, not legally subject to ad valorem taxation in Utah.

LEGAL BACKGROUND AND SUMMARY

Under Utah law, specifically Utah Constitution, Article XIII, Section 2(1), intangibles, including intangible assets that would be sold with tangible property, are not taxable. The Petition concludes, "tax credit incentives and environmental incentive payments extended to construct and operate wind power plants are independent of the tangible property. They are more akin to a 'federal low income housing credit,' which is expressly recognized in the Utah Code as an intangible that must be subtracted from the value of tangible, taxable property. Utah Code Ann. § 59-2-102(18)(b)." *Id.* at 14. This conclusion is supported by recent and unanimous Utah case law, discussed below.

Nonetheless, those favoring the inclusion of tax credits as part of an income approach to determine tangible, taxable value, have typically cited the Utah Supreme Court's decision in *Alta Pacific Associates, Ltd. v. Utah State Tax Comm'n*, 931 P.2d 103 (Utah 1997). In *Alta Pacific*, the Utah Supreme Court upheld the assessment of apartments using "contract rents," rather than "market rents." The "contract rents" included a low-income housing subsidy that federal agencies, the Farmers Home Administration (FHA) and Housing and Urban Development ("HUD") paid directly to apartment owners in addition to the rental income received from low income tenants. Apparently the subsidy amounts were payable even if the apartments were vacant. The *Alta Pacific* Court affirmed the Tax Commission's assessment methodology of the apartments, treating the Commission's determination of "fair market value" as a question of fact. No one – neither the Court, nor the Commission, nor the parties - raised the "intangible" issue that could have (and in Petitioners' view should have) been raised in the case, if not before the Court, then at the Commission level.

Because taxpayers and taxing authorities may not agree on whether tax credits are or are not intangibles, a resolution of the so-called "intangible issue" by Tax Commission rule is vitally important to provide certainty and avoid protracted litigation. State and federal wind power production credits and "green" subsidies will be substantial over the project life. Whether such subsidies are or are not taxable will determine whether continued construction of the Milford Wind Project will be economically viable.

As now proposed, Rule 62 expressly resolves the “intangible” issue, and provides, “The income indicator should be the primary indicator of value for wind power projects,” and that, for proper application of the Rule, “All intangibles should be removed from the projected revenues and expenses in determining the value of the project and its operations, including without limitation, all federal, state and local monetary and project incentives; [such as but not limited to] tax credits, [and] environment (green) subsidies, payments and incentives.”

Specifically including *Alta Pacific*, there is no credible argument that federal and state production tax credits for wind power are impounded with and inseparable from the taxable, tangible property in Utah. Such arguments do not survive rational scrutiny for the reasons explained below.

LEGAL ANALYSIS

I. THE UTAH SUPREME COURT’S DECISION IN *ALTA PACIFIC* DOES NOT ADDRESS, AND IS NOT A PRECEDENT FOR CONCLUDING THAT WIND POWER PRODUCTION TAX CREDITS DO NOT QUALIFY AS INTANGIBLES, WHICH ARE EXEMPT FROM PROPERTY TAXATION UNDER THE UTAH CONSTITUTION.

At the outset of analysis, it should be stressed that the Utah Constitution expressly limits property taxation to “tangible property.” Article XIII, Section 2(1) of the Utah Constitution provides that all “tangible [not intangible] property in the State that is not exempt under the laws of the United States or under this Constitution shall be (a) assessed at a uniform and equal rate in proportion to its fair market value, to be ascertained as provided by law; and (b) taxed at a uniform and equal rate.”

Article XIII, Section 2(5) further states: “The Legislature may by statute determine the manner and extent of taxing or exempting intangible property, except that any property tax on intangible property may not exceed .005 of its fair market value. If any intangible property is taxed under the property tax, the income from that property may not also be taxed.” Because the Legislature has chosen to tax income from intangibles, Utah Code Ann. § 59-7-101 *et. seq.* (imposing a corporate franchise and income tax), intangibles are constitutionally exempt from property taxation. Although the Utah Constitution gives the Legislature some latitude to define what is or is not an intangible, legislative authority to define intangibles is necessarily subordinate to the constitutional exemption quoted above.

In the above-referenced *Alta Pacific* case, decided in 1997, the precise issue the Utah Supreme Court was called upon to decide was whether the Glenbrook Apartments in Sevier County, “built under special federal housing programs for the needy and the elderly, had less value as a result of the restraints on the property imposed by the federal schemes.” *Id.* at 104. The apartments’ “fair market value” turned on whether “contract rent” or “market rent” should be used in an income approach to valuation. In affirming the Tax Commission’s income approach methodology, the Court in *Alta Pacific* upheld the use of “contract rents” to determine fair market value, which income included federal low-income housing subsidy payments. Significantly, however, the Court’s analysis did not address, discuss or decide whether federal low-income housing credits were or were not an intangible. Rather, the Court deferred to the Tax Commission’s valuation determinations because they were based upon the Tax

Commission's factual findings from expert testimony offered at the Commission level. Neither the "intangible/tangible" issue, nor the word "intangible," is mentioned in *Alta Pacific*. Neither is there any indication in *Alta Pacific* that the parties even raised the tangible/intangible issue, certainly not at the Supreme Court level, nor, significantly, at the Tax Commission level. As to the disputed factual issues in *Alta Pacific*, the apartment owners instead had bizarrely, and incorrectly, argued that subsidies were not a benefit, but a burden. *Id.* at 106. That factual argument flies in face of reality, as the Tax Commission ruled.

However, the Tax Commission's ruling on the factual issues the apartment owners raised in *Alta Pacific* has no bearing on the legal "intangible" issue Milford Wind raises here. The sole legal (as distinguished from factual) arguments the taxpayers in *Alta Pacific* asserted were that the Tax Commission's assessment of federally subsidized apartments violated "the uniform operation of laws clause and the uniformity in taxation requirement of article XIII, Section 2 of the Utah Constitution." As the Court succinctly summarized the constitutional issue on appeal, the "owners' argument under both clauses is the same. They argued that the Commission's order singles out subsidized properties for unfavorable treatment." *Id.* at 113.

Alta Pacific has no binding or precedential impact on the proper, constitutional definition of "intangibles" under Utah law because the case does not address or decide what constitutes an "intangible," which is exempt under the Utah Constitution. Moreover, both the Utah Supreme Court and the Utah Legislature have clarified Utah law on intangibles since *Alta Pacific* was decided. An objective application of this clarified Utah law necessarily includes wind power production tax credits as intangibles, not subject to property taxation.

II. SINCE DECIDING ALTA PACIFIC (1997), THE UTAH SUPREME COURT HAS SUBSEQUENTLY HELD, IN UTAH RAILWAY CO. (2000), THAT THE CONSTITUTIONAL AND STATUTORY TEST FOR EXCLUDING INTANGIBLES FROM ASSESSED VALUE RAISES A LEGAL QUESTION, NOT A FACTUAL QUESTION, AS ALTA PACIFIC DECIDED.

Even assuming, hypothetically, that *Alta Pacific* sanctioned inclusion of state or federal tax credits under an income valuation of tangible property, the case no longer represents Utah law. In *Utah Railway Co. v. Utah State Tax Comm'n*, 5 P.3d 652 (Utah 2000), decided three years after *Alta Pacific*, the Court held: "Whether a valuation methodology or group of methodologies meet the constitutional and statutory test of excluding intangibles from valuation of property is a legal question. Applying that legal query to the facts of any given case, however, is inextricably linked to a specific area of expertise vested in the Commission." *Id.* at 656 (emphasis added.) Because the Commission "failed to make findings or rulings upon which to base [the Supreme Court's review]" in *Utah Railway Co.*, the Court remanded the case to the Commission "for entry of appropriate findings and rulings to support its decision." *Id.* The Court's express directive was: "The Commission should also specifically address the question of whether the methodologies employed by the Division violated the constitutional and statutory proscriptions against taxation of intangibles, or it should explain the basis for its refusal to do so." *Id.* In other words, Tax Commission "appropriate findings and rulings" should (1) determine whether intangibles were included in an assessment, and if so (2) exclude them.

From the Court's holding in *Utah Railway Co.*, the important principle to underscore, once again, is that a valuation methodology or group of methodologies must exclude intangibles from valuation of property because such exclusion is constitutionally and statutorily required. That conclusion necessarily means *Alta Pacific* is limited to the facts and circumstances of that case. The *Alta Pacific* Court merely affirmed the Tax Commission's use of contract rents as an assessment methodology, deferring to the Tax Commission's application of valuation methodology as a question of fact. *Id.* at 109. Neither the Tax Commission, nor the Supreme Court in *Alta Pacific* addressed or decided whether tax credits were or were not intangibles using the "contract rents" valuation methodology. In fact, the Court majority in *Alta Pacific* expressly disagreed with then Justice Zimmerman who would have upheld the Commission's valuation methodology, which included contract rents under an income approach, as a matter of law.

III. IN *BEAVER COUNTY V. WILTEL* (2000), THE UTAH SUPREME COURT AS A MATTER OF CONSTITUTIONAL LAW EXCLUDED INTANGIBLES (WHICH INCLUDE "INTANGIBLE PROPERTY, INTANGIBLE ASSETS AND INTANGIBLES") FROM PROPERTY TAXATION.

In *Beaver County v. WilTel, Inc.*, 995 P.2d 602 (Utah 2000), also decided three-years after *Alta Pacific*, the Court held "The Commission correctly ruled that the terms 'intangible property, intangible assets, and intangibles' are synonymous, and all intangibles are tax-exempt." *Id.* at 609.

This holding is a matter of law, not limited to the facts of *WilTel*. While *WilTel* decided some issues as matters of fact, which facts may change with each case, the necessary exclusion of intangibles, decided as a matter of law, applies to all property tax assessments. As now Tax Commissioner (then Attorney) R. Bruce Johnson summarized *WilTel*'s impact: "In most jurisdictions, including Utah (both before and *clearly after the WilTel decision*) intangibles are not subject to property tax." R. Bruce Johnson, "The WilTel Decision – Taxation of Intangibles in Utah, Professional Education Systems, Inc." at 2 (Sept. 26, 1997)(emphasis added.) Mr. Johnson's comment was written after the Tax Commission's decision in *WilTel*, although three years before the Supreme Court affirmed the Tax Commission.

As to the factual issues in *WilTel*, the taxpayer argued that it should have been locally assessed, as were "resellers" of telecommunications services, and not assessed as an "asset based" enterprise that was centrally assessed. The Tax Commission held against the taxpayer, concluding that *WilTel* was properly state assessed. The Court reviewed the Tax Commission's findings of fact on this issue (not the "intangible" issue) under a "substantial evidence standard, granting deference to the Commission's written findings of fact." *Id.* at 606. The taxpayer lost on this factual issue.

However, the Court reviewed *WilTel*'s contention that its property included non property intangible assets and value, and that the privilege tax does not apply to intangibles as a question of law, under a "correction of error" standard, giving no deference to the Tax Commission. Stated differently, the "intangible" issues raised were permanently resolved as a legal matter for all property tax cases. Various Utah Counties on appeal from the Tax Commission in *WilTel* had argued before the Utah Supreme Court that "intangibles" are not property; and that, therefore, such intangibles as assembled workforce and contracts were taxable because the statutory

exemption, it was argued, is only extended to “intangible property.” In the Court’s words, “the Counties maintain that ‘intangible property’ should be limited to property that is ‘capable of being separately owned, used, transferred, or merely held,’ and that nonproperty intangibles are ‘simply elements of value associated with another asset.’” *Id.* at 609. The Counties had also argued in *WilTel* that “intangibles” were subject to a privilege tax, even assuming they were statutorily exempt. These arguments were premised on a narrow reading of the then applicable Utah statute, without reference to its supporting constitutional provision.

The Court rejected the Counties’ arguments, stating: “The extension of the privilege tax to intangible property would violate this prohibition [against taxing intangibles] and would therefore be unconstitutional.” *Id.* at 610 (emphasis added.) Similarly, the Court upheld the Tax Commission’s ruling as a matter of law that “intangible property, intangible assets, and intangible value are all exempt from taxation under Utah law.” *Id.* at 609. In part, the Court’s conclusion was based upon the Utah Code, which stated in 1995 that taxable property “does not include moneys, credits, stocks, representative property, franchises, goodwill, copyrights, patents, or *other intangibles*.” *Id.* (emphasis by the Court in original.)

It is important to emphasize, however, that the *WilTel* Court’s obvious intent in italicizing the words “*other intangibles*,” which were not then statutorily defined, necessarily means (1) the statutory list of intangibles, as enacted in 1995, was merely exemplary, and not exhaustive; and (2) the exemption for intangibles is constitutionally mandated. Since the Utah Code did not include a definition of “intangibles” in 1995, nor a list of “other intangibles,” the exemption for intangibles is not necessarily restricted to statutory lists or definitions. This conclusion is consistent with numerous Utah Supreme Court decisions holding that statutes, in this instance a statute extending a property tax exemption to “*other intangibles*,” must be construed according to their “plain and ordinary” meaning. *See, e.g.* for the most recent case, *Wasatch Crest Insurance Co., in Liquidation v. LWP Claims Administrators Corp.*, 2007 UT 32 (construing a liquidation statute, Utah Code Ann. § 31A-27-322(1) according to its “plain and ordinary” meaning.

The plain and ordinary definition of the word “includes” means “to take in or comprise as a part of a whole or group.” *See* Meriam-Webster online, “Includes” <http://www.m-w.com/home.htm>. Given this definition, the statutory list of intangibles, as enacted in 1995, is not exhaustive, but merely exemplary of a broader constitutional concept. Other intangibles could be and have been added to the list, whether they come within the statutory definition under Utah Code Ann. § 59-2-102(19)(a) that has not changed since 1998, or is analogous to the added list of intangibles in Section 102(19)(b) and (c) that share a common, constitutional parentage.

IV. FEDERAL AND STATE PRODUCTION TAX CREDITS FOR WIND POWER ARE INTANGIBLES FOR THE SAME REASON THE UTAH LEGISLATURE HAS INCLUDED LOW-INCOME HOUSING TAX CREDITS IN THE STATUTORY DEFINITION OF INTANGIBLES.

In 1998, the Utah Legislature provided further guidance on what constitutes “intangible property.” The then statutory definition is: “(14) ‘Intangible property:’ (a) means property that is capable of private ownership separate from tangible property; and includes . . .” Utah Code Ann. § 59-2-102(14)(1998). The 1998 list of exemplary intangibles did include “credits,” but did not

then include “goodwill” or “low-income housing tax credit.” In 2003, the Utah Legislature again amended the statute to add “a low-income housing tax credit,” although “goodwill” was not then on the list. Utah Code Ann. § 59-2-102 (17)(2003). The present statutory definition, at Utah Code Ann. § 59-2-102(19) states: (19) "Intangible property" means: (a) property that is capable of private ownership separate from tangible property, including: (i) moneys; (ii) credits; (iii) bonds; (iv) stocks; (v) representative property; (vi) franchises; (vii) licenses; (viii) trade names; (ix) copyrights; and (x) patents; (b) a low-income housing tax credit; or (c) goodwill.” Note that (b), “a Low-income housing tax credit,” and (c) “goodwill” are statutorily included as “intangible property,” even though they are not included within the definition under part (a), “property that is capable of private ownership separate from tangible property, including [specifically itemized intangibles].”

Once again, the overarching point to highlight in the foregoing overview of legislative history and amendments to the exemplary statutory list of intangibles is that the basic definition of what constitutes an intangible may not necessarily be limited to “property capable of ownership separate from tangible property,” although all categories of intangible property obviously share common characteristics. To take a hypothetical example, the tangible property, i.e. machinery and equipment, owned by a McDonald’s fast food franchise can be sold to a “Joe’s Burger Barn,” exclusive of McDonald’s goodwill, or, whatever “credits” (assuming such credits merely for illustrative purposes) to which a McDonald’s could legally be entitled. Simply stated, the point is that McDonald’s tangible personal property can be sold separately from its intangibles.

Logically, therefore, the addition of a “low-income housing tax credit” in 2003 to the statutory list of “intangible property” did not redefine an intangible. Rather, the inclusion of such credits clarified coverage within the already extant constitutional mandate excluding intangibles from taxation. Low-income housing tax credits, whether or not expressly listed as an example, have always met the statutory 1998 definition, and would have qualified as an intangible under that statutory and constitutional definition, whether in 1995, 1998, 2003 (when low-income housing tax credits were added to the list of exemplary intangibles) or now. “Credits,” which are expressly included within the exemplary list under the definition of intangibles pursuant to Utah Code Ann. § 59-2-102(19)(a), necessarily share similar characteristics as intangibles not included within the Section 102(19)(a) definition. As the Court held in *WilTel*, “intangibles” are not taxable whether they are or are not statutorily defined. In this case, “Credits,” now statutorily defined as “intangible property,” include state and federal production tax credits.

Several courts that have expressly decided the intangible issue – specifically, whether a low-income housing credit is or is not an intangible – (which would not include the Utah Supreme Court in *Alta Pacific*) have held that low-income housing credits are intangibles based upon a generic definition of intangibles. In *Cottonwood Affordable Housing v. Yavapai County*, 72 P.3d 357 (Az. Tx. Ct. 2003), the Arizona Tax Court held that low-income housing tax credits were intangible because they were sums of money being paid by the federal government as an incentive to invest in the project and were not income flowing from the operating rental of the property. Citing other courts, for example *Cascade Court Ltd. v. Noble*, 20 P.3d 977 (Wa. App. 2001), the Arizona Court concluded as a matter of law that tax credits are intangible personal property, and thus not subject to taxation as real property. In *Cascade*, the Washington Court of

Appeals reversed the Board of Equalization's decision, holding instead that "tax credits are intangible personal property and thus are not subject to real property taxation." *Id.* at 1002. Likewise, the Missouri Court of Appeals applied the same reasoning in *Maryville Properties, L.P. v. Nelson*, 83 S.W.3d 608 (Mo. App. 2002) to "reverse the [Tax] Commission's inclusion of the capitalized value of the accelerated depreciation to the partners in the valuation. Again, this tax benefit is personal to the owner and not directly tied to the real estate." *Id.* at 617.

Whether other courts have come or would come to a different conclusion than the courts cited above is irrelevant because the unassailable point to stress in this memorandum is that the Utah Legislature has codified the principles of the *Cottonwood*, *Cascade* and *Maryville* decisions in Utah Code Ann. § 59-2-102(19). As statutorily defined, not only "low-income housing tax credits," but "credits" in general are codified as "intangible property" in Utah.

Federal and state tax credits extended to the Milford Wind Project are intangibles for the same reason that the Utah Legislature and the above-cited state courts have concluded that low-income housing credits are intangibles: the sums of money are paid by the federal and state government, or the credits which reduce the income tax liability of the taxpayer, come directly from the federal and state government as incentives; they are not part of and are not revenue or income flowing from operations of the property that is subject to ad valorem taxation. These tax credits are subsidies, and hence are intangibles under any rational application of law. The federal and state credits are conceptually indistinguishable from the low-income tax credits expressly cited as an intangible under Utah law, and which fit within the broader definition of an intangible that has been codified in Utah since 1998. State and federal tax credits for wind power are intangibles because they meet the statutory definition of intangibles, even though they are not expressly listed on the exemplary list of intangibles under current Utah Code Ann. § 59-2-102(19).

CONCLUSION

There are no credible arguments that federal and state tax credits for wind power projects are taxable, tangible property. They are, instead, rights or incentives granted by governments that are independent of and separable from the tangible property. By definition, such are intangibles that are exempt from taxation under Utah law. Such subsidies must, accordingly, be excluded from the revenue stream generated to the taxpayer from the operation of the tangible, taxable property, not only under proposed Rule 62, but any other lawful methodology the Tax Commission would use to assess Milford Wind's property.

If the property tax assessment under an income approach valuing the Milford Wind Project includes the federal and state tax subsidies as taxable property, either: (a) the project will never be built because the construction and operating costs (property tax payments) will be prohibitively high to Milford Wind; or (b) the parties will expend considerable time, effort and money in re-litigating the "intangible issue" the Counties have already lost. Under Utah statutory and case law, the Counties would not prevail in arguing that federal and state tax credits are impounded with and taxable as tangible property.