

02-1574
Centrally Assessed Property
Signed 02/24/2004

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)	FINDINGS OF FACT,
)	CONCLUSIONS OF LAW,
Petitioner,)	AND FINAL DECISION
)	
v.)	Appeal No. 02-1574
)	
PROPERTY TAX DIVISION OF)	Tax Type: Property Tax/Centrally Assessed
THE UTAH STATE TAX)	Escaped Property
COMMISSION,)	Tax Year: 1997
)	Judge: Phan
Respondent.)	

Presiding:

Pam Hendrickson, Commission Chair
Palmer DePaulis, Commissioner
Marc Johnson, Commissioner
Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REPRESENTATIVE 1, Attorney at Law
 PETITIONER REPRESENTATIVE 2, Attorney at Law
For Respondent: RESPONDENT REPRESENTATIVE, Assistant Attorney General
For Intervening
Counties: COUNTY REPRESENTATIVE 1, Attorney at Law
 COUNTY REPRESENTATIVE 2, Attorney at Law

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on December 8, 9, and 10, 2003. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The subject of this appeal is an escaped property tax assessment issued against Petitioner on August 29, 2002, for tax year 1997. Petitioner timely filed an appeal of the escaped property assessment and the matter proceeded to the point of the Formal Hearing.

2. The original 1997 property tax assessment was issued on May 1, 1997 (“Original Assessment”).¹ At that time Petitioner appealed the Original Assessment and then shortly thereafter, withdrew its petition. The appeal was dismissed on July 28, 1997, and Petitioner paid the tax indicated in the Original Assessment.

3. The Original Assessment had been based on a system wide value as of the 1997 lien date of \$\$\$\$\$. This value was reconciled from a cost indicator value of \$\$\$\$\$, an income indicator using direct capitalization of \$\$\$\$\$, an income indicator using a yield capitalization method of \$\$\$\$\$, and a stock and debt indicator of \$\$\$\$\$.

4. For the cost approach value in the Original Assessment, Respondent relied on a particular schedule in Petitioner’s Annual Property Tax Report to determine a deduction for Deferred Income Tax (“DIT”) and Investment Tax Credit (“IT”) deductions. The schedule in the report had been completed, but Petitioner had significantly overstated the amounts for the DIT and IT. Petitioner does not dispute that the particular schedule relied on by Respondent had erroneous or incomplete information. However, elsewhere in the Annual Property Tax Report the correct numbers had been provided by Petitioner and overlooked by Respondent. The 1997-year would have been the first year that taxpayers were asked to complete the particular schedule to report the DIT and IT. APPRAISER 1, who had been an Assistant Director of the Property Tax Division during 1997 and for years prior, testified that Respondent had developed the particular schedule specifically to determine the amount of the DIT and IT deductions and that they had met generally with taxpayers explaining the purpose of the schedule.

5. In July 2000, during a deposition in preparation for a hearing on the 1999 value of Petitioner’s property, Respondent discovered that Petitioner had made an error on its 1999 Annual Property Tax

¹ Exhibit 1.

Report concerning the DIT and IT deductions. After learning of the error in the 1999 report Respondent reviewed Petitioner's Annual Property Tax Reports for previous years and determined that the same error had been made in Petitioner's 1997 and 1998 report.

6. The 1999 valuation proceeded to a Formal Hearing and the Final Order of the Commission for that year was issued on April 4, 2001 ("1999 Final Order"). In the 1999 Final Order, although the Commission found that Petitioner had over reported the DIT deduction on its 1999 Annual Property Tax Report, which increased a valuation indicator, the Commission ultimately reduced the value for the property for the 1999 tax year. The Commission outlined in the 1999 Final Order the various methodologies and approaches it used to determine the value of Petitioner's taxable property.

7. If the methodologies and approaches determined by the Commission and outlined in the 1999 Final Order were applied to the 1997 numbers to determine a value for 1997, the result would be a value lower than the 1997 Original Assessment value, even after the correction was made for the DIT and IT error.

8. On August 29, 2002, Respondent issued an escaped property assessment for the tax year 1997.² The escaped property tax assessment is a tax amount in addition to that already assessed and paid pursuant to the 1997 Original Assessment. The assessment was based on a system wide value of \$\$\$\$\$. This represents an increase of \$\$\$\$\$ in system wide value over the 1997 Original Assessment. The escaped property assessment was based on Respondent's correcting only the cost approach value by reducing the amount of the DIT and IT deductions. All other valuation factors in the cost and other approaches as well as the percentage weight given to each approach remained the same as in the Original Assessment. The valuation from the Original Assessment and Escaped Property Assessment are as follows:

² See Exhibit 2.

	Original Assessment	Weight	Escaped Property Assessment
Cost	\$\$\$\$	30%	\$\$\$\$
Income-Direct Cap	\$\$\$\$	25%	\$\$\$\$
Income-DCF/Yield	\$\$\$\$	30%	\$\$\$\$
Stock & Debt	<u>\$\$\$\$</u>	15%	<u>\$\$\$\$</u>
Reconciled	\$\$\$\$		\$\$\$\$

- i. Cost Approach: In the cost approach of the Escaped Property Assessment the Respondent determined that the net book value of the plant and construction work in progress was \$\$\$\$\$. From this Respondent deducted \$\$\$\$\$ in DFIT and \$\$\$\$\$ in IT, for a cost approach value of \$\$\$\$\$. In the Original Assessment Respondent had used the same net plant plus construction work in progress number but deducted \$\$\$\$\$ in DIT and \$\$\$\$\$ in IT, to equal a cost approach value of \$\$\$\$\$. The DIT and IT deductions made to the cost approach in the Original Assessment had been based on the information reported in error by Petitioner on its 1997 Annual Property Tax Report. Respondent determined the corrected amounts for the Escaped Property Assessment, although at the hearing in this matter Petitioner challenged Respondent's corrected amount to some extent, but did not contest that they were significantly less than claimed by Petitioner on the 1997 Annual Property Tax Report.
- ii. Income Approach: Respondent performed two income approaches in determining value, a direct capitalization approach and a discounted cash flow indicator.
 1. In the direct capitalization method, Respondent determined the estimate of normalized income to capitalize was \$\$\$\$\$ and the capitalization rate applied was %%%%, resulting in a value of \$\$\$\$\$.
 2. In the discounted cash flow analysis Respondent relied on a yield

capitalization or discount rate starting with %%%%, for a resulting value of \$\$\$\$.

iii. Stock and Debt: In this approach Respondent considered the price per share of the outstanding stock and the amount of the long-term debt to determine that the value from this approach was \$\$\$\$.

9. Petitioner timely appealed the escaped property assessment.

10. The parties filed motions in November 2002 and after a hearing on the motions on January 29, 2003, the Commission issued on March 5, 2003 its Order Granting in Part, Denying in Part Respondent's Motion for Summary Judgment, Denying Petitioner's Cross Motion for Summary Judgment ("March 2003 Order"). The Commission incorporates the March 2003 Order into the record in this matter and the subsequent May 12, 2003 Order Denying Reconsideration concerning the March 2003 Order.

11. On June 16, 2003, the Intervening Counties filed a Motion for Partial Summary Judgment and Motion in Limine. After a hearing the Tax Commission issued on August 14, 2003 its Order Granting Intervening Counties' Motion for Summary Judgment, Denying Motion in Limine ("August 2003 Order"). The Commission incorporates the August 2003 Order into the record in this matter. In the August 2003 Order the Commission ruled that Petitioner could not obtain a refund of tax amounts paid pursuant to the Original Assessment as a result of this proceeding. The Commission also held that "PETITIONER is entitled to argue that its property was not undervalued and to present a full challenge of all elements of value in the process."³

12. Petitioner presented an appraisal at the hearing in this matter that had been prepared

³ Commission's August 2003 Order, pg. 6

by APPRAISER 2, MAI, CAE and APPRAISER 3, RM, CAE (“APPRAISER 2 Appraisal”).⁴ It was their appraisal conclusion that on the lien date of January 1, 1997, the system wide value of the subject property was \$\$\$\$\$. In the appraisal they consider three approaches to value, determining that the cost approach value was \$\$\$\$\$, the income approach value using a discounted cash flow yield capitalization indicator was \$\$\$\$\$, and the stock and debt approach value was \$\$\$\$\$. In correlating the final value for the property of \$\$\$\$\$ the appraisers gave the most to the income approach and less weight to the cost approach. No weight was given to the stock and debt approach.

- a. Cost Approach: In the cost approach of the APPRAISER 2 Appraisal they used the historic cost new less depreciation (“HCLD”) method to derive the value. It was their conclusion that the cost new of the total electric plant was \$\$\$\$\$. From this amount they subtracted \$\$\$\$\$ for accumulated depreciation and then added materials, supplies, merchandise and other items to determine a net plant cost of \$\$\$\$\$. They then subtracted \$\$\$\$\$ for external obsolescence for an indicated value from cost approach of \$\$\$\$\$ (rounded).⁵
- b. Income Approach: In their calculation of the income approach to value for this property they determined an estimated net operating income and capitalized that amount by a discount rate.
 - i. To determine the appropriate income stream to capitalize, the appraisers considered a five-year period from 1992 though 1996 and made various calculations on the average and weighted average to determine that the appropriate estimate of the future net cash flow to capitalize was \$\$\$\$\$.

⁴ Exhibit 23.

⁵ The external obsolescence adjustment was determined by a method referred to as the income shortfall method. This is based on the difference between the investor required rate of return which they calculated to be %%%%, and the rate of return an investor could expect from the assets which they estimated to be only %%%%.

- ii. The capitalization or discount rate applied was %%, the same rate used to determine obsolescence in the cost approach. To determine the appropriate discount rate, or weighted average cost of capital, APPRAISER 1 used the band of investment technique, which requires a rate for both the cost of debt capital and a cost of equity capital.
 - 1. The cost of debt capital determined was %% and came from long-term debt yield to maturity rates from Moody's and Standard and Poor's.
 - 2. After considering the discounted cash flow method, the risk premium method and the capital asset pricing model, it was the appraisal conclusion that the appropriate cost of equity capital was %%.
- iii. Applying the %% rate to \$\$\$\$ of cash flow resulted in an income approach of \$\$\$\$.

13. At the hearing the Intervening Counties presented a Summary Opinion of Value for the subject property that had been prepared by APPRAISER 1, ASA ("APPRAISER 1 Report").⁶ APPRAISER 1 had been employed in 1997 as the Assistant Director of the Property Tax Division and had been personally involved in the preparation of, and, in fact, had approved every aspect of the Original Assessment. In his report he stated that based on the premise that the information submitted by Petitioner was accurate and correct, "It is my opinion that the system value of \$\$\$\$ determined by the Property Tax Division for the 1998 assessment of PETITIONER constitutes the fair market value of the subject property as that term is defined by Utah law and interpreted by the policies of the Utah State Tax Commission."⁷ He went on in the report to indicate that in his opinion Respondent had correctly and appropriately determined the amount of the

⁶ See Exhibit 27.

escaped property assessment after correcting the reporting error.

14. In December 1997 the Utah Tax Commission issued a Findings of Fact, Conclusions of Law and Final Decision in (X) v. (X), Appeal Nos. 95-00789 and 95-0824. In its decision the Tax Commission “strongly discouraged the use of the direct capitalization method and the stock and debt method using stock market indicators because of the tendency each has to impound intangibles at higher levels.” The Commission also determined that the cost approach and the yield capitalization approach should be used with each being weighted at 50%.⁸ The decision issued in (X), indicates the Commission’s valuation theories and approaches at the time of the Original Assessment. Had the Original Assessment proceeded to a hearing, the (X) decision reflects methodologies and theories the Commission may have applied to determine the fair market value at that time.

15. If the Tax Commission were to determine the value for the subject property using the methodologies it determined to be appropriate in the 1997 (X) decision⁹ no weight would be given to the stock and debt or direct capitalization income indicator. The corrected cost indicator as determined by Respondent is \$\$\$\$ and the yield capitalization approach value is \$\$\$\$\$. With each weighed at 50% the resulting value would be \$\$\$\$\$. This value is lower than the Original Assessment value of \$\$\$\$\$.

16. If the Commission disregarded the stock and debt approach and the direct capitalization income indicator as was indicated by (X), but gave 30% weight to the corrected cost indicator as had been done by Respondent in its assessments, the value would be slightly higher (2%) than the Original Assessment. However, the Commission has concerns with Respondent’s discounted cash flow/yield

⁷ See Exhibit 27, pg. 7.

⁸ The Tax Commission’s Order in (X) v (X), Appeal Nos 95-0789 & 95-0825 was affirmed in 2000 by the Utah Supreme Court in (X) et. a. v. (X)., and Utah State Tax Commission, 2000 UT 29, 995 P.2d 602.

⁹ The precise weighting used by the Tax Commission to value (X) was based on the nature of the evidence available in that case. (X) did not hold that the weighting was required for other companies or other years. The Commission’s concerns with the stock and debt method and the direct capitalization method have wider application.

capitalization approach in both the Original Assessment and the Escaped Property Assessment. The Commission determines that Respondent made the assumption concerning growth based on the premise that Petitioner would be making capital expenditures, which would generate additional income. This assumption is inconsistent with the Commission's previous and current position that any valuation must be based only on assets that are in place on the lien date of January 1. Even the most conservative adjustments for growth, such as leaving the direct capitalization rate in place for the terminal or "going out" rate reduces the adjusted value to or below the original assessment if the cost approach is given at least 10% weighting. A more appropriate adjustment such as applying the cost of capital of %%%%, including the terminal rate (effectively yield capitalization) results in an income approach value less than the cost approach. This would clearly generate a value for the subject property as of the 1997 lien date lower than the value in the Original Assessment.

17. The Commission finds based on the evidence presented in this matter that the Original Assessment did not undervalue the subject property for the 1997 tax year after corrections are made for the reporting error. The Commission reaches this same conclusion if the basis for its analysis is the Commission's 1997 valuation methodologies as implemented in the (X) case, or if the basis for the analysis is the Commission's current valuation methodologies, which would be more similar to those outlined in the 1999 Decision.

APPLICABLE LAW

1. The Tax Commission is required to oversee the just administration of property taxes to ensure that property is valued for tax purposes according to fair market value. Utah Code Ann. 959-1-210(7).

2. By May 1 of each year the following property . . . shall be assessed by the commission at 100% of fair market value, as valued on January 1, in accordance with this chapter: (a) all property which operated as a unit across county lines, if the values must be apportioned among more than one county or state;

Appeal No. 02-1574

(b) all property of public utilities. (Utah Code Ann. §59-2-201(1).)

3. Any escaped property may be assessed by the original assessing authority at any time as far back as five years prior to the time of discovery, in which case the assessing authority shall enter the assessments on the tax rolls and follow the procedures established under Part 13 of this chapter. (Utah Code Ann. Sec. 59-2-217 (1).)

4. “Escaped property” means any property, whether personal, land, or any improvements to the property, subject to taxation and is: . . . (iii) undervalued because of errors made by the assessing authority based upon incomplete or erroneous information furnished by the taxpayer. (Utah Code Ann. §59-2-102(11)(a)(iii).)

5. Property which is undervalued because of the use of a different valuation methodology or because of a different application of the same valuation methodology is not “escaped property.” (Utah Code Ann. §59-2-102(11) (b).)

DISCUSSION

In determining whether the Escaped Property Assessment should be sustained, the question before the Commission is whether PETITIONER’S property was undervalued because of errors made by Respondent based on the incomplete or erroneous information provided by Petitioner. *See* Utah Code Ann. Sec. 59-2-102(11)(a)(iii). Petitioner does not dispute that it provided incomplete or erroneous information on one portion of its 1997 Annual Property Tax Report. It is clear that Respondent’s Original Assessment would have been higher but for the erroneous or incomplete information. The issue is whether the property was actually undervalued as a result of the misstatement.

In determining whether the property was undervalued, the Division and the Intervening Counties would limit the valuation issue to whether Respondent’s corrected DIT and IT deductions are the

proper amounts. Respondent argues that it is limited in the Escaped Property Assessment to the same valuation methodology it used in the Original Assessment, pointing to Utah Code Ann. Sec. 59-2-101(11)(b). It is Respondent's position that Petitioner should be bound by the same limitation in appealing the Escaped Property Assessment.

The Intervening Counties argue that Petitioner had the opportunity to challenge the Original Assessment back in 1997 when it filed an appeal. However, Petitioner withdrew its appeal without a hearing and the Intervening Counties argue the doctrine of res judicata now mandates that the Commission adopt the same valuation methodology as used in the Original Assessment and does not allow Petitioner to challenge other aspects of the valuation.

The Commission had previously ruled in this appeal that should the matter proceed to a Formal Hearing, Petitioner "is entitled to argue that its property was not undervalued and to present a full challenge of all elements of value in the process."¹⁰ The Commission sustains its earlier decision. The Commission notes when a party files a valuation appeal in the first place they are appealing the final value, not the underlying methodology and valuation techniques. If a Petitioner withdraws an appeal or reaches a settlement, what the Petitioner is agreeing to accept is the total final value. This does not necessarily mean that the Petitioner agrees to each different valuation factor, methodology or approach. The Intervening Counties' position would require parties to review for accuracy all the assessment methodology and conclusions and to incur the costs of appeal, appraisals and experts to prove that, although offset by a methodology error in their favor on one value approach, Respondent has them overvalued on another approach. This would be a waste of the both the parties' and the state's resources. In essence, a taxpayer would have to argue against an incorrect methodology even though the final value would be correct.

¹⁰ See Commission's Order Granting Intervening Counties' Motion for Summary Judgment, Denying Motion in

Petitioner's appeal of the Original Assessment, which was later withdrawn, was an appeal of the final value conclusion. The Escaped Property Assessment is a new, higher final value conclusion which Petitioner is entitled to challenge. Had the Original Assessment been as high as the Escaped Assessment, Petitioner may very well have determined it was too high and fully pursued its appeal. The likely outcome, considering the facts presented in this matter would have been a refund to Petitioner despite the misreported information concerning the DIT and IT.

The Commission concludes that the escaped property assessment is a new and separate assessment and Petitioner is entitled under Utah Code Ann. Sec. 59-2-102(12) to challenge the assessment on the basis that its property was not undervalued for the year at issue. In making this challenge the Petitioner may consider and question all the valuation conclusions and methodologies in the unitary property value, and is not limited to challenging the DIT and IT amounts.

The Intervening Counties also argued that if the Tax Commission applies its current methodologies to determine the value, it raises an equalization issue for other similarly situated taxpayers who were valued and paid taxes based on the mass appraisal methodologies used by Respondent in 1997. The Commission disagrees with this argument. When a valuation is appealed to the Commission, the Commission's task is to determine the fair market value and when it is warranted the Commission makes its value decision based on methodologies that are different from the ones used by Respondent in its mass appraisal assessments. In this matter, if the Commission determined the fair market value of the property based on the methodologies it is currently employing it would find that there was no undervaluation in the Original Assessment due to the reporting errors. In the alternative, if the Commission determined the fair market value using the methodologies the Commission would likely have approved in a 1997 valuation appeal,

Limine, dated August 14, 2003, pg 6.

as evidenced by (X), the result would still be that the Original Assessment did not undervalue the property due to the reporting errors.

CONCLUSIONS OF LAW

1. In determining whether there was “escaped property,” Utah Code Ann. Sec. 59-2-102(11)(a)(iii) requires not only that there was incomplete or erroneous information reported by the taxpayer, but also that the property was undervalued because of the erroneous or incomplete information. Based on the evidence presented there was no undervaluation and, therefore, no “escaped property.”

2. The Commission concludes that the escaped property assessment is a new and separate assessment and Petitioner is entitled to challenge the assessment on the basis that its property was not undervalued for the year at issue. In making this challenge the Petitioner may consider and question all the valuation conclusions and methodologies in the unitary property value,¹¹ and is not limited to challenging only the DIT and IT amounts. Further, this review is not limited to valuation methodologies applied by Respondent in the 1997 mass appraisal setting or the Original Assessment.

3. The Commission declines to make a determination as to whether it is limited in its review of the Escaped Property Assessment to the valuation methodologies the Commission would have used during a 1997 valuation appeal, or if the Commission should review the assessment using its current valuation methodologies because under either approach the property was not undervalued in the Original Assessment.

DECISION AND ORDER

Based upon the foregoing, the Tax Commission abates the Escaped Property Assessment for tax year 1997. It is so ordered.

¹¹ The Commission notes in determining whether there has been escaped property, unitary valuation presents unique issues from properties that are not valued on a unitary basis, like locally assessed property where a value could be directly attributable to each separate building or improvement.

Appeal No. 02-1574

DATED this _____ day of _____, 2004.

Jane Phan
Administrative Law Judge

BY ORDER OF THE UTAH STATE TAX COMMISSION:

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this _____ day of _____, 2004.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

Notice of Appeal Rights: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63-46b-13. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §§59-1-601 and 63-46b-13 et. seq.

JKP/02-1574.fof.doc