06-0722
TAX TYPE: PROPERTY TAX-CENTRALLY ASSESSED
TAX YEAR: 2006
DATE SIGNED: 6-27-2008
COMMISSIONERS: P. HENDRICKSON, B. JOHNSON, D. DIXON
CONCURRENCE: M. JOHNSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

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| PETITIONER-1,<br><br>PETITIONER,<br><br>vs.<br><br>PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION,<br><br>Respondent. | **FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION**<br><br>Appeal No. 06-0722 |
| PETITIONER-2,<br>PETITIONER,<br>vs.<br><br>PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION,<br><br>Respondent. | Appeal No. 06-0760<br><br>Tax Type: Property Tax/Centrally Assessed<br>Tax Year: 2006<br><br>Judge: Phan |

**This Order may contain confidential "commercial information" within the meaning of Utah Code Sec. 59-1-404, and is subject to disclosure restrictions as set out in that section and Utah Admin. Rule R861-1A-37. The rule prohibits the parties from disclosing commercial information obtained from the opposing party to nonparties, outside of the hearing process. However, pursuant to Utah Admin. Rule R861-1A-37 the Tax Commission may publish this decision, in its entirety, unless the property taxpayer responds in writing to the Commission, within 30 days of this order, specifying the commercial information that the taxpayer wants protected.**

**Presiding:** Pam Hendrickson, Commission Chair
Marc Johnson, Commissioner
D'Arcy Dixon Pignanelli, Commissioner
Jane Phan, Administrative Law Judge

**Appearances:** For PETITIONER-1: REPRESENTATIVE-1 FOR PETITIONER-1, Attorney
For Property Tax Division: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
For Counties: RESPONDENT, Attorney

## STATEMENT OF THE CASE

On May 1, 2006, the Property Tax Division of the Utah State Tax Commission (the "Division") issued an assessment of property tax based on a Utah taxable value of PETITIONER-1 ("PETITIONER-1'S") operating property of $$$$$, as of January 1, 2006.

On May 29, 2006, PETITIONER-1 timely filed a Request for Agency Action, pursuant to Utah Code Sec. 59-2-1007, challenging the Division's assessed valuation against its operating property. PETITIONER-1'S petition was assigned Appeal No. 06-0722.

On or about June 1, 2006, the Counties filed a Petition for Redetermination, pursuant to Utah Code Sec. 59-2-1007, alleging that the Division's assessed valuation against PETITIONER-1'S Utah operating property was less than the fair market value of such property. The Counties' petition was assigned Appeal No. 06-0760.

PETITIONER-1'S and the Counties' appeals were consolidated before the Utah State Tax Commission (the "Commission") for purposes of the Formal Hearing which was held on Tuesday, November 13, 2007 through Thursday, November 15, 2007. The parties filed Proposed Findings of Fact, Conclusions of Law and Final Decisions on February 1, 2008, which have been incorporated in part into this decision.

Based upon the pleadings, evidence and testimony presented at the Formal Hearing, the Commission makes and enters its:

## FINDINGS OF FACT

1. The tax at issue is the Utah ad valorem property tax of PETITIONER-1's centrally assessed properties for the tax year 2006.

2. The subject lien date is January 1, 2006.

## PETITIONER-1

3. As of the subject lien date, PETITIONER-1 was the largest provider of cellular service in the United States and provided cellular services to approximately ##### subscribers throughout the United States.[1]

4. PETITIONER-1'S operating network was comprised of both intangible and tangible properties that it either owned or leased from others. Some examples of the types of properties that make up the PETITIONER-1 network includes: FCC licenses, customer lists, software, trademarks, land, cell sites, antennas, switches, and other cellular equipment.[2]

5. PETITIONER-1'S cellular technology and equipment have been rapidly evolving during the past several years. PETITIONER-1'S first generation technology ("REMOVED") is largely obsolete and is scheduled to be completely phased out by March of 2008.[3]

6. As of the subject lien date, PETITIONER-1'S digital network primarily utilized Time Division Multiple Access ("TDMA" or "2G") technology and Global System for Mobile Communications ("GSM" or "2.5G") technology.[4]

7. PETITIONER-1 has been moving its subscribers from TDMA to GSM. As of the

[1] Hearing Exhibit 13 (Form 10-K), p. DIV 59.
[2] Hearing Exhibit 13 (Form 10-K), pp. DIV 65, 89 and 75.
[3] Transcript, pp. 100-101, and Hearing Exhibit 13 (Form 10-K), pp. DIV 59, 65-66.

subject lien date 86% of the subscriber base used GSM equipment and 95% of the network's total minutes were carried on the GSM network.[5]

8. A third generation technology ( "REMOVED") was beginning to be implemented at the time of the subject lien date.[6]

9. As of the lien date January 1, 2006, PETITIONER-1 was essentially wholly owned by COMPANY-1("COMPANY-1") and COMPANY-2.[7], f/k/a/ COMPANY-3(in order to avoid confusion with COMPANY-4 ("COMPANY-4"), COMPANY-2. will be referred to as ("COMPANY-2").

10. PETITIONER-1 originally consisted of the wireless property formally owned by COMPANY-1 and COMPANY-2. On October 26, 2004, more than 14 months prior to the subject lien date, PETITIONER-1 acquired all of the assets of COMPANY-4.[8] PETITIONER-1 had no assets in Utah until it acquired COMPANY-4.

11. As a result of the COMPANY-4 acquisition, PETITIONER-1 booked the COMPANY-4 assets as of the acquisition date, October 26, 2004, under a fair value standard required by Statement of Financial Accounting Standards ("SFAS") number 141.[9]

12. PETITIONER-1 employed FINANCIAL ADVISORS to determine the fair value of the assets of COMPANY-4 as of October 26, 2004. The "fair value" standard applied by FINANCIAL ADVISORS was defined as "the amount at which an asset (or liability) could be

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[4] *Id.*
[5] *Id.*
[6] Transcript, p. 101, and Hearing Exhibit 13 (Form 10-K), p. DIV 66.
[7] Hearing Exhibit 13, p.3.
[8] Hearing Exhibit 13 (Form 10-K), p. DIV 59.
[9] Hearing Exhibit 9.

bought (or incurred or sold or (settled) in a current transaction between willing parities, that is other than in a forced liquidation or sale."[10]

13. FINANCIAL ADVISORS prepared a discounted cash flow analysis which indicated the business enterprise value of COMPANY-4 was $$$$$.[11]

14. At the time of the acquisition, the historic book cost of COMPANY-4' property, plant and equipment ("PP&E") was recorded as $$$$$.[12] Due to the rapid change in cellular technology, it was suspected that the fair value was actually less than the historical value placed on the books because the PP&E was suffering from significant functional obsolescence.[13] FINANCIAL ADVISORS determined that the fair value of COMPANY-4 PP&E was only $$$$$.[14] As a result, PETITIONER-1 was required to impair the value of the COMPANY-4 PP&E assets on its books and write them down by more than $$$$$ ($$$$$- $$$$$).[15]

15. FINANCIAL ADVISORS concluded that the fair value of the assets of COMPANY-4 were as follows: [16]

Property Plant & Equipment: $$$$$
FCC Licenses: $$$$$
Trademarks/Trade Names: $$$$$
Customers: $$$$$

Total: $$$$$

[10] Hearing Exhibit 9, p. CIN00005.
[11] Hearing Exhibit 9, BI or CIN00108-9.
[12] Hearing Exhibit 7, Addendum K.
[13] Transcript, pp. 100-116.
[14] Hearing Exhibit 9, p. CIN00008.
[15] Transcript, pp. 119-120.
[16] Hearing Exhibit 9, CIN00008

16. FINANCIAL ADVISORS expressly did not value goodwill.[17]

17. For comparison purposes, COMPANY-4 subscriber base was $$$$$ compared to PETITIONER-1'S subscriber base of $$$$$ immediately prior to the merger.[18]

18. PETITIONER-1, in anticipation of the acquisition of COMPANY-4, also prepared a discounted cash flow (DCF) for the combined unit that resulted in a total enterprise value of $$$$$.[19]

19. PETITIONER-1 performed a business enterprise value for financial accounting purposes as of October 1, 2005, three months preceding the lien date, and determined a value of $$$$$ for its enterprise.[20]

20. As of December 31, 2005, PETITIONER-1 reported on its books goodwill in the amount of $$$$$.[21]

21. The booked goodwill represents the residual amount primarily from the purchase price paid by PETITIONER-1 to acquire the assets of COMPANY-4 over the fair value of the identifiable COMPANY-4 assets.[22]

**Division's Original Assessment**

22. The Division's original assessment was prepared by APPRAIRER-1, a valuation analyst with the Division.[23] The Division prepared two indicators of value – a historic cost less depreciation ("HCLD") cost indicator and a yield capitalization income indicator. The Division

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[17] Hearing Exhibit 11, p. CIN00016.
[18] Hearing Exhibit 14, p.2.
[19] Hearing Exhibit 11, p. CIN00254.
[20] Hearing Exhibit 10, p. CIN00208.
[21] Hearing Exhibit 13.
[22] Hearing Transcript, p. 281.

placed 50% weighting upon each of its indicators.[24]

23. The Division's original assessment may be summarized as follows[25]:

| Indicator | Weighting | Value |
|---|---|---|
| HCLD | %%% | $$$$$ |
| Yield Capitalization | %%% | $$$$$ |
| Reconciled System Value | | $$$$$ |
| Utah Allocation | | %%% |
| Utah Value Before Adjustments | | $$$$$ |
| Adjustments (vehicles, exempt prop., etc.) | | <$$$$$> |
| Indicated Utah Assessment | | $$$$$ |

24. In preparing its cost approach, the Division took the total historical cost for plant in service and deducted accumulated book depreciation.[26] The Division did not make an adjustment for functional or economic obsolescence in its HCLD indicator.[27] The Division only deducted book depreciation from the historical cost amounts.[28]

25. The Division also did not include any historical costs associated with the FCC licenses ("spectrum") or goodwill, as it was the Division's position that these items represent intangible property that is not subject to Utah property tax.[29]

26. APPRAIRER-1 and APPRAISER-2 testified that the Division did not include spectrum or goodwill in the assessment of any other wireless company in the State of Utah in the

[23] Hearing Exhibit 5, and Transcript, p. 53.
[24] Hearing Exhibit 5.
[25] *Id.*
[26] Transcript, p. 60.
[27] Transcript, p. 61.

Division's 2006 assessments.[30]

27. In its yield capitalization approach, the Division utilized $$$$$ as its estimate of normalized net operating income ("NOI").[31] The Division used this estimate of NOI as its estimate for cash flow. In essence, it assumed that depreciation and deferred income taxes ("DIT") were fully offset by replacement capital expenditures.[32]

28. The Division estimated a cost of capital of 9.82%, and utilized an inflationary growth factor of 2.4%. By subtracting this growth rate from its cost of capital, the Division capitalized its estimate of NOI at a rate of 7.42%, and derived an income estimate of $$$$$ prior to adjustments for intangibles.[33]

29. The Division removed intangibles from its income estimate by using a book ratio of taxable operating property divided by total operating property minus goodwill.[34] In this formula, the Division used $$$$$ as its estimate of taxable operating property. The total operating property for PETITIONER-1 was $$$$$, and the Division deducted goodwill of $$$$$ from this amount to derive a total of $$$$$ that it used in the denominator of its ratio.[35] The result of the Division's ratio of taxable property to total property was 43.35% ($$$$$). By applying this ratio, the Division removed intangible property from its income estimate and

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[28] *Id.*
[29] Hearing Exhibit 5 and Transcript, pp. 62 and 85.
[30] Transcript, pp. 63 and 85-86.
[31] Hearing Exhibit 5, p. 6.
[32] Transcript, pp. 63-64.
[33] Hearing Exhibit 5, p. 6.
[34] Hearing Exhibit 5, p. 7.
[35] Hearing Exhibit 5, p. 7.

derived an income indicator of $$$$$.[36]

30. The Division testified that it believed it made several errors in its original assessment and decided that it needed to prepare a new assessment to present at the Formal Hearing.[37]

**Appraisal Evidence**

31. The parties agreed to exchange appraisals on September 21, 2007. PETITIONER-1 retained APPRAISER-3,[38] to prepare an appraisal of its property, the Counties retained APPRAISER-4,[39] to prepare a review appraisal of the Division's original assessment. The Division abandoned its original assessment and had APPRAISER-1 and APPRAISER-2 prepare a new appraisal.[40]

32. The conclusions from each of these appraisal documents are summarized as follows:

[36] Hearing Exhibit 5, p. 6.
[37] Transcript, pp. 81 and 427.
[38] Hearing Exhibits 1 and 7.
[39] Hearing Exhibits 2 and 8.
[40] Hearing Exhibits 3, 4 and 6.

| | Exhibit 5<br>Division's Original Assessment | Exhibit 6<br>Division's New Appraisal | Exhibit 7<br>APPRAISER-3 Appraisal | Exhibit 8<br>APPRAISER-4 Review Appraisal |
|---|---|---|---|---|
| **Cost Indicator** | HCLD | HCLD | HCLD | HCLD |
| Exclusions | Booked Goodwill<br>Customer Lists<br>Licenses/Spectrum | Booked Goodwill<br>Customer Lists<br>Licenses/Spectrum | Booked Goodwill<br>Customer Lists<br>Licenses/Spectrum | Customer Lists |
| Obsolesces Adjustment | None | None | $$$$$ | None |
| Cost Value | $$$$$ | $$$$$ | $$$$$ | $$$$$ |
| **Income Indicator** | Yield Cap | Yield Cap | Yield Cap | DCF |
| Cash Flow | $$$$$ | $$$$$ | $$$$$ | Initial:<br>$$$$$<br>Terminal:<br>$$$$$ |
| WACC | %%% | %%% | %%% | %%% |
| Flotation Adjust | None | None | Yes | None |
| Growth | %%% | %%% | %%% | %%% |
| Capitalization Rate | %%% | %%% | %%% | %%% |
| Value with Intangibles. | $$$$$ | $$$$$ | $$$$$ | $$$$$ |
| Adj. For Intangibles. | %%% | %%% | %%% | %%%* |
| Income Value | $$$$$ | $$$$$ | $$$$$ | $$$$$ |
| Weight (Cost/Income) | %%% | %%% | %%% | %%% |
| System Value | $$$$$ | $$$$$ | $$$$$ | $$$$$ |
| Allocation | %%% | %%% | %%% | %%% |
| Utah Value Before Vehicle Adjustments | $$$$$ | $$$$$ | $$$$$ | $$$$$** |

*Applied only to Customer Lists and "Other" intangibles.
** APPRAISER-4 also determined a value in his appraisal if he were to assume that the spectrum licenses were exempt from tax of $$$$$ for the Utah taxable value.

**A. Division's New Appraisal**

33. APPRAISER-1 and APPRAISER-2 submitted an appraisal for the Division in this matter in which it was their conclusion that the fair market value of PETITIONER-1'S Utah taxable property for ad valorem purposes on the lien date was $$$$$. Then after subtracting the final adjustment for vehicles the resulting value was $$$$$.[41] APPRAISER-1 is an Appraisal Specialist for the Division and is an Accredited Valuation Analysts by the National Association of Certified Valuation Analysts.[42] APPRAISER-2 is a Licensed Appraiser by the Utah Division of Real Estate and a Certified Appraiser by the Tax Commission.[43]

34. **Cost Approach**. In preparing its new appraisal, the Division did not change how it estimated its HCLD indicator, which had been a system wide value of $$$$$ in the original assessment as well as the appraisal.

35. The Division appraiser, APPRAISER-1, testified that PETITIONER-1 is worth more now as an integrated unit, than valuing COMPANY-4 and PETITIONER-1 separately. APPRAISER-1 testified that there is likely enhancement and assemblage value associated with the combined PETITIONER-1 unit that is subject to taxation in the state of Utah.[44]

36. The Division's cost indicator excluded the booked value of licenses, goodwill and customer lists in the amount of $$$$$.[45]

37. **Income Indicator**. In its appraisal the Division prepared an income indicator

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[41] Hearing Exhibit 6.
[42] Hearing Exhibit 3.
[43] Hearing Exhibit 4.
[44] Transcript, p. 425-427.
[45] Hearing Exhibits 6 & 13 p. DIV 135; Transcript, p. 411;

utilizing the yield capitalization method preferred by Utah Admin. Rule.R884-24P-62 ("Rule 62").[46] The most significant change made by the Division in the appraisal from the original assessment was that it increased its cash flow estimate from $$$$$ to $$$$$ by increasing its estimated NOI and including DIT in its cash flow. This resulted in an increased yield capitalization conclusion from $$$$$ to $$$$$.[47]

38. Because of PETITIONER-1'S acquisition of COMPANY-4 in 2004, the Division did not rely upon historical average to arrive at an estimated normalized NOI for cash flow purposes.[48] The Division based its normalized NOI estimate solely on the income as reported for the combined entity for 2005, the one full year that the information was available.

39. The Division estimated normalized NOI by adjusting the 2005 NOI for amortization and inflation. To calculate the 2005 NOI, the Division started with operating income of $$$$$. The Division explained that it added back amortization of $$$$$ for customer lists that had been previously deducted. However, this adjustment was not apparent in the appraisal. The Division then subtracted interest of $$$$$ before calculating and deducting income taxes at an assumed income tax rate of 33.59%. Interest was then added back to arrive at NOI of $$$$$ for December 31, 2005. The Division adjusted the December 31, 2005, NOI of $$$$$ for inflation to arrive at an estimated normalized NOI of $$$$$.[49]

40. APPRAISER-2 testified that the division could have made the amortization adjustment after calculating NOI, in which case, the estimated normalized NOI would have been

[46] Hearing Exhibit 6.
[47] Hearing Exhibit 6; Transcript, pp. 82 and 83.
[48] Transcript, p. 473.

$$$$$ and the amortization addition to arrive at cash flow, after tax would have been resulting in $$$$$ cash flow of $$$$$, the same as calculated in the appraisal.[50]

41. The Division assumed that no replacement capital expenditures would be needed for customer lists.[51]

42. The Division pointed out that if it were to assume that PETITIONER-1 would purchase in perpetuity additional customer lists similar to the COMPANY-4 acquisition, its assumptions of growth and NOI would be increased substantially.[52]

43. The Division noted that neither PETITIONER-1, nor FINANCIAL ADVISORS in their DCF analyses for the COMPANY-4 acquisition assumed that PETITIONER-1 would continue to purchase customer lists in perpetuity.[53]

44. The estimated normalized NOI of $$$$$ was adjusted for additional non-cash charges to arrive at a cash flow estimate of $$$$$.[54]

45. The cash flow of $$$$$ was capitalized by the weighted average cost of capital of 9.82%, less inflationary growth of 2.4%, to arrive at an income indicator of $$$$$, before the subtraction for intangible property.[55]

46. The Division's weighted average cost of capital of 9.82% was prepared in accordance with Rule 62. This consisted of a debt rate of 5.84% and an equity rate of 11.53%, which the Division weighted 30%/70% respectively. The Division did not add flotation costs to

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[49] Hearing Exhibit 6; Transcript 434-435.
[50] Transcript, pp. 436-437.
[51] Hearing Exhibit 6, p. 6.
[52] Transcript, pp. 415, 455.
[53] Hearing Exhibit 9, p. CIN00109; Hearing Exhibit 10, p. CIN00256; Transcript, pp. 439-441.
[54] Hearing Exhibit 6, p. 6.

its rate.[56]

47. APPRAISER-2 and APPRAISER-2 testified that the income indicator of $$$$$ did not include value from exempt goodwill or the goodwill booked upon the records of PETITIONER-1.[57]

48. APPRAISER-2 testified that PETITIONER-1 did not earn an above normal rate of return nor did it have any goodwill on its books that was not otherwise attributed to an acquisition of tangible property.[58]

49. The Division used the same approach to determine the taxable property ratio as it had in its original assessment, by dividing the book value of the taxable property by the book value of the total operating property excluding goodwill to arrive at a taxable property ratio of 43.35%.[59]

50. The Division then applied the taxable property ratio of 43.35% to the Division's income indicator of $$$$$ to arrive at an income indicator for the taxable property of $$$$$.[60]

51. The Division did not include book goodwill in the denominator of its taxable property ratio because the Division believed that its income indicator failed to capture value related to exempt goodwill.[61]

52. APPRAISER-2 stated that the yield capitalization method utilized by the Division does not capture intangible property to the same degree as other methods. The Division pointed

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[55] Hearing Exhibit 6, p.6.
[56] Hearing Exhibit 6, p. 10.
[57] Transcript, pp. 413,442,443.
[58] Transcript, p. 443.
[59] Hearing Transcript 6, p. 7.
[60] Hearing Exhibit 6, p. 6.

out that its income indicator with intangible property is $$$$$, which is almost $$$$$ below the enterprise value of $$$$$ determined by PETITIONER-1 as of October 1, 2005 for SFB 142 impairment purposes.[62] The $$$$$ determined by PETITIONER-1 was used to determine whether any of the booked goodwill should be impaired under Statement of Financial Accounting Standard, SFAS 142, and no goodwill was impaired.[63] It was the Division's position that it is likely under FASB 142 that all of the booked goodwill of PETITIONER-1 would be impaired and written off if the $$$$$ income value determined by the Division was used as the business enterprise value for SFAS 142 impairment testing[64]

53. The booked goodwill arises mainly from PETITIONER-1'S acquisition of COMPANY-4 in 2004.[65]

54. PETITIONER-1 purchased COMPANY-4 for $$$$$.[66] FINANCIAL ADVISORS, without valuing goodwill, arrived at an operating value for only the COMPANY-4 assets of almost $$$$$.[67] The Division's income indicator for PETITIONER-1, which includes the PETITIONER-1 and COMPANY-4 assets, is $$$$$ before the deduction for intangible property.[68]

55. **Correlation**. The appraisers for the Division did not prepare a market indicator. The weighed their income and cost indicators equally in reaching their conclusion that the system

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[61] Transcript, pp. 413, 442, 443.
[62] Hearing Exhibit 10, p. CIN00213; Transcript 445.
[63] Hearing Exhibit 10, pp. CIN00206-208.
[64] Hearing Exhibit 10, p. CIN00206.
[65] Hearing Exhibit 13.
[66] Hearing Exhibit 9, p.33.
[67] Hearing Exhibit 9, exhibit B.I.
[68] Hearing Exhibit 6, p. 98.

value of PETITIONER-1'S tangible property was $$$$$.

56. **Allocation Factor**. The Division determined its interstate allocation factor of 0.52% using its standard allocation method by giving 75% weight to a historical cost factor of 0.46% and 25% weight to a revenue factor of .67%.

57. The 0.52% interstate allocation factor for the subject year of 2006 is a substantial change from the 0.77% interstate factor used for January 1, 2005. This is primarily the result of a write down of the historical cost for the Utah assets, comprising the COMPANY-4 assets, from $$$$$ in 2004 to $$$$$ in 2005.[69]

58. For comparison purposes, the Division's assessment for PETITIONER-1, which was not appealed in 2005, indicated a Utah value of $$$$$, an amount substantially higher than the $$$$$ asserted by the Division in this matter.[70]

**B. APPRAISER-3**

59. PETITIONER-1 hired APPRAISER-3 to prepare an appraisal of the subject property. In the appraisal APPRAISER-3 prepared a cost indicator from which he determined a value of $$$$$ and an income indicator from which he concluded a value of $$$$$. He indicated in his appraisal that the income indicator was the most applicable method for appraising PETITIONER-1'S property and gave his value from that indicator approximately 70% of the weight. Based on these values and weighting, it was his conclusion that the system value of Petitioner's tangible property was $$$$$. He applied the Division's allocation factor of 0.52%, which resulted in a Utah taxable value of $$$$$ prior to adjustment for vehicles.

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[69] Hearing Exhibit 12, p. 23.

60. **Cost Approach**. APPRAISER-3 began with the same HCLD approach used by the Division, but then he made a $$$$$ deduction for functional obsolescence.[71]

61. APPRAISER-3 testified that an appraiser is required to look and see if any additional obsolescence is present in excess of book depreciation.[72]

62. APPRAISER-3 testified that an appraiser could readily observe functional obsolescence in the market data associated with the acquisition of COMPANY-4 in October 2004.[73] COMPANY-4 property, plant and equipment ("PP&E") had been carried on its books at a historical cost of $$$$$.[74] As part of the acquisition, a revaluation was performed by FINANCIAL ADVISORS that determined that the COMPANY-4 PP&E was only worth $$$$$.[75] As a result, the COMPANY-4 PP&E was written down in the financial records by $$$$$ ($$$$$- $$$$$), or a 38.07% decrease.[76]

63. APPRAISER-3 testified that values carried on PETITIONER-1'S books for its PP&E were very similar to the unadjusted values COMPANY-4 had been carrying on its books for its PP&E prior to the acquisition.[77]

64. APPRAISER-3 concluded that market evidence from the COMPANY-4 transaction supported a 38.07% decrease in historic cost numbers carried on PETITIONER-1'S

[70] Hearing Exhibit, p. 21.
[71] Hearing Exhibit 7, p. 12 and Addendum C.
[72] Transcript, p. 108, and *see* The Appraisal of Real Estate, p. 365 (12th Ed. Appraisal Institute 2001).
[73] Transcript, pp. 111-123.
[74] Hearing Exhibit 7, Addendum K.
[75] Hearing Exhibit 9, p. 94.
[76] Transcript, pp. 119-120.
[77] Hearing Exhibit 14, and Transcript, pp. 124-129.

books for its PP&E.[78] By applying, the 38.07% obsolescence adjustment to PETITIONER-1'S PP&E, APPRAISER-3 determined that the historic cost numbers should be reduced by $$$$$ to account for functional obsolescence.[79]

65. By deducting this amount for functional obsolescence from his HCLD approach, APPRAISER-3 derived a final HCLD estimate of $$$$$.[80]

66. **Income Indicator**. Like the Division, APPRAISER-3 used the yield capitalization method to determine an income indicator. APPRAISER-3 income value of $$$$$ was somewhat higher than the Division's Income indicator. One difference between APPRAISER-3 and the Division's indicators was that APPRAISER-3 estimated the cash flow to be capitalized was $$$$$,[81] while the Division's cash flow to be capitalized was $$$$$.[82]

67. APPRAISER-3 determined the cash flow by using PETITIONER-1'S December 31, 2005, NOI of $$$$$ and increasing it by 83.29%.[83] In assuming that NOI equals cash flow, APPRAISER-3 assumed that non-cash charges would be offset by capital expenditures in perpetuity.[84]

68. APPRAISER-3 calculated the 83.29% increase factor by using FINANCIAL ADVISORS estimated increase in cash flow for COMPANY-4 from 2005 to 2006 of $$$$$ to $$$$$ respectively.[85] In determining this factor he used the FINANCIAL ADVISORS cash flow,

[78] *Id.*
[79] Hearing Exhibit 7, p. 12, and Transcript, p. 122.
[80] Hearing Exhibit 7, pp. 14 and C-2.
[81] Hearing Exhibit 7, p. 8 and Addendum A.
[82] Hearing Exhibit 6.
[83] Hearing Exhibit 7, p. 8.
[84] Transcript, p. 148.
[85] Hearing Exhibit 7, p. 8.

which had adjusted the net income ("NI") for depreciation, amortization and capital expenditures. Had APPRAISER-3 used the NI estimates of FINANCIAL ADVISORS for 2005 and 2006 instead of the cash flow, the percentage growth would have been 224% not 83.29%.[86]

69. APPRAISER-3 NOI, before he adjusted it for 83.29%, contained a non-cash charge of $$$$$ for amortization related to customer lists. Since APPRAISER-3 adjusted his NOI by 83.29%, the $$$$$ non-cash charge to NOI for amortization is increased by 83.29% resulting in an assumption by APPRAISER-3 that PETITIONER-1 will incur annually into perpetuity an amount of $$$$$ in capital expenditures for additional customer lists.[87]

70. APPRAISER-3 recognized his assumption that amortization was offset in perpetuity by capital expenditures was not correct and it results in a cash flow assumption that is too low.[88]

71. APPRAISER-3 justified his amortization error by stating that his income indicator was still higher than the Division's so that no harm was done.[89]

72. Both FINANCIAL ADVISORS (in its DCF of COMPANY-4) and PETITIONER-1 (in its analysis of the acquisition) assumed in their terminal cash flow that depreciation equated capital expenditures and that no capital expenditures were provided for future customer list acquisitions.[90]

73. APPRAISER-3 cost of capital was comprised of a debt rate of 5.90% and an

[86] Transcript, p. 247.
[87] Hearing Exhibit 7, Addendum E; Hearing Exhibit 7 pp. DIV154-155.
[88] Transcript, pp. 149, 150.
[89] Transcript, p. 150.
[90] Hearing Exhibit 10, p. CIN00109; Hearing Exhibit 11, p. CIN00256.

equity rate of 11.71%, which included an adjustment for flotation. APPRAISER-3 recommended a flotation adjustment of 1% to his cost of debt and 5% to his cost of equity.[91] APPRAISER-3 calculated his flotation amounts by referring to Public Utility Tracker, a national service that follows and reports issuance costs associated with debt and equity. He gave the equity rate 79% weight and the debt rate 21% weight, for a weighed average cost of capital of 10.49%.[92] This rate was higher than the Division's weighted average cost of capital of 9.82%.[93]

74. However, after the deductions for growth APPRAISER-3 and the Division's adjusted rates were similar. APPRAISER-3 subtracted 3.25% for growth from his weighted average cost of capital of 9.82%, which resulted in an adjusted capitalization rate of 7.24% that was comparable to the capitalization rate adjusted for growth of 7.42% used by the Division.[94]

75. Utilizing his cash flow estimate of $$$$$ and capitalization rate adjusted for growth of 7.24%, APPRAISER-3 derived an income indicator value of $$$$$ prior to deduction for intangible property.[95]

76. **Deduction for Intangibles**. APPRAISER-3 used market numbers in his ratio to determine a deduction for intangibles in the cost approach. Like the Division he agreed that intangibles should be deducted from the income approach. He testified that he preferred to use market numbers in this ratio, but that an appraiser could also use book numbers.[96]

77. APPRAISER-3 agreed that the Division's general ratio of taxable operating

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[91] Hearing Exhibit 7, pp. B-4 and B-9.
[92] Hearing Exhibit 7, p. 9.
[93] Hearing Exhibit 6, p. 10.
[94] Hearing Exhibit 7, pp. 9-10.
[95] Hearing Exhibit 7, p. 10 and Addendum A.
[96] Transcript, pp. 175-176.

property divided by total operating property is an acceptable formula to use to remove intangibles from the income estimate.[97]

78. APPRAISER-3 testified that goodwill is an operating asset and it was his opinion that the Division had made a mistake by removing goodwill from its denominator in its ratio.[98] APPRAISER-3 testified that the correct ratio using book numbers would have been 30% ($$$$$/$$$$$).[99] If APPRAISER-3 applied the 30% ratio to his $$$$$ income estimate, his resultant income indicator would have been $$$$$.[100]

79. However, in his own calculation, APPRAISER-3 also excluded goodwill in the denominator. He testified that he had attempted to apply the operating property ratio by using market numbers from the FINANCIAL ADVISORS report. APPRAISER-3 used the PP&E estimate of $$$$$ for the COMPANY-4 assets in the numerator of the ratio and used $$$$$ in the denominator ($$$$$ of total COMPANY-4 assets - $$$$$ of investments) to derive a ratio of 31.51%.[101] By applying this ratio, APPRAISER-3 derived an income indicator of $$$$$ ($$$$$ x %%%%).[102]

80. APPRAISER-3 admitted that his ratio using this market data was incomplete because the denominator should have included goodwill.[103] He stated that he did not have a market estimate for goodwill and thus could not include it in the denominator. If he had had a goodwill estimate, he states that he would have included it in the denominator and the resultant

[97] Transcript, p. 175.
[98] Transcript, p. 176.
[99] Transcript, pp. 179-180.
[100] Transcript, pp. 180-181.
[101] Hearing Exhibit 7, p. 10, and Transcript, pp. 181-183.
[102] Hearing Exhibit 7, p. 10, and Transcript, pp. 183, 186.

ratio would have decreased.[104] Because the addition of goodwill would have decreased his ratio, he determined that his 31.15% ratio was very conservative and was consistent with a ratio of 30% based on book values and thus provided a reasonable estimate in this case.[105]

81. **Reconciliation & Allocation**. In his appraisal, APPRAISER-3 indicated that the most applicable method for appraising the tangible telecommunications operating property was the income approach. However, he did place some weight on the cost approach, approximately 30%, and his reconciled system value was $$$$$. APPRAISER-3 applied the same 0.52% factor, as had the Division to allocate the portion of the value to the operating property taxable to Utah.[106]

**C. APPRAISER-4 Review Appraisal**

82. APPRAISER-4 testified on behalf of the counties. He prepared a review appraisal of the Division's assessment and provided an opinion of value for PETITIONER-1'S operating property for tax year 2006. APPRAISER-4 is licensed by the (X) Society of Appraisers as an accredited senior appraiser and by the States of Utah and STATE as a certified general appraiser.[107]

83. APPRAISER-4 appraisal provided two opinions of value, one that included a value for the spectrum licenses and one taking into consideration the Commission's prior decisions regarding spectrum licenses. It was his appraisal conclusion that the system value of

[103] Transcript, p. 184.
[104] Transcript, pp. 184-185.
[105] Transcript, pp. 183-186.
[106] Exhibit 7, p. 16.
[107] Exhibit 2.

PETITIONER-1'S operating property was $$$$$ if the value of the spectrum licenses were considered in the taxable value and $$$$$ if the spectrum licenses were not subject to Utah property tax.[108] These values are significantly higher than the system value determined by the Division in its original assessment of $$$$$.[109] In his appraisal, APPRAISER-4 prepared both a cost and income indicator.

84. **Cost Indicator**. Like the Division and APPRAISER-3, APPRAISER-4 used an HCLD method for his cost indicator. APPRAISER-4 HCLD estimate differs from the Division's original assessment primarily in that he added FCC licenses or spectrum ($$$$$) and goodwill ($$$$$) into his cost approach to value.[110] APPRAISER-4 resultant cost approach was $$$$$.[111]

85. APPRAISER-4 testified that in his opinion the licenses owned by PETITIONER-1 to use the spectrum represents an interest in tangible property and is taxable.[112]

86. APPRAISER-4 testified that the booked goodwill of PETITIONER-1 is simply an accounting term to represent the surplus between the purchase price of COMPANY-4 and the summation of the identifiable individual assets of COMPANY-4. It was his opinion that the value of the booked goodwill in this case was dependent upon the methods employed by FINANCIAL ADVISORS to value the individual assets of COMPANY-4.[113] It was APPRAISER-4 conclusion that PETITIONER-1'S booked goodwill represented enhancement or

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[108] Exhibit 8.
[109] Exhibit 5.
[110] Hearing Exhibit 8, p. 18.
[111] *Id.*
[112] *Id., pp 13-14*.
[113] Transcript, pp. 281-285.

assemblage value of the property operating together as a unit.[114]

87. It was APPRAISER-4 opinion that since the allocated value of the tangible assets does not represent their contributory value to the unitary business, all of the goodwill residual should be attributable to the tangible assets. He indicted that the goodwill residual represents the enhancement in value that has occurred to the tangible assets by bringing them into the unit of assets functioning as a going concern. It was his position that the booked value of the identifiable intangible assets already represents this enhanced value because of the manner these assets were appraised in the purchase price allocation appraisal.[115]

88. APPRAISER-4 testified that in his opinion there was a nonuniform treatment of centrally assessed taxpayers with the application of the new goodwill statute. He found the statute "very troubling" especially the provision in the law that stated if the goodwill was booked it was deemed intangible. APPRAISER-4 testified that there are hundreds of unitary properties where this enhancement or assemblage value exists but is never booked because there is never a sale, purchase transaction or other triggering event. He argues that that when a triggering event occurs and a company books the goodwill, that company gets the exemption. However, the companies who have not had a triggering event, and have not booked goodwill for financial reporting purposes, are not entitled to the exemption under the statute.[116]

89. APPRAISER-4 conceded that if the booked costs for the FCC or spectrum licenses and goodwill were removed from his cost approach, his cost approach would essentially

[114] Hearing Exhibit 8, Transcript, p. 287.
[115] Hearing Exhibit 8, Transcript 280-288.
[116] Transcript, pp. 402-403.

be the same as the Division's HCLD approach.[117]

90. APPRAISER-4 was of the opinion that the HCLD cost approach was a "weak approach for the subject property" and that it should be given little if any weight in this matter.[118]

91. **Income Indicator.** APPRAISER-4 placed all weight on his income indicator. In his review appraisal, APPRAISER-4 income indicator system value for the operating assets was $$$$$, which included a value for spectrum and goodwill**,** or if he was to assume spectrum was not subject to tax, a value of $$$$$.[119] The large difference in value between APPRAISER-4 $$$$$ and the Division and APPRAISER-3 conclusion from the income indicator was that APPRAISER-4 did not remove goodwill from his income value, as it was his assertion that it was subject to tax.

92. Instead of the yield capitalization model used by the Division and APPRAISER-3, APPRAISER-4 estimated an income value using an eight year discounted cash flow model ("DCF"). APPRAISER-4 testified that the DCF valuation captured the net present value of the full-expected growth opportunities of PETITIONER-1.

93. APPRAISER-4 testified that projecting "future cash flows can be quite subjective," thus he decided to rely on many of the assumptions made in the FINANCIAL ADVISORS report for COMPANY-4 to prepare his DCF valuation.[120] APPRAISER-4 made an assumption that depreciation and capital expenditures would converge until year eight and then he used a one-step yield capitalization convention to estimate the residual value in the terminal

[117] Transcript, pp. 342-343.
[118] Hearing Exhibit 8, p. 43.
[119] Hearing Exhibit 8.

year.

94. APPRAISER-4 derived his own weighted average cost of capital (9.36% after tax adjustment) that he used in his model. Using this DCF model, APPRAISER-4 derived an income indicated value of $$$$$ prior to a deduction for intangible properties.[121]

95. APPRAISER-4 pointed out that the licenses from the COMPANY-4 acquisition were valued for PETITIONER-1'S book purposes using a terminal growth assumption of 3.5%, where the Division's income indicator relies upon inflationary growth of 2.40%.[122]

96. APPRAISER-4, along with PETITIONER-1 had made an adjustment to the 2005 NOI for the onetime integration expenses of $$$$$. It was APPRAISER-4 conclusion that the Division had underestimated its NOI because the Division failed to add back this onetime integration expense.[123] The Division had not made this adjustment in its appraisal. APPRAISER-4 correction of the Division's NOI for the one time integration expense resulted in an income indicator value of $$$$$ before the adjustment of intangible property.[124]

97. APPRAISER-4 applied the Division's taxable property ratio of 43.35% to his revision of the Division's indicator to arrive at a taxable property value of $$$$$ for the Division's income indicator adjusted for the integration costs.[125]

98. The Counties also contended that the Division's taxable property ratio is distorted because the Division's income indicator does not use the same growth assumptions used to book

[120] Hearing Exhibit 8, p. 26.
[121] Hearing Exhibit 8, p. 40.
[122] Transcript, p. 296.
[123] Transcript, p. 310.
[124] Hearing Exhibit 18.
[125] Hearing Exhibit 20.

the spectrum licenses and other exempt property.[126]

99. The Counties attempted to correct this distortion by using a ratio of the Division's income indicator to a full growth indicator and then applying that ratio to the amount of exempt property to be removed.[127]

100. APPRAISER-4 calculated the full growth ratio by comparing the Division's revised income indicator, $$$$$, to APPRAISER-4 full value growth indicator, $$$$$. The adjusted taxable property ratio resulted in an income indicator of $$$$$.[128]

101. **Deduction for Intangibles**. APPRAISER-4 testified that customer lists and some items referred to as 'other' intangibles should be deducted from his estimate of $$$$$, but there should be no deduction for goodwill.

102. APPRAISER-4 used the same taxable operating property divided by total operating property ratio used by the Division and APPRAISER-3 to remove intangibles from this income estimate.[129] APPRAISER-4 agreed with APPRAISER-3 that goodwill is an operating asset and he included goodwill in his denominator of $$$$$.[130] APPRAISER-4, however, argued that FCC licenses and goodwill were also tangible operating properties, so he added these items into the numerator in his ratio of 78.35% ($$$$$/$$$$$).

103. By applying this 78.35% ratio to the booked values for customer lists and 'other' intangibles, APPRAISER-4 deducted $$$$$ from his income estimate to derive a DCF income

[126] Transcript, p. 307.
[127] Hearing Exhibit 20, Transcript, p. 319.
[128] Hearing Exhibit 20.
[129] Hearing Exhibit 8, p. 39.
[130] Transcript, pp. 375-376, and Hearing Exhibit 8, p. 39.

indicator of $$$$$.[131]

104. If the FCC licenses or spectrum are deemed to be exempt intangible property, APPRAISER-4 testified he would eliminate their value from his income approach in the same manner that he had eliminated customer lists and other intangibles, using the 78.35% factor which resulted in his value excluding spectrum of $$$$$.[132]

105. On cross-examination, APPRAISER-4 conceded that if he had also deducted the goodwill from his income indicator using the same book ratio methodology, the resultant income indicator would have been approximately $$$$$.[133]

106. **Second DCF Model.** APPRAISER-4 submitted a Second DCF model at the Formal Hearing that yielded a significantly larger valuation conclusion at $$$$$.[134] APPRAISER-4 said he had changed the assumptions in his Second DCF model to conform to assumptions he had found in an internal DCF analysis that he believed had been prepared by someone in the PETITIONER-1 organization prior to PETITIONER-1'S 2004 acquisition of COMPANY-4 (the "Pre-merger DCF").[135] APPRAISER-4 testified that he thought the Pre-merger DCF assumptions were more reliable because they had been prepared by someone inside the company rather than an outside analyst such as FINANCIAL ADVISORS.[136] Thus, he testified that he considered his Second Model to be a more accurate estimate of value of

[131] Hearing Exhibit 8, p. 40.
[132] Hearing Exhibit 8.
[133] Transcript, pp. 377-380.
[134] Hearing Exhibit 19.
[135] Transcript, pp. 312-314.
[136] Transcript, pp. 358-359.

PETITIONER-1'S property in this matter.[137]

## FINAL CONCLUSIONS

107. **COST INDICATOR:** As discussed more fully under Conclusions of Law, the Commission finds that the Counties' interpretation of the law regarding spectrum licenses and goodwill was erroneous. These items should not be included in the cost approach. When spectrum and goodwill are removed from APPRAISER-4 cost approach, the resulting value is similar to the Division's HCLD indicator of $$$$$.[138]

108. The Commission also notes that in its cost indicator the Division accounted for construction work in progress, or CWIP, by including only the present value of expansionary CWIP in its cost indicator. The Commission recently sustained this approach in *Tax Commission Appeal Nos. 06-0773 and 06-0767, Findings of Fact, Conclusions of Law and Final Decision,* p. 41, issued on February 22, 2008. Although this was not a contested issue in this hearing, it appears that APPRAISER-3 included a higher amount than the Division for CWIP in his appraisal. The Commission concludes that the Division has appropriately accounted for CWIP in its cost indicator.

109. Obsolescence Adjustment. The only remaining issue for consideration in the cost approach is whether the Commission should deduct for functional obsolescence as recommended by APPRAISER-3. The Commission finds insufficient support for PETITIONER-1'S obsolescence adjustment. In his appraisal APPRAISER-3 made a deduction of $$$$$ for functional obsolescence based on the ratio of the book value of the COMPANY-4 assets on

[137] *Id.*

December 31, 2004 to the FINANCIAL ADVISORS valuation of the COMPANY-4 assets on October 24, 2004. APPRAISER-3 applied this ratio to the net book value of the PETITIONER-1 assets, as of December 31, 2004, to determine the functional obsolescence.[139] In determining the amount of this adjustment, APPRAISER-3 assumed that the COMPANY-4 assets are similar to the PETITIONER-1 assets and that any increase in net book value between December 31, 2004 and the lien date, January 1, 2006 would be offset by additional depreciation.[140]

110. APPRAISER-2 challenged APPRAISER-3 assumption that the assets were similar. APPRAISER-2 testified the companies evolved independently over a long period of time and even a slight difference could result in a significant change in value.[141]

111. The Division asked APPRAISER-3 to calculate the percentage of PETITIONER-1'S assets pre-acquisition to the COMPANY-4 assets pre-acquisition and APPRAISER-3 calculated 74%. The Division then asked APPRAISER-3 to (1) apply the 74% to FINANCIAL ADVISORS operating value for COMPANY-4 of $$$$$ to arrive at an operating value for the PETITIONER-1 assets and (2) then combine that number, $$$$$, with the COMPANY-4 value of $$$$$. This results in a combined value of the PETITIONER-1 and COMPANY-4 assets of $$$$$.[142] APPRAISER-3 disagreed with that approach because he said that there were differences between PETITIONER-1 and COMPANY-4 in the way that their assets were booked.[143] APPRAISER-3 statement appears to be inconsistent with his position that the pre-

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[138] Transcript, pp. 342-343.
[139] Hearing Exhibit 7.
[140] Hearing Exhibit 7; Transcript 115.
[141] Transcript, p. 449.
[142] Transcript, pp. 250-252.
[143] Transcript, p. 252.

acquisition assets were similar enough for him to rely upon the COMPANY-4 data for the functional obsolescence adjustment.[144]

112. APPRAISER-4 pointed out in his testimony, because of mergers and acquisitions (even though the assets themselves have not changed) the booked costs which are used as the basis not only for a cost indicator of value but also for purposes of interstate allocation can create very wide disparities in the ultimate value that is going to be placed on the assessment rolls for a particular property. [145]

113. The 2005 Utah assessment by the Division for PETITIONER-1 was over $$$$$.[146] The Division's 2006 revised Utah assessment for PETITIONER-1 was $$$$$. APPRAISER-4 testified that the value of the booked costs of Utah assets have been dramatically reduced very disproportionately to the costs of the system unit.[147] It was APPRAISER-4 contention that if there is a deduction in the cost approach for functional obsolescence as urged by APPRAISER-3, then an adjustment to the interstate allocation formula is necessary to have a proper match of the units that are being appraised. APPRAISER-3 failed to carry his $$$$$ adjustment through to the allocation formula. If APPRAISER-3 had been consistent in his appraisal, he would have calculated a .57% allocation factor, which results in a $$$$$, Utah value.[148]

114. Based on the information submitted, the Commission does not find the

[144] Hearing Exhibit 7.
[145] Hearing Exhibit 6; Transcript, pp. 324-330.
[146] Hearing Exhibit 21; Transcript, p. 324.
[147] Transcript, pp 324-330.
[148] Transcript, pp. 327-330.

obsolescence adjustment, which APPRAISER-3 derived from the COMPANY-4 reduction of its booked assets, to be sufficiently reliable to make the same percentage adjustment to the PETITIONER-1 assets. The Commission, therefore, concludes that the weight of the evidence before it supports the Division's cost indicator.

115. The Commission finds that the Division's cost indicator of $$$$$ is the more correct of the indicators presented in this matter.

116. **INCOME INDICATOR:** There were several issues presented with the Income Indicator. Both the Division and PETITIONER-1'S income indicators were based on yield capitalization models and resulted in similar values, with the Division's appraisal indicator resulting in a system value of $$$$$and PETITIONER-1'S indicator of $$$$$. In its appraisal the Counties offered two income values, one that included spectrum of $$$$$ and one that excluded spectrum of $$$$$.

117. The Counties' appraisal values differed primarily from the Division's and PETITIONER-1'S in that they included income attributable to goodwill and/or spectrum. When asked on cross examination what value would result if he assumed both goodwill and spectrum should be excluded from his appraisal conclusion, APPRAISER-4 testified this would result in a value of $$$$$; relatively similar to the other parties' appraisals in this matter.

118. As discussed in its Conclusions of Law, the Commission finds that any income and resulting value attributable to spectrum and goodwill should be excluded. The Commission rejects the Counties' appraisal conclusions of $$$$$ and $$$$$.

119. APPRAISER-4 also offered a Second DCF value at the hearing of $$$$$, which

he based on assumptions from a Pre-merger DCF. The Commission has a number of significant concerns with APPRAISER-4 Second DCF value of $$$$$, as the evidence did not support that this opinion of value was reliable. On cross-examination, APPRAISER-4 conceded that he did not know when the Pre-merger DCF had been prepared,[149] who had prepared the analysis,[150] or what information that source may have relied upon to derive his or her assumptions. APPRAISER-4 acknowledged that the analysis was likely prepared before the February 2004 announcement of the COMPANY-4 acquisition and thus was likely prepared more than two years prior to the subject lien date.[151] He also admitted that he had not made any adjustments to the assumptions contained in the Pre-merger DCF to account for subsequent events or information that had become available during the two years leading up to the subject lien date.[152]

120. The actual financial records reveal significant deviations from what the unidentified source of the Pre-merger DCF model had assumed. For example, the unknown party had forecast that capital expenditures would be $$$$$ in 2005.[153] PETITIONER-1'S Form 10-K shows that the actual capital expenditures were $$$$$ in 2005.[154] This represents more than a $$$$$ disparity between the original forecast in the Pre-merger DCF and what actually occurred. A similar disparity is present in the depreciation account. The Pre-merger DCF source estimated that depreciation would be $$$$$ in 2005.[155] The actual depreciation was only $$$$$.[156] This

[149] Transcript, pp. 361-362.
[150] Transcript, p. 360.
[151] Transcript, p. 362
[152] Transcript, pp. 362-363
[153] Hearing Exhibit 11, p. CIN00254 and Transcript, p. 364.
[154] Hearing Exhibit 13, p. DIV 139 and Transcript, p. 364.
[155] Hearing Exhibit 11, p. CIN00254.
[156] Hearing Exhibit 13, p. DIV 139.

represents more than a $$$$$ disparity between the forecast and what actually occurred. Each of these items would have significantly overestimated the company's cash flow from what it actually was in 2005.

121. For these reasons the Commission finds that APPRAISER-4 Second DCF model is unreliable. There was no support as to how and why the original assumptions were made by the unidentified source for the Pre-merger DCF, or for what purpose the study was prepared. In addition, APPRAISER-4 did not properly adjust any of the assumptions in the analysis to account for subsequent information that would have been known or knowable by a would-be purchaser prior to the subject lien date of January 1, 2006.

122. Cash Flow. In reviewing the appraisals submitted by the parties there were several remaining differences, despite that after the spectrum and goodwill adjustment, they resulted in similar value conclusions. On difference was the amount of the cash flow and manner in which it was determined by the Division and PETITIONER-1 in the yield capitalization approach.

123. The Division underestimated its normalized Net Operating Income ("NOI") because it failed to add back $$$$$ of the onetime integration expense for PETITIONER-1.[157] The Division conceded that it failed to make the appropriate adjustment for the one-time integration expenses. The Division admitted that this error caused it to severely underestimate the correct cash flow to be capitalized. Both APPRAISER-3 and APPRAISER-4 properly

[157] Transcript, p. 310.

accounted for the one-time integration expenses.[158]

124. The Commission concludes that the Division should have made this adjustment as a way to normalize historical income. The amount of the onetime integration expense was $$$$$. To then properly account for the income tax affect this amount is reduced by the income tax rate of 33.59% used by the division, or $$$$$. The result of this change is a cash flow increased from the $$$$$ indicated in the Division's Appraisal to $$$$$. If this were the only change made to the Division's income indicator it would result in a value of $$$$$ with all other factors being equal.[159]

125. In the appraisal submitted by PETITIONER-1, APPRAISER-3 had relied on the FINANCIAL ADVISORS cash flow, which was adjusted for depreciation, amortization and capital expenditures. For example APPRAISER-3 NOI contained a non-cash charge of $$$$$ for amortization related to customer lists.[160] APPRAISER-3 adjust his NOI by an 83.29% factor and this would have increased the amortization by 83.29%, resulting in an assumption by APPRAISER-3 that PETITIONER-1 will incur annually, into perpetuity, the sum of $$$$$ in capital expenditures for additional customer lists. APPRAISER-3 recognized this assumption was incorrect and resulted in a cash flow that was too low. The Commission finds APPRAISER-3 treatment of amortization to be in error.

126. In its appraisal, the Division was not clear in its treatment of amortization; however, it was not material to the overall value in this matter. APPRAISER-2 explained that

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[158] Hearing Exhibits 7 & 8; Transcripts pp. 334-335.
[159] Hearings Exhibits 18 & 20.
[160] Hearing Exhibit 7.

when the Division calculated its cash flow to capitalize in its yield capitalization model, it added amortization back to the operating income when it estimated the stabilized NOI it used to determine the cash flow.[161] The Division argued that its resulting cash flow would be essentially the same in this case whether the amortization were added in as a component of NOI or as a separate item of cash flow.[162] However, it was not transparent in the actual appraisal what the division had done, which was to add amortization back in to the operating profit. The taxpayer did not substantially challenge this representation.

127. While the testimony suggests that it may not make a material difference in the Division's cash flow calculation in this matter, the Commission directs the Division in future assessments to follow Rule 62 and clearly identify the treatment of amortization in its estimate of stabilized NOI in its analysis.[163]

128. Cost of Capital. After the deduction from the WACC for growth the capitalization rates derived by the Division and PETITIONER-1 are very similar: 7.42% for the Division and 7.24% for APPRAISER-3. APPRAISER-4 discount rate after making the deduction for growth of 3%, based on his terminal capitalization rate, was lower at 6.36%. The differences among these estimates primarily result from the parties' choices for capital structures, comparable companies and APPRAISER-3 flotation adjustment. The various components of the cost of capital as applied by the parties in their appraisals are as follows:

| **Division – Exhibit 6** | **APPRAISER-3– Exhibit 7** | **APPRAISER-4– Exhibit 8** |
|---|---|---|

[161] Transcript, pp. 434-435, 468-478.
[162] Transcript, pp. 436-437, 476-477.
[163] *See Verizon Wireless VAW LLC*, p. 5 (Appeal No. 01-0883 etc., Utah State Tax Comm'n, Jan. 29, 2008).

| | Rate | Structure | | Rate* | Structure | | Rate | Structure | |
|---|---|---|---|---|---|---|---|---|---|
| Debt | 5.84% | x 30% = | 1.75% | 5.84% * | x 21% | 1.23% | 6.10% | X 25% | 1.53% |
| Equity | 11.53% | X 70% = | 8.07% | 11.12% * | x 79% | 8.78% | 11.25% | X 75% | 8.44% |
| WACC | | | 9.82% | | | 10.01% | | | 9.96% |

* APPRAISER-3 actual debt and equity rates both contain an adjustment for flotation. For purposes of direct comparison, the Commission removed the flotation costs, and will address that issue separately.

129. The capital structure used by the Division was 30% debt and 70% equity. The structures used by APPRAISER-3 and APPRAISER-4 were respectively: 21% debt / 79% equity and 25% debt / 75% equity. Both APPRAISER-3 and APPRAISER-4 believed that the Division should not have used COMPANY-5 and COMPANY-6 as comparable companies in determining capital structures because they had no cellular operations.[164] When these two entities are removed the structure would be approximately 25% debt and 75% equity.

130. APPRAISER-3 made an additional adjustment, suggesting that COMPANY-7 should not be used as a comparable because of its relatively small size.[165] APPRAISER-3 also recommended that three foreign wireless entities should be included as comparables because they were in the same market and because one of these entities (COMPANY-8) had even attempted to acquire PETITIONER-1.[166] When these two additional adjustments are made the structure becomes 21% debt and 79% equity. The preponderance of the evidence and expert testimony indicates a capital structure of 25% or less for debt.

131. The Commission also concludes the preponderance of the evidence supports a growth rate higher than the Division's rate. The Division used a growth rate of only 2.4%.

[164] Hearing Exhibit 8, pp. 23 and 30, and Transcript, p. 155.
[165] Transcript, p. 155.
[166] Transcript, p. 155, and Hearing Exhibit 7, p. B-10.

APPRAISER-3 used 3.25%. APPRAISER-4 had a terminal growth rate of 3%, while his implied growth rate for the holding period appears to be at least 7.5%. The Commission finds that a 3% growth rate is best supported by the evidence and testimony. Applying a 25/75 capital structure and a 3% growth rate to the Division's WACC results in a capitalization rate of 7.11%.

132. A concern that the Commission has with APPRAISER-3 weighted average cost of capital is that he has included an adjustment in both his equity and debt rates for flotation. For the debt factor, APPRAISER-3 made a 1% flotation adjustment. For the cost of equity it was a 5% flotation adjustment. The Commission has considered whether flotation is an appropriate adjustment and concluded that no adjustment should be made for flotation in prior decisions. Recently, in an appeal for another property owner the issue was raised and fully addressed and the Commission reconfirmed in a recent decision, *Tax Commission Findings of Fact Conclusions of Law and Final Decision*, Appeal Nos. 06-0767 & 06-0773, that it did not find flotation adjustments to be appropriate in a business valuation for ad valorem purposes. The information presented at this hearing did not provide basis for the Commission to conclude that its prior decisions on this issue were incorrect.

133. Income Indictor with Intangibles. The Commission finds the appropriate income indicator should be based on the Division's cash flow corrected for the onetime integration expense which results in a revised estimate of normalized NOI of $$$$$. After making the adjustments for depreciation, deferred income tax, normal replacement capital expenditures and increased working capital, based on the adjustments the Division made in its appraisal for these

items, the result is a cash flow of $$$$$.[167] Applying the Commission's adjusted capitalization rate of 7.11%, the resulting income value is $$$$$ prior to the removal of intangibles.

134. Ratio to Remove Intangibles. All of the parties used the same general ratio to remove intangibles from the income approach: taxable operating property divided by total operating property for the taxpayer. The parties disagreed, however, about the components of the numerator and the denominator. The Division asserted that its yield capitalization model did not include goodwill and thus it would be an error to include goodwill in the denominator, which consists of the total operating property. The Division indicated it would like further clarification on this issue because the Division had used the same ratio for other wireless carriers and there have been other appeals based upon this same concern. Both APPRAISER-3 and APPRAISER-4 recognized that inasmuch as goodwill is an operating asset, it must be included in the denominator as part of the total operating property. APPRAISER-4 included goodwill in the denominator of his ratio[168] but unlike the other appraisers, APPRAISER-4 also included both goodwill and spectrum in the numerator of the equation as he considered these items to be taxable operating property.

135. By excluding booked goodwill from its ratio, the Division has implicitly allocated any booked goodwill (assuming any was captured) in its income indicator between the tangible and intangible assets following the Tax Commission's decision in *Finding of Fact, Conclusions of Law and Final Decision, Appeal No. 03-1000*. In *Appeal 03-1000* the Commission had applied a pro-rata allocation of the booked goodwill between the identifiable intangible assets

[167] Hearing Exhibit 18.

and identifiable tangible assets. Subsequent to the issuance of the decision in *Appeal 03-1000*, and effective for the 2006 tax year, the Utah Legislature made a revision to its definition of intangible property, which specifically addresses booked goodwill.[169] It is the Division's position that it was the intent of the legislature to make the 2006 revision consistent with the Commission's practice at that time. This argument is incorrect.

136. The Division points out that its income indicator in this matter, including intangible property, was only $$$$$. The business enterprise value for impairment purposes two days before the lien date as determined by PETITIONER-1 [170] was $$$$$. Booked goodwill was only $$$$$. The Division argues that it is unlikely that booked goodwill is in the Division's income indicator. However, the Division has provided no analysis or other evidence to support this position.

137. Based on the evidence presented, the Commission finds that each income indicator inherently captures income attributable to business enterprise value, and that goodwill should thus be included in the denominator of operating property ratio to remove intangibles. The Commission finds that if book numbers were used in the formula for this ratio, the correct intangible ratio would be 30% ($$$$$). Applying this ratio to the Division's corrected income indicator of $$$$$ results in a value of $$$$$.

138. **CORRELATION.** In its appraisal the Division placed 50% weight on the income approach and 50% on the cost approach. APPRAISER-3 indicated that he typically

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[168] Transcript, pp. 176-177, and 375.
[169] Utah Code Sec. 59-2-102(16)(2006).
[170] Hearing Exhibit 10, p. CIN00208

places more weight on the income approach. A review of his reconciliation suggests that he placed approximately 70% weight on the income approach and 30% on the cost approach.[171] APPRAISER-4 recommended that virtually all weight be placed on the income approach.[172] As the Commission bases its value primarily on the Division's value indicators, with some significant corrections to the income indicator, the Commission gives some deference to the weighting used by the Division's appraisers. Additionally, upon consideration of the fact that the Division had only one full year's worth of income for the combined entity from which to determine the normalized NOI, the Commission is not convinced that the income approach represents a better value than the cost approach in this case. Therefore, the Commission does not find it appropriate to place more weight on the income approach. Financial analysis at the time of PETITIONER-1'S acquisition of COMPANY-4 tends to indicate that even corrected for the onetime expense, the Division's income value is conservative. Placing equal weight on the income indicator of $$$$$ and cost indicator of $$$$$ results in a system value of $$$$$ for the lien date January 1, 2006.

139. **ALLOCATION TO THE STATE OF UTAH.** The Division used an allocation factor of 0.52% to the State of Utah. This allocation is largely based on a historical cost allocation formula that is used by the Division for each of the other wireless entities in the State of Utah. It was suggested by APPRAISER-4 that a different allocation percentage might be appropriate because APPRAIRER-1 reduced his cost approach for additional forms of obsolescence. Despite this testimony, no recommendations for other allocation factors were

[171] Hearing Exhibit 7, p. 16.

presented at the hearing. Based on the evidence presented, we see no reason to change the allocation formula or percentage in this matter. Consequently, we accept the allocation factor used by each of the parties of 0.52%. When this is applied to the system value of $$$$$, the resultant Utah value is $$$$$ prior to any adjustment for vehicles or exempt property.

140. **ADJUSTMENT FOR VEHICLES AND EXEMPT PROPERTY.** The Division deducted vehicles and other exempt property from the Utah value to derive its final assessment. It was undisputed that the net book value of the PETITIONER-1'S vehicles and other exempt property was $$$$$.[173] The Division applied a ratio to this net book number that was calculated by dividing the HCLD cost estimate by the reconciled system estimate.[174] If this same ratio is applied to the adjusted income figures, the percentage would be 83.56%, and the correct amount of vehicles and exempt property to deduct from the Utah allocated value would be $$$$$.

141. The resultant final Utah assessment value less the vehicle adjustment is $$$$$.

## APPLICABLE LAW

The Utah Constitution mandates that all tangible property in the state shall be taxed at a uniform and equal rate. Utah Const. Article XIII, Section 2(1) provides as follows:

> So that each person and corporation pays a tax in proportion to the fair market value of his, her, or its tangible property, all tangible 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

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[172] Hearing Exhibit 8, pp. 42-43.
[173] Hearing Exhibit 6, p. 2.
[174] *Id.*

(b) taxed at a uniform and equal rate.

Consistent with the Constitutional provisions to tax all property at its fair market value, the Legislature enacted Utah Code Ann. § 59-2-103, which provides as follows:

> (1) All tangible property shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law.

Utah Code Ann. § 59-2-201 describes which classes of property must be centrally assessed. The relevant parts of section 59-2-201 provide:

> (1) 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 operates as a unit across county lines, if the values must be apportioned among more than one county or state; (b) all property of public utilities;

Utah Code Ann. § 59-2-102(12) defines "fair market value" in relevant part, as follows:

> (9) "Fair market value" means the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts. . . .

The Utah Constitution also provides that if intangible property is taxed as property it may not be subject to income tax. Utah Const. art. XIII, § 2(5) provides, in relevant part, as follows:

> (5) The Legislature may by statute determine the manner and extent of taxing or exempting intangible property, except that a 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.

The Legislature has also created by statute an exemption for intangible property. Utah Code Ann. § 59-2-1101 provides as follows:

> (3) The following property is exempt from taxation . . . .(g) intangible property.

In Utah Code Ann. § 59-2-102(20) (emphasis added), the Legislature has defined intangible property as follows:

> "Intangible property" means:
>
> (a) property that is capable of private ownership separate from tangible property, including:
>
> (i) monies;
>
> . . .
>
> (vii) licenses;
>
> (viii) trade names;
>
> (ix) copyrights; and
>
> (x) patents;
>
> (b) a low-income housing credit; or
>
> (c) goodwill.

Utah Code Ann. § 59-2-102(16) defines "goodwill" to mean "(i) acquired goodwill that is reported as goodwill on the books and records: (A) of a taxpayer; and (b) that are maintained for financial reporting purposes . . .

The Commission has adopted Rule 62 for the valuation of state assessed properties. The relevant portions of that Utah Admin. Rule R884-24P-62 are:

> E. Appraisal Methodologies.
>
> 1. Cost Approach. Cost is relevant to value under the principle of substitution, which states that no prudent investor would pay more for a property than the cost to construct a substitute property of equal desirability and utility without undue delay. A cost indicator may be developed under one or more of the following methods: replacement cost new less depreciation (RCNLD), reproduction cost less depreciation (reproduction cost), and historic cost less depreciation (HCLD).
>
> a) "Depreciation" is the loss in value from any cause. Different professions recognize two distinct definitions or types of depreciation.
>
> (1) Accounting. Depreciation, often called "book" or "accumulated" depreciation, is calculated according to generally accepted accounting principles or regulatory guidelines. It is the amount of capital investment written off on a firm's accounting records in order to allocate the original or historic cost of an asset over its life.

Book depreciation is typically applied to historic cost to derive HCLD.

(2) Appraisal. Depreciation, sometimes referred to as "accrued" depreciation, is the difference between the market value of an improvement and its cost new. Depreciation is typically applied to replacement or reproduction cost, but should be applied to historic cost if market conditions so indicate. There are three types of depreciation:

(a) Physical deterioration results from regular use and normal aging, which includes wear and tear, decay, and the impact of the elements.

(b) Functional obsolescence is caused by internal property characteristics or flaws in the structure, design, or materials that diminish the utility of an improvement.

(c) External, or economic, obsolescence is an impairment of an improvement due to negative influences from outside the boundaries of the property, and is generally incurable. These influences usually cannot be controlled by the property owner or user.

* * *

2. Income Capitalization Approach. Under the principle of anticipation, benefits from income in the future may be capitalized into an estimate of present value.

a) Yield Capitalization. The yield capitalization formula is CF/(k-g), where "CF" is a single year's normalized cash flow, "k" is the nominal, risk adjusted discount or yield rate, and "g" is the expected growth rate of the cash flow.

(1) Cash flow is restricted to the operating property in existence on the lien date, together with any replacements intended to maintain, but not expand or modify, existing capacity or function. Cash flow is calculated as net operating income (NOI) plus non-cash charges (e.g., depreciation and deferred income taxes), less capital expenditures and additions to working capital necessary to achieve the expected growth "g". Information necessary for the Division to calculate the cash flow shall be summarized and submitted to the Division by March 1 on a form provided by the Division.

* * *

(b) Capital expenditures should include only those necessary to replace or maintain existing plant and should not include any expenditure intended primarily for expansion or productivity and capacity enhancements.

* * *

(2)(b) i) The CAPM is the preferred method to estimate the cost of equity.

> More than one method may be used to correlate a cost of equity, but only if the CAPM method is weighted at least 50% in the correlation.

* * *

> (3) The growth rate "g" is the expected future growth of the cash flow attributable to assets in place on the lien date, and any future replacement assets.

* * *

> b) A discounted cash flow (DCF) method is impractical to implement in a mass appraisal environment, but may be used to value individual properties.

## BURDENS AND PRESUMPTIONS

When a party protests a property tax assessment, the Division "must present the available evidence supporting the original valuation" and "[o]nce that is done, [the protesting party] . . . must meet its twofold burden of demonstrating 'substantial error or impropriety in the [original] assessment,' and providing 'a sound evidentiary basis upon which the Commission could adopt a lower valuation." *Utah Railway Co. v. Utah State Tax Comm'n*, 2000 UT 49 ¶ 10, 5 P.3d 652, 655, 656, *quoting*, *Utah Power & Light Co. v. Tax Comm'n*, 590 P.2d 332 (Utah 1979).

As a general rule, the "original valuation is entitled to a 'presumption of correctness.'" *Id.* at ¶ 9. "This presumption does not arise, however, unless and until available evidence supporting the original property valuation is submitted to the Commission." *Id.* In the present matter, the Division did submit the original assessment as an exhibit but admitted that it contained errors and elected to submit a new appraisal wherein it asserted an increased assessment against PETITIONER-1'S operating property. The uncontroverted evidence at the hearing supports the conclusion that the original assessment was erroneous, and thus, we do not

give the original assessment any presumption of correctness in this matter.

When the Division admits error in its original assessment, as it has done in this matter, the first burden of showing "substantial error or impropriety in the [original] assessment" is satisfied. Thus, we move to the second burden of receiving "a sound evidentiary basis upon which the Commission can adopt" a different valuation. *Id.* at ¶ 10. In reviewing the valuation evidence in this matter we apply a preponderance of the evidence standard.

## **CONCLUSIONS OF LAW**

1. **Taxation of FCC Licenses (Spectrum).** This Commission previously ruled in *Verizon Wireless et al v. Property Tax Division et al.,* Appeal Nos. 05-0829 and 05-0826 (Utah State Tax Comm'n February 2, 2007) and *Verizon Wireless VAW, LLC, et al. v. Property Tax Division et al.*, Appeal Nos. 01-0883, etc. (Utah State Tax Comm'n Nov. 13, 2007) (collectively the "Verizon Decisions") that FCC licenses and spectrum are not subject to property tax or privilege tax in the State of Utah. Despite these rulings, the Counties raised the same spectrum issue in this case. The Counties did not present any argument or evidence in regard to the taxation of spectrum that has not already been considered by the Commission in the prior Verizon Decisions. The issue of taxing spectrum has been resolved. "[S]pectrum is not subject to either property or privilege tax." *Verizon*, Nov. 13, 2007, p. 6. The Commission reaffirms its rulings in the *Verizon* Decisions that "spectrum is not subject to either property or privilege tax."

2. **Taxation of Goodwill**. Effective January 1, 2006, Utah law provides that goodwill is intangible property that is not subject to property tax. Utah Code Ann. §§ 59-2-

102(16) and (20)(c). Utah law defines goodwill to mean "acquired goodwill that is reported as goodwill on the books and records: (A) of a taxpayer; and (B) that are maintained for financial reporting purposes. Utah Code Ann. § 59-2-102(16)(a)(i)(A)&(B). It is undisputed that PETITIONER-1 has recorded on its financial books and records $$$$$ of goodwill as of the subject lien date.[175]

a. The Counties assert that Utah Code Ann. § 59-2-102(16) is ambiguous. The Counties point to subparagraph (b) of this statute, which states that goodwill "does not include" "the enhancement or assemblage value specifically attributable to the interrelation of the existing tangible property in place working together as a unit." Utah Code Ann. § 59-2-102(16)(b)(iv). The Counties argue that all of PETITIONER-1'S booked goodwill identified in the Form 10-K comes from the enhancement or assemblage value of its existing tangible property and thus subsection (b) (iv) trumps the definition of the booked goodwill provided under subsection (a).

b. The Counties' reading of the statute in this manner is not well taken. Contrary to the Counties' position, the Division can exclude booked goodwill from its assessment and still capture any enhancement value associated with the assemblage of the tangible assets. This is exactly what the Utah Supreme Court ruled in *Beaver County v. WilTel*, 2000 UT 29. In *WilTel,* the Court said it "eschew[ed]" the Counties attempt to include "goodwill" in their valuation "in light of the specific exclusion of 'goodwill and

[175] Exhibit 13 (Form 10-K), p. 78.

other intangibles' from taxable property under" the Utah statute. *WilTel*, at ¶ 38. The Court went on to rule that even though goodwill would not be included in the assessment, the Commission could, and did, capture the enhancement value associated with the property operating as a unit. *WilTel*, at ¶ 40. The Court ruled that much of this enhancement value was captured in the yield capitalization approach by capitalizing the income stream that is associated with the operation of the assets together as a unit.

c. The Commission also notes that the Counties' interpretation of the goodwill statute would render the statute meaningless and would violate Utah's rules for statutory construction. Utah law requires that statutes be interpreted to "give effect to the legislative intent, as evidenced by the plain language, in light of the purpose the statute was meant to achieve." *In re West Side Property Associates,* 2000 UT 85. It is clear from this statute that the legislature intended to define booked goodwill as intangible property that is not subject to property tax. The Counties' interpretation would rarely, if ever, allow any goodwill to be considered intangible property that is not subject to property tax.

d. The Counties failed to offer any financial, appraisal, legal, or economic text or treatise that specifically defines goodwill as tangible property, or even as an enhancement of the value of tangible property. Nor did they establish any rationale to indicate that intangible property cannot enhance the value of other intangible property or the business enterprise. Finally, the Commission observes that the statutory treatment of goodwill is consistent with the common understanding that goodwill is intangible.

e. PETITIONER-1 pointed out that the general rule in taxation cases is that "if any doubt exists as to the meaning of the statute, 'our practice is to construe taxation statutes liberally in favor of the taxpayer, leaving it to the legislature to clarify an intent to be more restrictive if such intent exists.'" *Hercules Inc. v. Utah State Tax Comm'n*, 2000 UT App 372, quoting, *Wasatch County Bd. of Equalization v. State Tax Comm'n*, 944 P.2d 370, 374 (Utah 1997) and *Salt Lake County v. State Tax Comm'n*, 779 P.2d 1131, 1132 (Utah 1989). It was PETITIONER-1'S position that whether the goodwill was subject to tax was an issue of tax imposition and, therefore, unless and until the legislature acts to clarify an intent that would impose property tax on the subject goodwill, this statute should be construed liberally in favor of PETITIONER-1 to prevent taxation of its booked goodwill.

f. Both the Division and the Counties argued that the determination of whether or not the goodwill was an intangible was an issue of tax exemption, which is strictly construed against the taxpayer. The Utah legislators have enacted legislation specifying that intangibles are exempt from taxation and defining what constitutes an intangible for purposes of the exemption at Utah Code Sec. 59-2-1101(3).

g. Although intangibles have been referred to legislatively as an exemption, the Commission notes that the Utah Constitution, at Article XIII, Section 2(1), and tax implementation statute at Utah Code Sec. 59-2-103(1) impose property tax only on tangible property. Determining if any particular item of property is tangible, and therefore subject to tax, inherently involves tax implementation. However, even if the

issue is one of a tax exemption that must be strictly constructed against the taxpayer, PETITIONER-1'S booked goodwill clearly and specifically is exempt pursuant to the pursuant to Utah Code Sec. 59-2-1101(3)(g) and Utah Code Sec. 59-2-102(16)(a)(i).

From its interpretation of the law in this matter, and the facts presented the Commission finds that the $$$$$ of goodwill recorded on PETITIONER-1'S books constitutes intangible property that is not subject to property tax in this matter. The Division and PETITIONER-1 acted appropriately and in accord with Utah law by excluding PETITIONER-1'S booked goodwill in their respective cost indicators and it is appropriate to remove goodwill from the income indicator based on the ratio the Commission has determined appropriate in its Findings of Fact.

3. **Ratio to Remove Goodwill from the Income Approach**. As the Commission has concluded that the booked goodwill should be removed from the value for purposes of determining the tax assessment, the Commission must consider the proper method for the removal of goodwill from the system income indicator. This raises a mixed issue of both law and fact.

a. The Division acknowledged that the ratio to remove intangibles is taxable operating property divided by total operating property, and yet excludes goodwill from the denominator. The Division argues that its yield capitalization indicator did not capture the booked goodwill, and, therefore, the value should not be further diluted by adding goodwill into the denominator.

b. However, the Commission concludes that the cost indicator, before

adjusting for intangible assets, inherently captures all of the business enterprise value. In addition, the income approach, although more restrictive under Rule 62, still captures some elements of the value for the business enterprise, including, presumably, goodwill. Further, the Commission concludes that the statutory revision at Utah Code Sec. 59-2-102(16) which now specifically exempts acquired goodwill that is on the books and records maintained for financial purposes, is a departure from the Commission's prior application of the law. Instead of allocating the booked goodwill between the tangible and intangible booked assets, and deducting only that portion attributable to the intangible assets, the new law makes all qualifying goodwill exempt.

c. There was no dispute that Petitioner had acquired goodwill on its books and records for financial reporting purposes in the amount of $$$$$. Such goodwill is exempt. In spite of its position, the Division offered no evidence to demonstrate that goodwill was not included in the income approach. The Commission concludes that, without evidence to the contrary, it would be inappropriate to adjust one indicator for specific intangible property without a corresponding adjustment to other indicators. Therefore, the Division must now remove any of the $$$$$ of booked goodwill that is included in the income indicator. In the absence of any other methodology, the appropriate way to do so is the correct application of the ratio of taxable operating assets divided by total operating assets.

4. **Amortization**. Rule 62 directs that amortization should not be an adjustment in the NOI calculation, but rather should be added into the cash flow estimate as a separate item.[176] The Commission had previously ruled that the Division's practice of making the adjustment in the NOI tends to obscure the amortization in the assessment worksheets and does not provide an open and clear presentation of how the cash flow was derived. "The Commission is concerned that by burying amortization into the NOI calculation process, it not only has the potential of reaching an incorrect value estimate, it becomes difficult to detect whether there is a potential problem."[177] In the present hearing, it was explained that the Division was simply removing amortization altogether from the estimate of stabilized NOI. It is, nonetheless, not readily apparent in the appraisal. Although this adjustment may not make a substantial mathematical difference in the value calculation in this appeal, the Commission instructs the Division, in the future, to clarify any adjustments to NOI and/or cash flow for amortization.

5. **Depreciation/Obsolescence**. Utah Admin. Rule R884-24P-62.E.1.(a) recognizes that there are two distinct types of depreciation: Accounting or book depreciation and appraisal depreciation. Book depreciation is "the amount of capital investment written off on a firm's accounting records in order to allocate the original or historic cost of an asset over its life."[178] Appraisal depreciation is to account for all losses in value and is defined as the "difference between the market value of the improvement and its cost new."[179] While Rule 62 recognizes

[176] Utah Admin. Rule R884-24P-62(E)(2)(a)(1).
[177] *Verizon Wireless VAW LLC*, p. 21 (Appeal No. 01-0883, etc., Utah Tax Comm'n Nov. 13, 2007).
[178] Utah Admin. Rule R884-24P-62.E.1(a)(1).
[179] Utah Admin. Rule R884-24P-62.E.1(a)(2), *see also* The Appraisal of Real Estate, p. 365 (12th Ed. Appraisal Institute 2001).

that "book depreciation is typically applied to historic cost to derive HCLD," it also states that appraisal depreciation "should be applied to historic cost if market conditions so indicate."[180] In this matter the Division deducted only book depreciation from the historic cost. Petitioner argued that appraisal or functional obsolescence should also be deducted from the cost indicator. The Commission would find this appropriate in some circumstances. However in this matter Petitioner did not provide a sufficiently reliable basis to support the appraisal or functional obsolescence adjustment.

## DECISION AND ORDER

Based on the foregoing, the Commission finds that the Utah value of PETITIONER-1'S operating property in the State of Utah on January 1, 2006, after adjustments for vehicles and other exempt property, is $$$$$.

DATED this _____ day of ________________, 2008.

______________________________________
Jane Phan
Administrative Law Judge

BY ORDER OF THE COMMISSION:

DATED this _____ day of ________________, 2008.

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[180] Utah Admin. Rule R884-24P-62.E.1(a)(1) and (2).

| | |
|---|---|
| Pam Hendrickson<br>Commission Chair | R. Bruce Johnson<br>Commissioner |
| D'Arcy Dixon Pignanelli<br>Commissioner | |

**CONCURRENCE**

I concur with the majority in this decision. I wish, however, to elaborate on two points. First, although I agree with my colleagues that the Division failed to establish sufficient evidence to determine whether the income approach captured goodwill, I am, nevertheless, concerned that the Division's premise may be correct. To begin, the yield capitalization method promulgated in Rule 62, by its nature removes intangible value by restricting growth and capital expenditures. Furthermore, much of the evidence submitted strongly suggests to me that the anticipated growth from the acquisition had not materialized as of the lien date. In addition, I believe it improbable that cash flow increased in one year following the acquisition. It follows, then, that a growth rate based solely on inflation would not capture any additional growth attributable to goodwill. Finally, a brief perusal of PETITIONER-1'S own internal analysis[181] suggests that actual income did not meet expectations. Consequently, I believe it quite possible, if not probable, that no income was attributable to goodwill. However, as my colleagues correctly observed, there was nothing more than an assumption offered to support this position.

Secondly, I wish to explain the rational behind the Commission's methodology for

adjusting the income approach for intangible property. Developing a ratio for removing exempt intangibles was established out of necessity. By its very nature, the income approach used in unitary appraisal inherently captures some element of intangible value. Historically, in proceedings before this body, various parties have attempted to address the issue. However, the Commission has observed that these methods range from either ignoring intangibles in their entirety to developing an income approach so restrictive in its application as to render a unitary valuation meaningless. Although more generally accepted methods of valuing intangibles exist, such techniques are rarely presented before the Commission. Consequently, the Commission, by default established what we believe to be reasonable methodology based on the concept of applying a ratio of booked intangible assets to total booked assets to the income approach. This does not imply that better techniques do not exist to determine the value of exempt intangible property. Rather, the Commission uses this approach in the absence of other, more reliable methods being offered.

___________________________________

Marc B. Johnson
Commissioner

[181] Exhibit 11.

**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. Sec. 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 Sec. 59-1-601 et seq. and 63-46b-13 et seq.

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