

06-0772 & 07-0650  
CENTRALLY ASSESSED PROPERTY  
SIGNED 02-10-09

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BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER,

Petitioner,

v.

PROPERTY TAX DIVISION OF  
THE UTAH STATE TAX  
COMMISSION,

Respondent

**FINDINGS OF FACT, CONCLUSIONS OF  
LAW AND FINAL DECISION**

Appeal No. 06-0772 & 07-0650

Tax Year: 2006 & 2007

Tax Type: Centrally Assessed Property

Judge: Phan

COUNTIES,

Petitioners,

v.

PROPERTY TAX DIVISION OF  
THE UTAH STATE TAX  
COMMISSION, ex rel.  
PETITIONER,

Respondent.

Appeal No. 07-0747

Tax Year: 2007

Tax Type: Centrally Assessed Property

Judge: Phan

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**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 PETITIONER:

PETITIONER REP 1, Attorney at Law  
PETITIONER REP 2, Property Tax Manager, PETITIONER

Appeal Nos. 06-0772, 07-650, 07-0747

For Petitioners COUNTIES:

COUNTIES REP, Attorney at Law for COUNTIES

For Respondent:

RESPONDENT REP 1, Assistant Attorney General  
RESPONDENT REP 2, Property Tax Division  
RESPONDENT REP 3, Analyst, Property Tax Division

### **STATEMENT OF CASE**

This matter came before the Utah State Tax Commission (“Commission”) for a Formal Hearing on October 27, 2008, pursuant to the provisions of Utah Code Secs. 59-2-1007 & 63G-4-2-1 et seq. Petitioner PETITIONER (“PETITIONER”) is appealing the Notice of Assessment issued by the Property Tax Division (the “Division”) on May 1, 2006, in which the Division asserted that the system value of PETITIONER’s operating property was \$\$\$\$\$ as of January 1, 2006, and the allocated value of PETITIONER’s taxable Utah operating property was \$\$\$\$\$.<sup>1</sup> Petitioners PETITIONER and COUNTIES (“Counties”) also appeal the Notice of Assessment issued by the Division for the 2007 tax year on May 8, 2007, in which the Division asserted that the system value of PETITIONER’s operating property was \$\$\$\$\$ as of January 1, 2007, and the allocated value of PETITIONER’s taxable Utah operating property was \$\$\$\$\$.<sup>2</sup>

PETITIONER’s timely appeals for the 2006 and 2007 tax years were assigned Appeal Nos. 06-0772 & 07-0650. The Counties’ timely appeal for the 2007 tax year was assigned Appeal No. 07-0747. PETITIONER and the Counties’ appeals were the subject of the Formal Hearing.

Based upon the oral and written pleadings, as well as the evidence, testimony, and exhibits presented at the Formal Hearing, the Commission makes and enters its:

### **FINDINGS OF FACT**

1. The Division’s Utah property assessment for tax year 2006 was based on a cost indicator of \$\$\$\$\$ and an income indicator of \$\$\$\$\$. The Division gave 75% of the weight to the cost indicator and 25% to the income indicator, which resulted in the reconciled system value of \$\$\$\$\$. The Division concluded that the appropriate interstate allocation factor for Utah was 7.77%, which it applied to the reconciled system value. After deduction for locally assessed vehicles and other exempt property, this

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<sup>1</sup> See Exhibit 1.

<sup>2</sup> See Exhibit 4.

resulted in a Utah taxable value of \$\$\$\$\$.<sup>3</sup>

2. Included in the cost approach in its original assessment, the Division had added to the tangible plant in service and other items an amount of \$\$\$\$\$ for Contributions in Aid of Construction (“CIAC”). In addition, the Division had subtracted from the tangible plant in service and other items, an amount of \$\$\$\$\$ for Deferred Income Taxes (“DIT”).<sup>4</sup>

3. In the income indicator in its original assessment for 2006, the Division had offset Normalized Depreciation Expenses in the amount of \$\$\$\$\$ and Operating Amortization Expenses in the amount of \$\$\$\$\$ with an equal amount for Normal Replacement Capital Expenditures. However, the Division did not offset the DIT expenses. The Division applied a yield capitalization rate of %%% and subtracted 0 growth.<sup>5</sup>

4. For the 2007 tax year, the Division’s Utah property assessment had been based on a cost indicator of \$\$\$\$\$ and an income indicator of \$\$\$\$\$. The Division gave 75% of the weight to the cost indicator and 25% to the income indicator, which resulted in the reconciled system value of the \$\$\$\$\$. The Division concluded that the appropriate interstate allocation factor for Utah was %%%, which it applied to the reconciled system value. After deduction for locally assessed vehicles and other exempt property, this resulted in a Utah taxable value of \$\$\$\$\$.<sup>6</sup>

5. Included in the cost indicator in the original assessment, the Division had added to the tangible plant in service and other items an amount of \$\$\$\$\$ for CIAC and then subtracted back out an amount of \$\$\$\$\$ for Depreciation-Contributions in Aid of Construction. In addition the Division had subtracted from the tangible plant in service and other items, an amount of \$\$\$\$\$ for DIT.<sup>7</sup>

6. In the income indicator of the original assessment for 2007, the Division had offset Normalized Depreciation Expenses in the amount of \$\$\$\$\$ and Operating Amortization Expenses in the amount of \$\$\$\$\$ with an equal amount of Normal Replacement Capital Expenditures. The Division did not offset the DIT with Normal Replacement Capital Expenditures. The Division applied a yield capitalization rate of %%% and subtracted zero growth.<sup>8</sup>

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<sup>3</sup> Hearing Exhibit 1, pg.1.

<sup>4</sup> Hearing Exhibit 1, pg. 4.

<sup>5</sup> Hearing Exhibit 1, pg. 5.

<sup>6</sup> Hearing Exhibit 4, pg. 1.

<sup>7</sup> Hearing Exhibit 4, pg. 4.

<sup>8</sup> Hearing Exhibit 4, pg. 6.

7. After the assessments had been issued for the 2006 and 2007 tax years and while these appeals were pending, the Tax Commission issued, on February 28, 2008, its Findings of Fact, Conclusions of Law, and Final Decision in Appeal Nos. 06-0773 and 06-0767 (“Appeal No. 06-0767 Decision”). The property that was the subject of the Appeal No. 06-0767 Decision was a mature, cost regulated utility.

8. PETITIONER is also a mature cost regulated utility. There was no dispute on this point from any party.

9. After reviewing the Appeal No. 06-0767 Decision and concluding that findings reached by the Commission in Appeal No. 06-0767 would equally apply to PETITIONER, the Division issued revised assessments for both tax years 2006 and 2007.<sup>9</sup> The revised assessments had been prepared by RESPONDENT REP 3, Analyst. He testified regarding the revisions that he made to the original assessments. Although there was some disagreement among the parties with the Commission’s conclusions in the Appeal 06-0767 Decision<sup>10</sup>, there was no substantial disagreement that if you applied the findings of the Commission in the Appeal 06-0767 Decision to the PETITIONER valuations, the indicated value would be as determined by the Division in its revised assessments.

10. The changes that the Division made in its revised assessments for the 2006 and 2007 tax years were the removal of CIAC from the cost indicator and, in the income indicator, offsetting DIT by an equal amount of capital expenditures. The Division made an additional correction to the NOI for the tax year 2007 for an error it had found while reviewing that assessment.

11. The Counties argued that CIAC should remain an item included in the cost approach, that DIT should not be offset in the income approach. Further the County argued that DIT should not be deducted in the cost approach and that the Division erred in adding only a discounted value for expansionary Construction work in progress in the cost approach. The Counties did not submit an appraisal in this matter or testimony from an expert witness, but did submit some worksheets showing the value that would result from the changes to the factors for which they advocated.<sup>11</sup>

12. PETITIONER did not submit an appraisal in this matter. PETITIONER argued that the Commission should apply the Appeal 06-0767 decision to this matter and agreed that if the decision were

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<sup>9</sup> Hearing Exhibits 2 & 5.

<sup>10</sup> The Counties have appealed the Appeal 06-0767 decision to District Court.

<sup>11</sup> Hearing Exhibit 8.

applied, the values that resulted would be as indicated in the Division’s revised assessments.

13. A detailed comparison of the Division’s original assessments, the Division’s revised assessments as well as the factors that the Counties argue should be applied in deriving the values are as follows:

	<u>2006</u>		
	<b>Division’s Original<sup>12</sup></b>	<b>Division’s Revised<sup>13</sup></b>	<b>Counties’ Worksheet<sup>14</sup></b>
<b>Income</b>			
DIT Offset by Cap X	no	yes	no
Income Capitalized	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Capitalization Rate (“r”)	% % % % %	% % % % %	% % % % %
Income Value	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<b>Cost</b>			
Total Plant	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
CIAC	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
CWIP	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Deduction for DIT	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Cost Value	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<b>Weighting</b>	Cost 75%/Inc.25%	Cost75%/Inc.25%	Cost 75% / Inc. 25%
<b>System Value</b>	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<b>Interstate Allocation</b>	% % % % %	% % % % %	% % % % %
<b>Utah Taxable</b>	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

	<u>2007</u>		
<b>Income</b>			
DIT Offset by Cap X	no	yes	no
Income Capitalized	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Capitalization Rate (“r”)	% % % % %	% % % % %	% % % % %
Income Value	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<b>Cost</b>			
Total Plant	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

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<sup>12</sup> Hearing Exhibit 1.

<sup>13</sup> Hearing Exhibit 2.

<sup>14</sup> Hearing Exhibit 8.

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CIAC	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
CWIP	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Deduction for DIT	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Deduction for Intangibles	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Cost Value	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<b>Weighting</b>	Cost 75%/Inc.25%	Cost75%/Inc.25%	Cost 75% / Inc. 25%
<b>System Value</b>	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<b>Interstate Allocation</b>	% % % % %	% % % % %	% % % % %
<b>Utah Taxable</b>	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

14. Upon review of the evidence submitted in this matter, which was primarily the original assessments and revised assessments based on the Appeal No. 06-0767 Decision, the Commission concludes that the weight of the evidence supports the Division’s revised assessments. The Counties did not offer an appraisal or expert testimony in this matter. There was no dispute that PETITIONER was a mature, cost regulated utility similar to the property in Appeal No. 06-0767, and therefore the Commission concurs with the Division’s determination to apply the Appeal 06-0767 findings to PETITIONER. There was no evidence submitted in this matter that would lead the Commission to reconsider its position that CIAC should not be included in the cost approach. The reasons for this determination were explained in the Appeal 06-0767 Decision, as well as the Commission’s conclusion that DIT should be offset by capital expenditures in the income approach for mature, cost regulated utilities. These and other arguments of the Counties were more fully presented and rebutted by a number of expert witnesses in the Appeal 06-0767 matter and ruled on by the Commission.

**APPLICABLE LAW**

1. 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
- (b) taxed at a uniform and equal rate.

2. Consistent with the Constitutional provisions to tax all property at its fair market value, the Legislature enacted Utah Code Ann. § 59-2-103 (2005), which provides as follows:

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(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.

3. Utah Code Ann. § 59-2-102(12) (2005) 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. . . .

4. The Legislature has also created by statute an exemption for intangible property. Utah Code Ann. § 59-2-1101 (3)(g) provides as follows:

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

5. In Utah Code Ann. § 59-2-102(19), 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;
  - (ii) credits;
  - (iii) bonds;
  - (iv) stocks;
  - (v) representative property;
  - (vi) franchises;
  - (vii) licenses;
  - (viii) trade names;
  - (ix) copyrights; and
  - (x) patents. . . .
- (c) goodwill.

6. 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:

D. General Valuation Principles. Unitary properties shall be assessed at fair market value based on generally accepted appraisal theory as provided under this rule.

\* \* \*

2. The preferred methods to determine fair market value are the cost approach and a yield capitalization income indicator as set forth in E.

a) Other generally accepted appraisal methods may also be used when it can be demonstrated that such methods are necessary to more accurately estimate fair market value.

b) Direct capitalization and the stock and debt method typically capture the value of intangible property at higher levels than other methods. To the extent intangible property cannot be identified and removed, relatively less weight shall be give to such methods in the reconciliation process, as set forth in E.4.

#### E. Appraisal Methodologies.

\* \* \*

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.

\* \* \*

(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.

\* \* \*

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

#### 1. Cost Regulated Utilities.

a) HCLD is the preferred cost indicator of value for cost regulated utilities because it represents an approximation of the basis upon which the investor can earn a return. HCLD is calculated by taking the historic cost less depreciation as reflected in the utility's net plant accounts, and then: (1) subtracting intangible property; (2)

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

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

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

### **CONCLUSIONS OF LAW**

1. When a taxpayer protests its property tax assessment, the Division "must present available evidence supporting the original valuation" and "once that is done the taxpayer . . . 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." (X) v. Utah State Tax Comm'n, 2000 UT 49 ¶ 10, 5 P.3d 652, 655, 656, quoting, (X) 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 all parties argued for a value other than the original assessment and all share an equal burden of proof.

2. As it had concluded and discussed in detail in the Appeal 06-0767 Decision, the purpose of the HCLD approach pursuant to Utah Admin. Rule R884-24P-62.F.1(a) is to determine the "basis upon which the investor can earn a return." Subsection 2 of Utah Admin. Rule R884-24P-62.F.1(a) requires the subtraction of "any items not included in the utility's rate base." The evidence in Appeal 06-0767 established that properties funded by CIAC were not included in the rate base. There was no evidence or argument that the CIAC in the matter currently before the Commission was included in PETITIONER's rate base. The Commission finds that Utah Admin. Rule 884-24P-62.F.1 requires that CIAC be deducted from the cost value. In response to the Counties' argument that deducting CIAC is giving rise to an exemption from property tax, the Commission disagrees. The Commission is not

exempting CIAC. The value of the CIAC property is implicit in the total value of the property. Furthermore, when a property has utilities available through use of the CIAC, it increases the value of the property that the CIAC serves, therefore being captured in property tax assessments in the properties to which it provides the utilities.

3. After listening to the expert witnesses' testimony in the Appeal 06-0767 matter, the Commission concluded that when the DIT is not offset by capital expenditures, it results in a mismatch of assumptions in the numerator and denominator of the yield capitalization formula. Therefore, for a mature, cost regulated utility like Appeal 06-0767, the DIT expense should be equally offset by capital expenditures. There was nothing additional presented in the PETITIONER matter that convinces the Commission it had reached the wrong conclusion in Appeal 06-0767. Further, the parties did not dispute that PETITIONER was a mature, cost regulated utility similar to Appeal 06-0767.

4. In addition to DIT expenses, the Counties argue a growth factor should have been subtracted from the yield capitalization rate. This is an issue that was addressed in the Appeal 06-0767 Decision fully after testimony from several expert witnesses. The Counties presented no testimony or expert opinion in this matter for PETITIONER and the Commission has no basis upon which it would consider a different growth factor. The Commission notes that in the Counties' value worksheets, the Counties did not subtract a growth factor and relied on the same capitalization rate as the Division. Further, the Counties again raised the argument that the Division had improperly determined the amount of CWIP. For the 2006 year the Division had added \$\$\$\$ for the present value of expansionary CWIP in the cost approach. It was the Counties' position that the proper amount to add for CWIP for the 2006 year was \$\$\$\$\$. As the Commission determined in Appeal 06-0767, the correct amount to add for CWIP was the discounted value of expansionary CWIP. The Commission specifically ruled against the Counties' assertion that a discounted value of all CWIP should be added in the cost approach, because doing so captures a double value for some of the property.

**FINAL DECISION**

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Based on the foregoing, the Commission finds that for the lien date January 1, 2006 the Utah taxable value of the subject property is \$\$\$\$\$, and for the lien date January 1, 2007 the Utah taxable value is \$\$\$\$\$. It is so ordered.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2009.

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Jane Phan  
Administrative Law Judge

BY ORDER OF THE COMMISSION:

The Commission has reviewed this decision and the following concur.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2009.

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Pam Hendrickson  
Commission Chair

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R. Bruce Johnson  
Commissioner

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D'Arcy Dixon Pignanelli  
Commissioner

**CONCURRENCE**

I reiterate my concurrence in the previous decision for Appeal No. 06-0767, wherein I expressed my concerns with relying on compliance with Rule 62, rather than on market-based valuation principles. In that case we had an actual sale of cost regulated utility, similar to the subject property. I will not restate my specific concerns. I will, however, add that I am particularly uncomfortable with the wording under Rule 62F.1.a) that although HCLD “represents an approximation of the basis upon which the

investor can earn a return,” it must be adjusted by “subtracting any items not included in the utility’s rate base (e.g. deferred income taxes . . .).” My concern is that a basis on which an investor can earn a return is not necessarily the same as fair market value as required and defined under § 59-2-102(12).

As I stated previously, it is obvious that, even in a regulated environment, rate base may not be equivalent to fair market value. I also stated that I believe that the cost approach is the most reliable predictor of value for a rate regulated utility, and should be the main approach considered. And finally, I noted that the starting point for a cost approach should be net book value.

At the time, I had recommended to my colleagues that we convene a study group for rule-making hearings. I reiterate that suggestion, but would also clarify that further rule-making is not necessarily the outcome. Rather, the findings of that group would help determine if rule-making is appropriate.

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Marc B. Johnson  
Commissioner

**NOTICE:** You have twenty (20) days after the date of this order to file a Request for Redetermination with the Commission pursuant to Utah Code Ann. § 63G-4-302. A Request for Redetermination must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Redetermination with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. § 59-1-601 et seq. and 63G-4-401 et seq.

*JKP/06-0772.fof*