

16-904

TAX TYPE: PROPERTY TAX

TAX YEAR: 2016

DATE SIGNED: 11/8/2019

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL, L. WALTERS

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<p>PETITIONER,</p> <p> Petitioner,</p> <p>COUNTY-1, COUNTY-2,COUNTY-3, COUNTY-4,COUNTY-5, COUNTY-6, COUNTY-7, COUNTY-8, COUNTY-9 & COUNTY-10,</p> <p> Cross Petitioners,</p> <p>v.</p> <p>PROPERTY TAX DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p> Respondent.</p>	<p>FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION</p> <p>Appeal No. 16-904</p> <p>Tax Type: Property Tax</p> <p>Tax Year: 2016</p> <p>Judge: Phan</p>
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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 regulation pursuant to Utah Admin. Rule R861-1A-37. Subsection 6 of that rule, pursuant to Sec. 59-1-404(4)(b)(iii)(B), prohibits the parties from disclosing commercial information obtained from the opposing party to nonparties, outside of the hearing process. Pursuant to Utah Admin. Rule R861-1A-37(7), 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 notice, specifying the commercial information that the taxpayer wants protected. The taxpayer must send the response via email to taxredact@utah.gov, or via mail to Utah State Tax Commission, Appeals Division, 210 North 1950 West, Salt Lake City, Utah 84134.

Presiding:

John L. Valentine, Commission Chair
Michael J. Cragun, Commissioner
Rebecca L. Rockwell, Commissioner
Lawrence C. Walters, Commissioner
Jane Phan, Administrative Law Judge

Appearances:

For PETITIONER: REPRESENTATIVE-1 FOR PETITIONER, Attorney at Law
REPRESENTATIVE-2 FOR PETITIONER, Attorney at Law
For Petitioning Counties: REPRESENTATIVE-1 FOR COUNTIES, Attorney at Law
REPRESENTATIVE-2 FOR COUNTY-10, Deputy District
Attorney
For Respondent: REPRESENTATIVE-1 FOR RESPONDENT, Assistant
Attorney General
REPRESENTATIVE-2 FOR RESPONDENT, Assistant
Attorney General

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on DATE, 4-17, 2019, in accordance with Utah Code Ann. §59-2-1007 and §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The issue before the Tax Commission at the Formal Hearing is the determination of the proper Utah assessed value for property tax purposes for Petitioner PARENT COMPANY's Utah tangible taxable property as of the lien date DATE, 2016.

2. The unit subject to this assessment is the North American operating subsidiaries of PARENT COMPANY, excluding the TV Broadcast operations, which are locally assessed.¹ The North American subsidiaries which constitute the subject unit will be referred to herein as "PETITIONER". PARENT COMPANY. is the parent corporation of the PETITIONER unit subject to this appeal and for clarity, when the parent corporation is referred to herein, it will be referred to as "PARENT COMPANY"

3. PETITIONER's property is centrally assessed by Respondent ("Division") under Utah Code Sec. 59-2-201. For tax year 2016 the Division had issued its assessment and

¹ Transcript p. 352: APPRAISER, Utah Licensed Appraiser.

PETITIONER had timely filed an appeal of the Division's assessment under Utah Code Sec. 59-2-1007.

4. PETITIONING COUNTIES ("Petitioning Counties") also timely filed cross appeals of the assessment under Utah Code Sec. 59-2-1007.

5. The Division had assessed the property subject to this appeal with a Utah assessment value as of DATE, 2016 of \$\$\$\$\$. However, at the hearing the Division argued that it had made an error in the original assessment and when that error was corrected, the 2016 Utah assessment value was higher, at \$\$\$\$\$.

6. At the hearing, all parties conceded error in the original assessment, with the Division and Counties arguing the original assessment was too low and that the assessed value should be raised to \$\$\$\$\$ to correct the error. PETITIONER argues the original Utah assessed value was too high and the Utah assessed value should be lowered to \$\$\$\$\$.²

I. General Information

7. PARENT COMPANY is an international facilities-based communications network. PARENT COMPANY, together with its subsidiaries, operates as a provider of a range of integrated communications services in North America, FOREIGN COUNTRY-1, FOREIGN COUNTRY-2, the FOREIGN COUNTRY-3 and FOREIGN COUNTRY-4.³ The network is primarily composed of an INFRASTRUCTURE that reaches extensively throughout North America as well as globally. The Division has calculated that %%% of PARENT COMPANY.'s property is attributable to the PETITIONER unit at issue in this appeal.⁴

8. (PARAGRAPH REMOVED).⁵

9. NAME-1, Vice President Finance, PETITIONER, testified at the hearing that "PETITIONER is a telecommunications company, and it provides a host of services, (WORDS REMOVED)"⁶ He explained that PETITIONER provides four types of services to its customers: 1) IP and data services; 2) transport and fiber; 3) voice services; and 4) co-location and datacenter services.⁷ Revenue from these 4 service areas in 2015 had been \$\$\$\$\$.⁸ In the range

² Exhibits 15, 30 & 31.

³ Exhibit 15, p. 00004.

⁴ Exhibit 31, p. 00016.

⁵ REMOVED PARAGRAPH

⁶ Transcript p. 12: NAME-1, Vice President Finance, PETITIONER.

⁷ Exhibit 5.

⁸ Exhibit 1, 00200.

of two thirds to three fourths of PETITIONER's revenues came from the first two types of services, which were the IP and data services and the transport and fiber services.⁹ In addition to these four service areas, PETITIONER provides wholesale voice service or WVS. For 2015, the WVS revenue was \$\$\$\$\$.¹⁰

10. PARENT COMPANY has an INFRASTRUCTURE throughout North America as well as globally. NAME-1, PETITIONER's witness, explained INFRASTRUCTURE is basically a piece of glass that allows the company to send a photon, which is a little piece of light, down that fiber strand and it will come out on the other end. To transport data through the lines, (X) equipment sends a light down the line, primarily in the ultraviolet spectrum and the equipment at the other end receives it. The lines are unidirectional, meaning they use one strand to send traffic one way and a different strand to send it back.¹¹

11. For the core network, or the portion of the network actually constructed by PARENT COMPANY, the company placed ##### conduit tubes in the ground first. Once the conduit was in the ground, the INFRASTRUCTURE was placed inside the conduit. NAME-1 explained that once the conduit was in the ground, the company would "blow the fiber through with air pressure."¹² He explained that was how the core network was constructed, but PARENT COMPANY, also acquired some assets from other companies where the fiber was direct buried in the ground. PARENT COMPANY purchased fiber from COMPANY-1, COMPANY-2 and COMPANY-3. PETITIONER ended up with direct buried fiber from these acquisitions.¹³

12. For the core portion of the network (SENTENCES REMOVED). And since everyone else has been more or less constrained, it's extremely expensive to go and build, you know, more fiber, they've pushed the equipment vendors, and the equipment vendors have . . . been able to develop new technologies and new ways and new optics to send more and more down the existing fiber. So we flat out haven't needed to use the other conduits."¹⁴

13. NAME-1 also explained that they have been able to use higher density fiber in metro areas. PETITIONER's metro networks have a much higher density, 500 density fiber. The equipment deployed around the 2014 period was between 4 and 8 terabit per fiber. He explained

⁹ Transcript p. 52: NAME-1.

¹⁰ Transcript p. 102: NAME-1; Exhibit 1, 00200.

¹¹ Transcript p. 18: NAME-1.

¹² Transcript p. 19: NAME-1.

¹³ Transcript pp. 20, 97: NAME-1.

¹⁴ Transcript p. 57: NAME-1.

in the inner city fiber architecture, PETITIONER “will multiplex different signals on the same fiber.” The technology is called dense wavelength division multiplexing, or DWDM and it allows PETITIONER to send different colors of light down the same fiber, therefore, enabling the fiber to be shared.”¹⁵

14. PETITIONER does sell or lease to some extent “dark fiber” which is fiber that PETITIONER does not need for its own network. PETITIONER sells or leases some of the fiber strands to a customer and PETITIONER does not install equipment on either end of these strands to light this fiber or send information. The customer acquiring the “dark fiber” would put in its own equipment to send light down the fiber strands. In addition, many customers do not need a full fiber and can get a wavelength on a shared fiber. They are sold as 2.5 gigabit, 10 gigabit, 40 gigabit and 100 gigabit wavelengths. For these transactions, PETITIONER does provide the equipment that lights this fiber.¹⁶

15. The technology PETITIONER uses has improved rapidly over time so that the capacity has been increasing and costs per unit have gone down. An example of this was provided by NAME-1 who points out that as part of the network, in order to send data through the fiber, PETITIONER has wavelength transport equipment that is connected to the fiber. The technology for this equipment has changed rapidly. PETITIONER has had MANUFACTURE wavelength transport equipment and has been replacing it with the next generation equipment, which is EQUIPMENT. NAME-1 testified regarding the rapidly developing equipment, “So really, everything gets better in this space with time. It’s - - it’s a little bit like computers. We can send more data down a single fiber pair with this new generation of EQUIPMENT. The equipment associated with a single fiber pair takes up less space. And, you know, specifically, the increments that the industry goes through is usually about a 2 ½ step and then another step. So you go through basically a 10 X improvement roughly every 12 to 15 years.”¹⁷ He explained that one rack of the new EQUIPMENT can haul the same as four racks of the MANUFACTURE equipment it was replacing. The EQUIPMENT was about 6 years newer than the equipment it was replacing. “Our cost on our – on our financial statements to buy this equipment goes down over time.” He explained that a rack of the new equipment may cost the same as what a rack of the older equipment did when purchased, but the new equipment provides much more capacity

¹⁵ Transcript pp. 23-24: NAME-1.

¹⁶ Transcript pp. 27-28: NAME-1.

¹⁷ Transcript pp. 31-34: NAME-1.

than the old equipment.¹⁸ NAME-1 gave the example that in 2000 the highest capacity wavelength PETITIONER could sell was one gigabit and today it is 100 gigabits.¹⁹ He also explained that it was not the fiber that was actually seeing the rapid changes, but the equipment that sends and receives signals across the fiber which has been seeing such increased capacity. He testified it was his understanding from the equipment vendors that the increases in capacity would continue in the future.²⁰

16. NAME-1 also testified regarding “price compression.” He explained that until 2015 and even before, PETITIONER was seeing significant “price compression” in the market, meaning that the price for which PETITIONER could sell one of its contracts would decrease year over year.²¹ NAME-1 testified that he had even developed and patented an equation to measure this price compression for the purposes of evaluating the contract terms.²²

17. Although there was this price compression, the demand for data was increasing %%% per year in North America around the lien date. This meant that although the prices per unit were going down, the volume of units sold were increasing, so the revenue was remaining stable.²³ In addition to increasing demand, PETITIONER also considered the fact that although what it could sell its data for was decreasing on a per unit basis, PETITIONER’s costs to provide that data were also going down. NAME-1 explained, “Cost compression is what’s happening with the equipment that we’re buying and how much it costs us to buy it.”²⁴ He stated that PETITIONER assumes in the long run that price compression and cost compression are equal.²⁵

18. NAME-1 explained that there was limited capacity in the network to add new customers based on the equipment currently in existence. He explained, “you don’t want to have a huge stock of things because then you’re paying to hold it and carry it when you don’t need it, and you don’t want to have too small of stock.” His opinion was, “We’ve got capacity for maybe another couple months of demand.”²⁶ But he also indicated it depends on the product the

¹⁸ Transcript pp. 39-40: NAME-1.

¹⁹ Transcript p. 40: NAME-1.

²⁰ Transcript p. 108: NAME-1.

²¹ Transcript p. 76: NAME-1.

²² Exhibit 11.

²³ Transcript p. 83-85: NAME-1. Exhibit 10 demonstrative of testimony of NAME-1.

²⁴ Transcript p. 90: NAME-1.

²⁵ Transcript p. 91: NAME-1.

²⁶ Transcript pp. 93-94: NAME-1.

customer is purchasing, noting that for example if a building is not on PETITIONER’s network, PETITIONER would have to lay fiber to the building, but could on an interim basis pay to use fiber from another provider that already had access. He did explain that for longer route services, they may have to add more capacity in a segment that is full. However, he noted the Company tries “to be a little more proactive with those, you know, on our big core routes that we don’t hold up specific orders.” There is planning to make “sure we have a little bit of room in the network so that we don’t have to hold up orders.”²⁷ NAME-1 also explained that a lot of PETITIONER’s IP contracts are structured on the concept of usage and the more they consume the more PETITIONER builds out its system. He provided the opinion that over time if they started to consume more, PETITIONER wouldn’t have enough network to give them the quantity they needed and you’d start having issues.²⁸

II. Original Assessment

19. The original assessment had been based on equal weighting between a cost and yield capitalization income approach adjusted for intangibles of the system value and then applying a Utah allocation percentage of %%%%. The original assessment is summarized as follows:²⁹

	Cost Approach	\$\$\$\$% % % % \$\$\$\$
	Income Approach	\$\$\$\$% % % % <u>\$\$\$\$</u>
	Reconciled System Value Rounded	
		\$\$\$\$
	Utah Allocation Percentage	
<u>X % % % % %</u>		
	Utah Value Before Adjustments	
		\$\$\$\$
	Less Adjustments	
		<u>\$\$\$\$</u>
	Utah Assessment for DATE, 2016	
		\$\$\$\$

20. The Division’s cost approach in the assessment was a historical cost less depreciation (HCLD) approach, which the Division noted was the preferred Rule 62 cost approach. This was based on the historic costs of the tangible property using the accounting

²⁷ Transcript pp. 100-101: NAME-1.

²⁸ Id. p. 86.

²⁹ Exhibit 30.

\$\$\$\$\$. The portion of this system value attributable to Utah was calculated out by the Division to be an allocation percentage of %%%%. In addition, the Division made a final adjustment of \$\$\$\$ for motor vehicles for which taxes are paid as a fee in lieu when they are registered. This resulted in the Division's original Utah assessment for DATE, 2016 of \$\$\$\$.³³ At the Formal Hearing, however, the Division made a correction to this assessment which was set out in the Division's Hearing Appraisal and is discussed below.

III PETITIONERS Valuation Report

24. PETITIONER submitted a "Valuation Analysis" or a "price estimate between a willing buyer and a willing seller"³⁴ of PETITIONER's North American operating properties, which had been prepared by NAME-2.³⁵ NAME-2 is not a licensed or certified appraiser and did not follow USPAP in preparing his report.³⁶ He did not label his report as an appraisal. NAME-2 has a Ph.D. in Finance, Masters Degrees in both Economics and Business Administration, and had been a Professor of Finance since 1982.³⁷ Although not an appraiser and not constrained by the requirements of USPAP, NAME-2 is an expert in the area of Finance and his report provides relevant information which is admissible in this proceeding in regards to determining the unitary value for the subject property.

25. In his report, NAME-2 had prepared both a HCLD cost approach and a discounted cash flow income approach. However, he placed no weight on the HCLD cost approach, citing that it ignored economic and functional obsolescence. He did not prepare a market sales comparison approach pointing to the lack of sales of similar operating properties. His conclusion of value from his discounted cash flow income indicator, after making an adjustment to remove intangibles, was \$\$\$\$ for the tangible unit value. It was his conclusion that as of the lien date at issue in this appeal, DATE, 2016, the unit value of the tangible assets of the subject property was the \$\$\$\$ conclusion from his income approach. Using the Division's Utah allocation factor of %%%%, he calculated that the Utah taxable value was \$\$\$\$.

A. PETITIONER's Cost Indicator

³³ Exhibit 30, p. 00363.

³⁴ Transcript p. 263.

³⁵ Exhibit 15.

³⁶ Transcript p. 263.

³⁷ Exhibit 14.

26. NAME-2 did prepare a cost indicator, using the “historical cost” of the taxable property as reported on PETITIONER’s financial statements and he summarized this in his report as follows:³⁸

	(\$\$\$\$\$)
Gross Plant and Equipment	\$\$\$\$\$
Construction Work in Progress	+ \$\$\$\$\$
Total	\$\$\$\$\$
Less Accumulated Depreciation	(\$\$\$\$\$)
Total Net Historical Cost	\$\$\$\$\$

27. NAME-2 noted that the cost numbers did reflect a restatement of assets due to the acquisition of COMPANY-1 in 2011 and COMPANY-3, in 2014, noting that the accountants allocated the value of the shares purchased to the various items on the balance sheet. NAME-2 explained why he placed no weight on his cost approach noting in his report, “there is substantial evidence that the estimate above overstates value due to the existence of economic and functional obsolescence. As discussed, telecommunications equipment technology changes rapidly with new technology usually costing less and having greater capacity. As evidence of economic obsolescence, since its restructuring in YEAR, [PETITIONER] has seen a major collapse in its share price . . .”³⁹ He testified that it was his opinion that the HCLD cost model overstated the value of the assets because most of the equipment “is going to be functionally obsolete.” In fact he stated, “It is almost functionally obsolete the day it goes in because” of “how rapid” the technology changes.⁴⁰ He goes on to provide in his report the opinion that there are three factors that indicate the value is less than the cost approach:

- 1) The assets are generating less cash flow than necessary to justify the cost approach indicator;
- 2) The collapse of stock price value; and
- 3) The technological obsolescence that occurs regularly in the telecommunications/networking industry.⁴¹

28. Although NAME-2 had concluded there was obsolescence in the cost approach, he did not quantify a specific dollar amount of adjustment to make for obsolescence. Instead he chose to put no weight on his cost approach in his reconciliation of his cost and income

³⁸ Exhibit 15, p 000017.

³⁹ Exhibit 15, p. 000017.

⁴⁰ Transcript p. 143, NAME-2

⁴¹ Exhibit 15, p. 000019.

conclusions. He provided the opinion that he would use his cost approach “as a benchmark as a maximum value that it could conceivably be, but not weight in the normal sense.”⁴² He explained, “I’ve only really got one approach I can use here, and that’s my income. I know that the cost approach is high because I know that the assets are functionally obsolete.” He stated he considered the historical costs only “as a check against” his tangible asset conclusion number, to make sure that “whatever the tangible asset conclusion I reach” is “below that historical cost.”⁴³

B. PETITIONER’s Income Indicator

29. NAME-2’s income approach was a discounted cash flow model. He explained for this approach the appraiser first estimates future cash flows after all expenses, investments in working capital and capital expenditures.⁴⁴ NAME-2 notes that a “key consideration of this valuation analysis” was that only the unit of operating assets existing as of DATE, 2016, the lien date at issue in this appeal, should be included in the value. He explains, “if only the unit of existing operating assets on DATE, 2016 is valued then only the future revenue from the existing assets should be forecast and only the capital expenditures necessary to maintain the existing assets should be subtracted.” For this reason NAME-2 had not based his forecasted net cash flows on the expected revenue and cash flow forecasts made by PETITIONER because PETITIONER was expecting to have expansion capital expenditures and growth from those capital expenditures beyond what the assets existing on the lien date could produce. Instead NAME-2’s forecasted cash flows declined for each year of the holding period. NAME-2 provided the opinion that his forecast “reflected only the unit of operating assets in existence as of DATE, 2015” and was based on the operating capacity of the existing assets going forward.⁴⁵

30. NAME-2’s “no growth” or declining cash flow approach was a disputed issue between the parties at the hearing as the Division, although using a single stage yield capitalization model, had included a growth factor. NAME-2 had instead forecasted declining cash flow for each year of the holding period in his DCF model. At the hearing NAME-2 testified that “Forecasted growth may be used where unusual income patterns are attributed to . . . unused capacity; . . . economic conditions; or similar circumstances.” But for PETITIONER, NAME-2 said prices per unit of capacity had been falling from %%% to %%% per year,

⁴² Transcript p. 146:NAME-2.

⁴³ Transcript p. 251:NAME-2.

⁴⁴ Exhibit 15, p. 000020.

⁴⁵ Exhibit 15, p. 000021.

so the only way revenue could be flat would be to add additional capacity in the future. “But that means that you’re capturing value from assets that don’t exist on the lien date.” He explains “the existing assets can only carry a certain amount of capacity, a certain amount of gigabits. And since that price to transport them is falling, the revenue from the existing assets on DATE, 2016, must fall.”⁴⁶

31. Based on this consideration, NAME-2 looked at price per unit data on more than %%% of the products sold by PETITIONER and concluded a decrease in price by %%% per year based on historical information. To determine his net cash flow estimates, he declined his forecasted revenue by %%% each year.⁴⁷ His revenue forecast was the following:⁴⁸

(\$\$\$\$\$)	2016	2017	2018	2019	2020
Revenue	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

32. In addition to estimating operating revenue for the five years going forward, an estimate is made for the operating expenses in the DCF income approach. For his estimate of operating expenses, NAME-2 acknowledged that in the past years the costs or expenses had been declining faster than the revenues. NAME-2 explained that for his estimates he continued “to widen those margins” and “drop costs faster than our revenues fall.” NAME-2 estimated his operating expenses in this manner for years 2016 through 2019. He does explain that “margins cannot widen forever” so for year 5 he assumed PETITIONER would earn its cost of capital going forward.⁴⁹ His total operating expense and resulting net operating income are as follows:
.⁵⁰

(\$\$\$\$\$)	2016	2017	2018	2019	2020
Revenue	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
- Total Operating Expense	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)
Net Operating Income	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

33. The next step in estimating cash flow was to subtract the state and federal income taxes at the marginal rate and then add back depreciation. Depreciation is subtracted as an

⁴⁶ Transcript p. 155: NAME-2.
⁴⁷ Transcript pp. 161-162: NAME-2.
⁴⁸ Exhibit 15, p. 25.
⁴⁹ Transcript pp. 163-164: NAME-2.
⁵⁰ Exhibit 15, p. 25.

expense to determine the tax amount and then added back. NAME-2 testified at the hearing that he used “tax depreciation” rather than GAAP accounting depreciation.⁵¹ Finally, he subtracted for “maintenance capital expenditures.” NAME-2 testified that the amount he deducted for “maintenance capital expenditures,” was only about %%% of what PETITIONER was actually spending on capital expenditures because he was looking only at the expenditures needed for replacing “the heating, air-conditioning, power, shelves . . . the infrastructure.” NAME-2 did not include the costs of buying network equipment in his “maintenance capital expenditures.”⁵² He explained that he was assuming the network equipment “lasts indefinitely . . . which it does.” So he was not adding for new, higher capacity equipment to the unit.⁵³ Based on the operating income calculated above, NAME-2’s net cash flow was the following:⁵⁴

(\$\$\$\$\$)	2016	2017	2018	2019	2020
Net Operating Income	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
- Taxes at %%%	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)
NOI after Tax	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
+ Add Back Depreciation	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
- Maintenance Cap Ex	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)	(\$\$\$\$\$)	
Net Cash Flow	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	

34. Once the net cash flow had been estimated, the next step in the income approach was to discount the future cash flow to a present value by using the cost of capital or discount rate. NAME-2 did this in years 1 through 4. For the fifth year he determined the terminal value using the perpetual growth formula: *Terminal Value = Net Operating Profit After Tax/Discount Rate*. The discount rate he used was %%%. Using his estimated net cash flows and his discount rate, NAME-2 concluded from his income approach a unit value of \$\$\$\$\$, which was the sum of the years 1 through 4’s net cash flow forecasts divided by the discount rate plus the terminal value as follows:⁵⁵

(\$\$\$\$\$)	2016	2017	2018	2019	2020
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⁵¹ Transcript p. 168: NAME-2.

⁵² Transcript p. 317: NAME-2.

⁵³ Transcript p. 326: NAME-2.

⁵⁴ Exhibit 15, p. 25.

⁵⁵ Exhibit 15, p. 25.

Net Cash Flow	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Terminal Value				\$\$\$\$\$
Present Value at 12.1%	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Income Approach Value:	\$\$\$\$\$			

35. NAME-2's %%% discount rate was highly disputed at the hearing. It was significantly higher than the Division's cost of capital rate of %%%. NAME-2 had prepared a Cost of Capital study for PETITIONER and testified at the hearing in regards to his %%% conclusion.⁵⁶

36. NAME-2 argued a higher rate was indicated because of the risks. He provided the opinion that early January 2016 was a difficult time to estimate PETITIONER's cost of capital due to restructuring actions in the telecommunications/networking industry as a whole and also within PETITIONER specifically. For the industry in general, COMPANY-8 had recently tried to acquire COMPANY-4, but failed. COMPANY-4 acquired COMPANY-5, and FOREIGN COUNTRY-6 CORPORATION, purchased a sizable portion of a COMPANY-6 had acquired COMPANY-7. COMPANY-6 appeared to be launching an action to acquire COMPANY-4. (REMOVED SENTENCE)

37. In addition it was NAME-2's contention that there were significant risks in the telecommunications industry in early 2016. There was the constantly changing technology. NAME-2 points out that prior to 1995 the industry was analog. Analog was replaced by digital networks starting in 1995. Four years later the original digital networks were replaced with 2G or 2.5G networks. Then about four years later, these were replaced with 3G networks and again, another four years later, there were 4G networks. About four years after that, it was the 4G Advanced Technology. Then, in early 2016, the transition to 5G technology was beginning. NAME-2 noted it was very expensive to remove the old technologies and install the new technologies. In addition, he noted, "As a result of the constantly changing technology, at any given time much of the existing operating property of [PETITIONER] was obsolete or would be in the next couple of years."⁵⁷

38. NAME-2 testified another factor was the increasingly competitive market. Competitors were announcing significant price cuts. Consumers were shifting to smartphones

⁵⁶ Exhibit 15, Appendix A.

⁵⁷ Exhibit 15, Appendix A, p. 000032.

and there was skyrocketing demand for bandwidth. PETITIONER did not compete directly in the consumer market, but NAME-2 opined its enterprise customers would benchmark PETITIONER’s cost and capabilities against typical consumer and wholesale costs and capabilities.

39. NAME-2 had concluded his %%% discount rate based on the weighted average cost of capital (WACC) method. The WACC is generally comprised of three components. It requires: 1) estimating the cost of equity; 2) estimating the cost of debt; and 3) estimating the capital structure which is the percentage mix of debt and equity available to a buyer of PETITIONER. In calculating his cost of capital, NAME-2 made two different adjustments that had not been made by the Division. He tax adjusted his cost of debt to account for the tax-deductibility of interest. He also added an illiquidity premium to his cost of equity. His conclusion of %%% was an after tax WACC, and was comprised of the following components:⁵⁸

	Adjust for Tax	Liquidity	Capital Structure	
Cost of Debt %%%	x (1-.38)	%%%		= %%%
Cost of Equity %%%		+ %%%		= %%%
				%%%
			Rounded	%%%

40. For the first component of his WACC, the cost of equity, NAME-2 considered two different equity models. His %%% cost of equity estimate was based on a Capital Asset Pricing Model (“CAPM”) and a Dividend Growth Model (“DGM”). In his Cost of Capital Report, NAME-2 did not specify how he weighted his conclusions from these two models to get the %%% cost of equity rate.

41. For the CAPM model, which he calculated to be %%%. NAME-2 followed the formula: $R_f + B(R_m - R_f) = r$. In this formula “Rf” is the risk free rate, “Rm” is the market expected return, “B” is the beta, and “r” is the rate of return on equity. NAME-2 also referred to the portion in parentheses, “(Rm-Rf),” as the equity risk premium.

42. To determine the appropriate beta, NAME-2 looked to several telecommunication companies as “benchmark companies.” He noted that PETITIONER was unique in the market and that he did not have a good comparable to use as guideline companies. Most of his

⁵⁸ This information is from Exhibit 15, Appendix A, although not presented in this format.

benchmark companies were in MARKETS. He had included COMPANY-8 and COMPANY-9 which he testified were a lot less risky than PETITIONER as they had been profitable for decades and they were dominant players in the market in his opinion. (SENTENCE REMOVED). One of the “benchmark companies” he considered was PARENT COMPANY, which he noted was not the subject PETITIONER, but instead the worldwide corporate entity which was the parent of the PETITIONER subject unit PARENT COMPANY. (SENTENCE REMOVED). NAME-2 testified that he did place the most weight in determining his beta from PARENT COMPANY.⁵⁹ NAME-2 had concluded it was appropriate to use the levered beta of 1.15, based on COMPANY-17 market information and accounting for the different debt levels. NAME-2 had tried to pull out the effect of the debt leverage on the beta compared to the business risk of the beta.⁶⁰ He provided the following information from his guideline or “benchmark” telecommunication companies as follows:⁶¹

Percent Debt	COMPANY-17	Unlevered Beta	Beta	
COMPANY-8	%%%	0.75	0.48	
COMPANY-11	%%%		1.05	0.85
COMPANY-12	%%%	0.86	0.45	
PETITIONER	%%%		1.28	0.95
COMPANY-6	%%%	0.93	0.32	
COMPANY-4	%%%	1.05	0.70	
COMPANY-10	%%%	0.93	0.72	
COMPANY-9	%%%			

43. NAME-2 then applied a formula to separate out the risk from the amount of debt or leverage. The formula he used was $B_L = B_U \times (1 + \text{Debt} (1-T)/\text{Equity})$. In this formula “ B_L ” is the leveraged beta, “ B_U ” is the unleveraged or asset beta, “Debt” is the amount of debt based on the companies’ SEC filings, “T” is the combined federal and state tax rate and “Equity” is the market capitalization. Using this formula, NAME-2 calculated the appropriate levered beta for PETITIONER was #####.⁶²

44. It was NAME-2’s conclusion that the risk free rate, “Rf” in the $R_f + B (R_m - R_f)$ =CAPM formula, was %%%%, which he testified was based on the 30-year Treasury Rate. He explained that he used the 30-year rate, instead of the 20-year rate used by the Division,

⁵⁹ Transcript pp. 191-192: NAME-2.

⁶⁰ Transcript pp. 192-194: NAME-2.

⁶¹ Exhibit 15, Appendix A, p. 000037.

⁶² Exhibit 15, Appendix A, p. 000037-38.

because that was the longest term Treasury note issued by the U.S. government and that in principle he was valuing an “infinite set of cash flows.”⁶³ NAME-2 acknowledged that Rule 62 said to use a 20-year treasury rate, but he said he thought the rule might have said this because there was a period from the 1990’s to the early 2000’s when the U.S. had stopped issuing a 30-year Treasury note and the longest note issued at that time had been a 20-year note. He acknowledged, “I don’t recall exactly, but that’s probably a reasonable explanation.” It was his contention that “the longest term rate makes more sense.”⁶⁴

45. In the CAPM formula, the third factor was the “ R_m ” or market rate. NAME-2 explained that most people will use the S&P 500 as their benchmark. NAME-2 used the equity risk premium, which was the “ $(R_m - R_f)$ ” portion of the equalization from the Ibbotson Risk Premium Report, which indicated %%% as the historical average for the equity risk premium. Therefore, his $R_f + B(R_m - R_f)$ calculation was: #####.

46. The Ibbotson Risk Premium Report is based on 20-year risk free bond data and NAME-2 stated Ibbotson does not provide the 30-year data, so he used the Ibbotson 20-year risk premium as “a rough estimate of - - - pretty close estimate actually, of what the premium would be on a 30 year.” He acknowledged that Rule 62 had said to use the 20-year treasury rate and not the 30-year treasury rate, so that if he had followed Rule 62 the risk premium would match the risk free rate.⁶⁵

47. NAME-2 provided the opinion that this CAPM conclusion understated the return investors would require for an equity position in PETITIONER. He pointed out that PARENT COMPANY, the parent company’s stock price had been extraordinarily risky. There had been a %%% collapse in stock price from 2000 to 2001 and another significant price drop in 2004 and 2006. NAME-2 also provided the opinion that the CAPM understates the cost of equity because it relies in part on the treasury rate, which he opined had been artificially lowered by the Federal Reserve beginning in 2012. He argued that the artificially low Treasury bond rates were not a sustainable situation, and they likely caused the CAPM to understate the true required returns.⁶⁶ Although he acknowledged that a willing buyer would look at the current market

⁶³ Transcript pp. 184-185: NAME-2.

⁶⁴ Transcript pp. 185: NAME-2.

⁶⁵ Transcript pp. 275-276: NAME-2.

⁶⁶ Exhibit 15, Appendix A, p. 000039-0040; Transcript p. 186: NAME-2.

conditions on the lien date, which was a %%%% treasury rate, he argued the treasury rate was temporarily moved “from what would otherwise be an economic equilibrium.”⁶⁷

48. NAME-2 also relied on a DGM model to estimate the cost of equity. The equation he followed for his DGM model was: $Required\ Return = (D_1/P_0) + g$. In this equation “D₁” was the next year’s expected dividend, “P₀” was the current stock price, and “g” was the future expected growth. To calculate the DGM, NAME-2 did look at the same telecommunications guideline or “benchmark” companies and developed the DGM estimated return using the formula for each, whether or not there was a forecasted dividend, as follows:⁶⁸

	Share Price Estimated Projected	Valueline Projected Dividend Forecast	Yield (12/31/15) Return	Valueline Growth	COMPANY-17 2016 Growth
COMPANY-8	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
COMPANY-11	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
COMPANY-12	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
PETITIONER	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
COMPANY-6	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
COMPANY-4	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
COMPANY-10	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
COMPANY-9	\$\$\$\$\$	\$\$\$\$\$	%%%	%%%	%%%
Average			%%%	%%%	%%%

49. NAME-2 had provided the average of his DGM calculations in his report but did not specifically state in his report what his DGM conclusion had been, whether it was the average of %%%% or some other amount. At the hearing, NAME-2 testified regarding his DGM conclusion that “I show an average [DGM] there, but I don’t use an average. What I am doing there is using these as benchmarks.” He indicated that PETITIONER’s DGM would be higher than COMPANY-8 and COMPANY-9’s because they “are substantially lower risk than PETITIONER.” He also indicated that the COMPANY-12 and COMPANY-4 numbers were outliers so he was “suspicious” of those and placed little weight on them. He indicated he put a

⁶⁷ Transcript p. 318: NAME-2.

⁶⁸ Exhibit 15, Appendix A, p. 000041.

lot of weight on PARENT COMPANY and considered that PETITIONER's DGM (REMOVED PART OF SENTENCE) although this was not stated anywhere in his report, he testified at the hearing, "something about 13 percent is what I would conclude as being an appropriate number for the subject property [for the DGM]."69

50. Additionally in his report, NAME-2 did not state how he weighted his CAPM and DGM conclusions to get to his cost of equity rate of %%%%. He stated in his report only, "As a result of the obvious risk that PETITIONER has experienced and based on the two approaches, I selected %%%%."70 At the hearing, NAME-2 testified about his concluding the %%%% rate. He testified, "Well, the short answer is appraiser judgment. I know that I have to be above the CAPM of 10.9, but it's substantially riskier than that. And I - - I simply chose %%%% percent as an appraiser judgment." He acknowledged that he did not do a specific weighting of his CAPM and DGM rates.71

51. After concluding a %%%% rate for his cost of equity, NAME-2 explained that this cost of equity comes from securities and he was trying to value property, so he had added a %%%% illiquidity premium to his %%%% cost of equity, for a total of %%%%.

52. NAME-2 testified about why in his opinion the %%%% should be added. He provided the opinion that securities typically have less risk than the underlying property and can be sold quicker than the underlying property.72 He also provided that the costs to sell securities is significantly less than to sell property, giving the example of going on line and selling \$\$\$\$ worth of shares in a single company by clicking a button and being charged for the sale a \$\$\$\$ fee, versus the time and costs of selling a million dollar home. He testified "investors require a higher return to investment in property, and that's called the illiquidity premium."73 He provided a quote he attributed to NAME-3, a Professor who has written extensively on valuation who had stated, "By ignoring illiquidity, we are understating the costs of equity and capital for all firms but more so for smaller firms that face more costs in raising capital and emerging market firms that operate in illiquid markets. . . . Conclusion: Illiquidity matters. Investors are generally willing to pay higher prices for more liquid assets than for otherwise similar illiquid assets."74

69 Transcript pp. 217-218: NAME-2.

70 Exhibit 15, Appendix A, pp. 41 & 42.

71 Transcript p. 219: NAME-2.

72 Transcript pp. 229-230: NAME-2.

73 Transcript p. 232: NAME-2.

74 Exhibit 15, Appendix A, p. 00050.

NAME-2 also testified that there have been several studies that have looked at the illiquidity amounts. He pointed to studies of the difference between selling restricted stock and unrestricted stock and cost differences were around %%% to %%%. He also pointed to studies of private placement of public equities and long term put options. It was his conclusion that this research supported that at %%% to %%% discount would be a reasonable estimate of the liquidity discount necessary for an operating property to similar risky tradable securities.⁷⁵

53. NAME-2 testified that there were different ways to adjust for illiquidity but he had chosen to make the adjustment to his discount rate.⁷⁶ He followed an approach to estimating the additional cost that he attributed to NAME-3, which he calculated from the guideline companies. His conclusion from these calculations was that %%% should be added to his cost of equity as his illiquidity adjustment.⁷⁷

54. For the second component of the WACC, the cost of debt, NAME-2 also looked to the same guideline or benchmark companies. He notes that they generally represented more diversified assets than PETITIONER’s network assets and also that the small size of PETITIONER impacted the debt rate. He also noted that because PETITIONER was less diversified the “debt component based on debt ratios for these companies is likely to overstate the portion of the capital structure that could be supported by debt for a standalone telecommunications property such as [PETITIONER].”⁷⁸ He provided the following capital structure and credit rating information for his guideline companies:⁷⁹

	Percent Debt	Credit Rating
CORPORATION - 1& 2 ⁸⁰		
COMPANY-8	%%%	REMOVED
COMPANY-11	%%%	REMOVED
COMPANY-12	%%%	REMOVED
PARENT COMPANY	%%%	REMOVED
COMPANY-6	%%%	REMOVED
COMPANY-4	%%%	REMOVED
COMPANY-10	%%%	REMOVED
COMPANY-9	%%%	REMOVED

⁷⁵ Exhibit 15, Appendix A, pp. 000051-53.

⁷⁶ Transcript p. 239: NAME-2.

⁷⁷ Exhibit 15, Appendix A, pp. 000056-57. Hearing Transcript pp. 245-248: NAME-2.

⁷⁸ Exhibit 15, Appendix A, p. 43.

⁷⁹ Exhibit 15, Appendix A, p. 43.

⁸⁰ Transcript p. 224: CORPORATION 1&2.

55. NAME-2 concluded that smaller companies like PETITIONER had a harder time obtaining an investment grade rating and concluded that to obtain an investment grade rating of BBB, PETITIONER would likely not be able to obtain more than % debt financing. He opined that this would be what the typical buyer would select. He explained, “it is my belief and opinion that a willing buyer would want an investment grade rating.” “And so I now have to say what amount of debt could PETITIONER take on and still get an investment grade rating.”⁸¹ He noted that PETITIONER was more risky and more volatile than COMPANY-8 and COMPANY-9 which have been profitable for decades while PETITIONER has “just barely been profitable.” COMPANY-9 had % debt and an investment grade rating in the high B range. He testified that it was his opinion PETITIONER would need a lower percent of debt to get an investment grade rating and it was his appraisal judgment that the capital structure would be % debt. With a % debt, he estimated the cost of debt based on a Baa or BBB rating and that was % as reported by COMPANY-13.⁸²

56. (SENTENCE REMOVED).

57. NAME-2 tax adjusted his cost of debt by multiplying the % debt rate by (1-.38). He explained that 38% is the combined marginal federal and state tax rate average that PETITIONER would be paying. He explained because the interest on the debt was tax deductible this adjustment should be made to the cost of debt and, “I am going to be discounting net after tax cash flows. So I want an after tax discount rate.”⁸³ The Division pointed out that although he adjusted the debt using the marginal tax rate of % he had adjusted his cash flows at a rate of %, which the Division argued and NAME-2 agreed was a mismatch. NAME-2 explained that it was “a trivial difference.”⁸⁴

58. As noted above, his final conclusion was a cost of capital or a discount rate of %, which was based on a capital structure of % debt and % equity, with the debt rate tax adjusted and a % illiquidity adjustment added to the cost of equity.⁸⁵ After discounting his net cash flow and terminal value estimates by this % discount rate, his income approach conclusion for the unit value was \$\$.⁸⁶ This includes his value for both

⁸¹ Transcript p. 225: NAME-2.

⁸² Exhibit 15, Appendix A, p. 46; Transcript pp. 225-226: NAME-2.

⁸³ Transcript pp. 249-259: NAME-2.

⁸⁴ Transcript p. 277.

⁸⁵ Exhibit 15, p. 00057.

⁸⁶ Exhibit 15, p. 00025.

the tangible and intangible property. NAME-2 did make an adjustment to get to just the taxable tangible value at a later step in his report.

C. PETITIONER's Reconciliation and Other Adjustments

59. NAME-2's cost approach conclusion was \$\$\$\$\$ and his income approach conclusion was \$\$\$\$\$. However, he placed no weight on his cost approach and his conclusion of the unit value of \$\$\$\$\$ was based on 100% of the weight being placed on his income approach.

60. After NAME-2 concluded the unit value of the operating assets was \$\$\$\$\$, he noted the next step was to remove the value for the intangibles from this unit value. NAME-2 used a similar calculation as had the Division, based on the ratio of the book value of tangible assets to the total book value of the tangible and intangible assets. His numbers, however, had come from a different source than had the Division's, so he had reached a different conclusion. NAME-2's calculation was based on information reported on PETITIONER's books while the Division's had been based on PARENT COMPANY.'s audited financial statements. NAME-2 concludes %%% of the unit value was the value attributed to the tangible property. Multiplying \$\$\$\$\$ by %%% resulted in a unit value for the tangible property of \$\$\$\$\$.⁸⁷ NAME-2 criticized this method for making the adjustment for intangibles, arguing that the method tended to overvalue the tangible assets. However, he did not offer a different method for removing the value for intangibles from his income approach unit value.

61. Another adjustment was made for the Utah allocation factor. NAME-2 used the same Utah allocation factor as the Division had calculated, which was %%%, and when applied to NAME-2's \$\$\$\$\$ unit value minus intangibles results in a Utah value for the tangible assets in the amount of \$\$\$\$\$.⁸⁸

IV. Division's Appraisal

62. The Division submitted an appraisal for the hearing that had been prepared by Division employee APPRAISER, who is a Utah Licensed Appraiser. It was APPRAISERS' appraisal conclusion that as of the DATE, 2016 lien date at issue in this appeal, the tangible taxable system value of the subject property was \$\$\$\$\$. This value was based on %%% weighting being given to an HCLD cost approach and %%% weighting being given to a

⁸⁷ Exhibit 15, pp. 000026-27.

⁸⁸ Exhibit 15, pp. 000027.

yield capitalization income approach. After applying the Utah allocation factor of 0.95% and subtracting an additional \$\$\$\$ for motor vehicles, APPRAISERS’ appraisal conclusion was a Utah assessed value for 2016 of \$\$\$\$.⁸⁹ This was a higher value than the original Utah assessment value, which had been \$\$\$\$.

63. APPRAISER explained that the difference between the original assessment and the appraisal he presented at the hearing was that he applied a higher ratio for tangible property in his appraisal than he had in the original assessment. He explained in the original assessment he had failed to apply the parent subsidiary ratio to the booked intangibles costs, which he had taken from PARENT COMPANY’s 10-K. This resulted in an overstatement of the intangibles that were removed.⁹⁰ He stated, “I failed to make a calculation that I think is appropriate. It did have an effect on the value conclusion.” At the hearing, the Division requested that the value be raised to the appraisal amount and APPRAISER testified in his opinion the best conclusion of value was the one reached in his appraisal. However, APPRAISER provided the opinion, “I also think that the original assessment probably still falls within a reasonable range of fair market value.”⁹¹

64. APPRAISERS’ appraisal conclusions were the following:⁹²

Cost Approach	\$\$\$\$	50%	\$\$\$\$
Income Approach	\$\$\$\$	50%	\$\$\$\$
Reconciled System Value Rounded			\$\$\$\$
Utah Allocation Percentage			X % % % %
Utah Value			\$\$\$\$
Less Adjustment for Motor Vehicles			-\$\$\$\$\$
Utah Assessment for DATE, 2016			\$\$\$\$\$

65. In completing his appraisal, APPRAISER testified that his appraisal was developed in accordance with the Utah Constitution, Utah Code, Title 59, Chapter 2, Property Tax Act, and Utah Administrative Rules R884-24P-62 (“Rule 62”), R884-24P-20 (“Rule 20”) and R884-24P-61 (“Rule 61”).⁹³

⁸⁹ Exhibit 31.
⁹⁰ Transcript p. 343: APPRAISER.
⁹¹ Transcript pp. 343-344: APPRAISER.
⁹² Exhibit 31, p. 000029.
⁹³ Transcript p. 346: APPRAISER.

66. APPRAISER explained he had performed a unitary appraisal, which “means valuing an integrated group of assets as one thing without reference to the independent value of the component parts.” He further explained that, “Informed buyers and sellers will most likely buy or sell a viable operating unit as one thing” and a “going concern is an established and operating business with an indefinite future life.”⁹⁴ It was his opinion that for valuation of a unitary property, “We expect . . . a unitary property valued under a going concern to operate into the foreseeable future.”⁹⁵ In addition, he provided his appraisal opinion that, “Premiums are paid for the immediate availability of established operating units.”⁹⁶ APPRAISER testified that captured in the value of his income approach was “the assemblage value of the assets working together as a functional economic unit.”⁹⁷ When valuing a property as a going concern the Division makes the assumption that replacement capital expenditures will equal depreciation, which APPRAISER felt was a reasonable assumption.⁹⁸ APPRAISER pointed out that because of the advances in technology, the cost to replace the existing equipment was less, and that PETITIONER could replace their existing capacity for a fraction of the price. He stated, “I would say . . . they can replace their existing capacity for a quarter of the price or maybe a fifth or a sixth of the price. If that was the case, then I would have to alter the amount of capital expenditures that - - that I remove, which would result in a higher cash flow.”⁹⁹ APPRAISER testified it was the Division’s broad appraisal assumption that PETITIONER will continue operating into perpetuity at the same capacity it was operating at on the lien date.¹⁰⁰

A. Division’s Appraisal Cost Indicator

67. The Division’s appraisal used the Rule 62 preferred cost indicator which is the historic cost less depreciation (“HCLD”) cost indicator. APPRAISER testified that for this type of cost indicator he used the book cost of the property, plant, and equipment as well as the book depreciation from PETITIONER’s balance sheet.¹⁰¹ In preparing his cost indicator, the costs of

⁹⁴ Transcript p. 354: APPRAISER.

⁹⁵ Transcript pp. 354-355: APPRAISER.

⁹⁶ Transcript p. 355: APPRAISER.

⁹⁷ Transcript p. 351: APPRAISER.

⁹⁸ Transcript p. 476: APPRAISER.

⁹⁹ Transcript p. 477: APPRAISER.

¹⁰⁰ Transcript p. 478: APPRAISER.

¹⁰¹ Transcript p. 359: APPRAISER.

the intangibles were not included. APPRAISERS’ cost indicator, which was similar but marginally lower than NAME-2’s cost indicator, was the following:¹⁰²

Total Plant in Service	\$\$\$\$\$
Property Held for Future Use	
Construction Work in Progress at Present Value	<u>\$\$\$\$\$</u>
Total	\$\$\$\$\$
Less Depreciation	<u>(\$\$\$\$\$)</u>
Total Net Historical Cost	\$\$\$\$\$

68. The difference between APPRAISERS’ and NAME-2’s cost indicator conclusion, with APPRAISER at \$\$\$\$\$ and NAME-2 at \$\$\$\$\$ was the difference in construction work in progress. APPRAISER had calculated the present value for construction work in progress to be \$\$\$\$\$ based on the provisions of Rule 20.¹⁰³ NAME-2 did not discount the CWIP, which resulted in his higher value for the CWIP of \$\$\$\$\$.¹⁰⁴

69. APPRAISER provided the opinion that PETITIONER’s booked costs and booked depreciation were relevant to its value because PETITIONER’s network had been constructed in “large part through acquisition of other telecommunications companies” and when that happens the booked costs of the assets being acquired are adjusted to the “best estimate of the current fair value” of the assets. He pointed out that there had been an asset impairment occurring in 2001, in which “PETITIONER wrote down \$\$\$\$\$ of their property, plant, and equipment.”¹⁰⁵ APPRAISER also noted that PETITIONER did periodically evaluate and adjust its depreciation schedules.¹⁰⁶ He provided that he believed that there was technical or functional obsolescence present in the PETITIONER plant in service, but provided the opinion, “I believe that the book depreciation that I apply in my HCLD sufficiently covers that loss of value. I don’t believe that an additional loss of value is warranted.”¹⁰⁷ APPRAISER also pointed to a 2015 Long-Lived Assets Impairment Analysis prepared by PARENT COMPANY, which had concluded the long-lived assets were not impaired for accounting purposes.¹⁰⁸ He explained that the study “doesn’t

¹⁰² Exhibit 31 p. 000010.

¹⁰³ Exhibit 31; Transcript p. 360: APPRAISER.

¹⁰⁴ Exhibit 15.

¹⁰⁵ Transcript pp. 362-363: APPRAISER.

¹⁰⁶ Transcript p. 366: APPRAISER.

¹⁰⁷ Transcript p. 369: APPRAISER.

¹⁰⁸ Exhibit 37, p 0219.

necessarily mean . . . that the book costs equal market value” but it did tell him that “there’s not a gross difference.”¹⁰⁹

70. APPRAISER opined that obsolescence is a form of depreciation. In order to recover additional obsolescence from the cost approach, he argued one would need to identify the obsolescence, measure the obsolescence, quantify the obsolescence, and prove that it was above and beyond the original book depreciation.¹¹⁰ He opined that “it appears in this case that book depreciation adequately accounts for all these different forms of appraisal depreciation”¹¹¹ and that “the HCLD is a ‘reasonable estimate’ of the market value of this property.”¹¹²

71. It was APPRAISERS’ contention that there was a value in having a unit that was already operating and generating revenue as opposed to spending years building a new unit, even if the new unit costs less. He provided his opinion, “There’s a present value benefit of having those cash flows immediately available.” He also noted that even the best, most technologically advanced communications network would have some individual components that were obsolete but there wouldn’t be obsolescence in the unit as a whole. It was his position that PETITIONER’s unit was not obsolete as a whole.¹¹³

B. Division’s Appraisal Income Approach

72. In his appraisal and for the original assessment, APPRAISER used the preferred income approach under Rule 62, which is the “yield capitalization” method. Under this single stage capitalization method the equation is $PV=CF/(k-g)$. “PV” is the present value in this equation, “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.¹¹⁴

73. To estimate the cash flow, APPRAISER testified that he followed Rule 62, in which cash flow equals net operating income, plus noncash charges, minus replacement capital expenditures, minus increase in working capital necessary to maintain any expected growth. APPRAISER looked at the two years of operating revenues from 2014 and 2015. He explained that there was only the two years of data because PETITIONER acquired COMPANY-3 in 2014. It was a large acquisition that altered PETITIONER’s financial performance. For his estimate of

¹⁰⁹ Transcript p. 566: APPRAISER.

¹¹⁰ Transcript p. 372: APPRAISER.

¹¹¹ Transcript p. 530: APPRAISER.

¹¹² Transcript p. 531: APPRAISER.

¹¹³ Transcript pp. 373-374: APPRAISER.

¹¹⁴ Exhibit 31, p. 000010.

cash flow, he relied on the two years of information, as well as income estimates from various analysts as follows:¹¹⁵

	Operating Revenue	-Operating Expenses	=Operating Income	Tax Adjusted Net Operating Income	Normalized Net Operating Income
2014	\$\$\$\$\$	-\$\$\$\$\$	=\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2015	\$\$\$\$\$	-\$\$\$\$\$	=\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
<u>Other Income Estimates</u>					
	2015 NOI x Inflation (% % % % %)			\$\$\$\$\$	
	COMPANY-13 Analyst Projection:			\$\$\$\$\$	
	COMPANY-14 Analyst Projection:			\$\$\$\$\$	
	COMPANY-15 Analyst Projection:			\$\$\$\$\$	
	COMPANY-13 New Income Analysis:			\$\$\$\$\$	
	Average			\$\$\$\$\$	
	Parent/Subsidiary Ratio % % % % %				
	Estimated North America NOI			\$\$\$\$\$	
	APPRAISER Conclusion of Estimated Normalized Income: \$\$\$\$\$				

74. Although APPRAISER did include the Analyst Projections in his appraisal, he did acknowledge that the analysts would be considering future investments; therefore the Analyst Projections could be considering property that was not in existence on the lien date.¹¹⁶

75. APPRAISER did acknowledge that if he applied his % % % % % growth factor to his tax adjusted net operating income for 2015 of \$\$\$\$\$, that would indicate an estimate of normalized income in the amount of \$\$\$\$\$, and yet he used \$\$\$\$\$ as his estimate, which was about % % % % % higher.¹¹⁷ APPRAISER explained that his conclusion was based primarily on his normalized operating income from 2015, but he “did use the analyst forecasts, the projections to . . . basically” round up, rather than down, to get to his \$\$\$\$\$ conclusion.¹¹⁸

76. One component that APPRAISER incorporated into his \$\$\$\$\$ normalized cash flow estimate was a calculation to adjust for the tax-deductibility of interest. APPRAISER explained that because he is valuing PETITIONER as a going concern, there is the expectation that PETITIONER will pay taxes at the marginal rate, which the Division indicated was 38.5%, at some point in the future. So, like NAME-2, APPRAISER had also made an adjustment for the

¹¹⁵ Exhibit 31, p. 000012.
¹¹⁶ Transcript p. 473: APPRAISER.
¹¹⁷ Transcript p. 539: APPRAISER.
¹¹⁸ Transcript p. 574: APPRAISER.

tax-deductibility of interest in his appraisal, however, he had used a different method for making that adjustment. NAME-2 had tax adjusted his value by using an after-tax debt rate in the weighted average cost of capital, which lowers the debt rate. APPRAISER instead chose to adjust for the tax-deductibility of interest in his normalized net operating income. The effect of this was a smaller subtraction for tax from the operating income and this resulted in a higher normalized cash flow. Either method increases the income conclusion by some amount. APPRAISERS' tax adjustment calculation is the following:¹¹⁹

	Operating Income Plus Amortization	-Interest Expense	=Operating Income Minus Interest Expense	xTax Rate %% % %	=Tax Amount
2014	\$\$\$\$\$	-\$\$\$\$\$	=\$\$\$\$\$	-x % % % %	=\$\$\$\$\$
2015	\$\$\$\$\$	-\$\$\$\$\$	=\$\$\$\$\$	-x % % % %	=\$\$\$\$\$

	Operating Income Plus Amortization	-Tax Amount	=Tax Adjusted Net Operating Income
2014	\$\$\$\$\$	-\$\$\$\$\$	=\$\$\$\$\$
2015	\$\$\$\$\$	-\$\$\$\$\$	=\$\$\$\$\$

77. APPRAISER acknowledged NAME-2's method of adjusting for the tax-deductibility of interest using an after-tax debt rate in the weighted average cost of capital, was a recognized method. APPRAISER stated, however, that the Division has done it by adjusting the normalized operating income as he had done in his appraisal "way before my employment with the Tax Commission."¹²⁰ APPRAISER provided the opinion that, "Both methods are designed to achieve the same goal" and "[b]oth methods are appropriate," so he did not see a reason to change from how the Division had been doing it.¹²¹ APPRAISER pointed out that depending on the method used, an individual company will get a higher or lower value for one year, but it could switch for the next year. He provided the example that for PETITIONER, using the Division's method for the subject tax year resulted in a higher value than using the after-tax debt rate approach NAME-2 had used. However, for PETITIONER and the next tax year, the Division's method resulted in a lower value than resulted from NAME-2's after-tax debt rate

¹¹⁹ Exhibit 31, p. 000012 and Exhibit 18.

¹²⁰ Transcript pp. 379-380: APPRAISER.

¹²¹ Transcript pp. 380-381: APPRAISER.

approach. APPRAISER stated that the method that resulted in the lowest value could change for a single taxpayer year after year and within a single year one method would result in a lower value for some taxpayers and a higher value for other taxpayers. It was the Division’s position that the method for estimating the amount of taxes to remove should be applied consistently to all taxpayers and all tax years.¹²²

78. After concluding that the estimate for normalized income was \$\$\$\$\$, some additional additions and subtractions were made to get normalized cash flow under the Rule 62 yield capitalization model. The Division’s original assessment and APPRAISERS’ appraisal were based on the premise that in valuing the company as a going concern it is assumed that, into perpetuity, replacement capital expenditures will equal depreciation and that PETITIONER’s cash flows will grow at the forecast inflationary rate of %%%%. APPRAISER explained you assume that the equipment that is replaced, will be replaced with whatever the currently available version of that equipment is and that you are not seeking to include adding additional equipment or acquiring new companies.¹²³ APPRAISER also argued that he thought that PETITIONER had the ability to increase its capacity somewhat using the existing assets, for example in some cases they could pull equipment from their warehouse, or make the dark fiber available for customers to use.¹²⁴ APPRAISER anticipated a %%%% increase in working capital to support that growth. This increase in working capital is not available in free cash flow so is subtracted. The additions and subtractions from the normalized income to get to the total normalized cash flow are the following:¹²⁵

Normalized Net Operating Income	\$\$\$\$\$
Add: Depreciation Expenses	+ \$\$\$\$\$
Add: Operating Amortization Expense	+ 0
Add: Deferred Income Taxes	+ 0
Add: Other Non-Cash Expense	+ 0
Less: Replacement Capital Expenditures	- (\$\$\$\$\$)
Less: Increase in Working Capital	- (\$\$\$\$\$)
Total Normalized Cash Flow	\$\$\$\$\$

79. For his income approach, APPRAISER then divided his total normalized cash flow of \$\$\$\$\$ by his “k-g” in the yield capitalization formula. The “k,” or capitalization rate,

¹²² Transcript pp. 381-382: APPRAISER.
¹²³ Transcript p. 567: APPRAISER.
¹²⁴ Transcript p. 568: APPRAISER.
¹²⁵ Exhibit 31 p. 000014; Exhibit 30 p.000367.

APPRAISER used in his appraisal was %%%%. The “g,” or growth rate, was %%%%, which the Division points out was only the forecasted long-term inflationary growth rate. This formula then was $\text{value} = \text{value} / (\text{growth rate})$ which equals \$\$\$\$\$. This was the Division’s and APPRAISERS’ conclusion of the unit value including exempt intangibles.

80. One factor in dispute at the hearing in determining the value from the Rule 62 yield capitalization method is the capitalization rate or cost of capital rate used in the equation. APPRAISERS’ capitalization rate of %%%% was the same rate as had been used in the original assessment. APPRAISER testified that the Division’s capitalization rate complied with Rule 62, noting that Rule 62 says the rate “shall be based upon a weighted average cost of capital considering current market debt rates and equity yields.”¹²⁶ The Division, like NAME-2, used the WACC method to determine the appropriate cost of capital to use for the capitalization rate, developing the three components which are the cost of equity, cost of debt and capital structure.

81. The Division annually prepares and publishes a Capitalization Rate Study for each of the industries that are centrally assessed and as part of the process holds an industry day where the Division invites the industries to discuss the study, to provide input and tell the Division what is going on with the company and industry.¹²⁷ This study sets the rates and capital structure the Division uses in its original assessments for all properties in the industry category.¹²⁸ For PETITIONER, the industry category was the COMPANY-18 Category, which included seven or eight telecommunications companies.¹²⁹ In his appraisal, APPRAISER used the same WACC as set out in the Division’s 2016 Capitalization Rate Study.¹³⁰

82. For the COMPANY-18 Category, the Division used only two guideline companies, those being PARENT COMPANY and COMPANY-16. The Division had used a larger group of guideline companies for its Wireless Telecom and Wireline Telecom categories in the study. APPRAISER pointed out, however, that using the larger group of guideline companies resulted in lower costs of equity and less favorable capital structures than was determined for the COMPANY-18 Category.¹³¹

83. (FACTORS REMOVED).

¹²⁶ Transcript p. 404: APPRAISER.

¹²⁷ Transcript p. 406: APPRAISER.

¹²⁸ Exhibit 2.

¹²⁹ Transcript pp. 408-409: APPRAISER.

¹³⁰ Exhibit 31.

¹³¹ Exhibit 2; Transcript p. 581: APPRAISER.

84. APPRAISER explained the reason the Division had relied on only the two guideline companies was that the other broadband companies are not publicly traded. Both guideline companies' capital structures were around %%% debt and %%% equity and the Division and APPRAISER used a capital structure of %%% debt and %%% equity.¹³² APPRAISER pointed out that Rule 62 states, "The weighted average cost of capital should reflect a typical capital structure for comparable companies within the industry."¹³³ In the original assessment and for his appraisal, APPRAISER followed the Rule 62 requirement that for the cost of equity at least %%% of the weight is placed on a specific preferred CAPM model. The formula for this specific CAPM model is rate = R(f) + (beta x risk premium). In this calculation "R(f)" is the risk free rate, which based on Rule 62 is to be the current market rate for 20-year Treasury Bonds. The current market rate for 20-year Treasury Bonds was %%% is what the Division and APPRAISER had used in the CAPM model. NAME-2 had used the 30-year Treasury Bond rate, which was %%% instead of the 20-year Treasury Bond rate specified in Rule 62 and NAME-2's CAPM conclusion had been slightly higher than the Division's, at %%% as a result.¹³⁴ The Division and NAME-2's other factors were similar. The Division's Rule 62 compliant CAPM, which was %%%, was calculated as follows:¹³⁵

Market Risk Premium	%%%
x Industry Beta	x <u>1.15</u>
Industry Risk Premium	%%%
Add Risk Free Rate	+ %%%
Indicated Rate	%%%

85. In addition to the preferred Rule 62 CAPM, APPRAISER and the Division had looked at other cost of equity models. APPRAISERS' appraisal made it clear that %%% of the weight was placed on the preferred Rule 62 CAPM model and \$\$\$\$ each on two other CAPM models. APPRAISERS' conclusions from the equity models and how he had reconciled those conclusions were stated clearly in his appraisal as follows:¹³⁶

CAPM Rule 62	%%%	%%%
CAPM Supply Side	%%%	%%%
CAPM Implied Equity Risk Premium	%%%	%%%
Division's Risk Premium	%%%	%%%

¹³² Exhibits 30 & 31.

¹³³ Transcript p. 406: APPRAISER; Citing Utah Admin. Rule R884-24P-62.

¹³⁴ Exhibit 15, p. 000038.

¹³⁵ Exhibit 31, p. 000019.

¹³⁶ Exhibit 31, p. 000021.

86. The Division and APPRAISER did not prepare or consider a dividend growth model as part of their determination of the cost of equity. NAME-2 had considered a dividend growth model and had given it significant weight. APPRAISER explained that there had been no dividends issued by the two guideline companies that the Division had used in its capitalization rate study for the broadband industry. APPRAISER testified that if he had expanded his guideline companies to the larger telecom market, only about half of those telecoms had paid a dividend, but a dividend growth model could be developed if he excluded the half of the market that had not issued dividends. APPRAISER also testified that the Division had prepared dividend growth models for other industries assessed by the Utilities Section of the Division, even where some of the guideline companies for those other industries did not pay dividends. APPRAISER testified that for those companies at least one DGM model resulted in the highest cost of equity for that industry.¹³⁷

87. Cost of Debt: For the cost of debt, both APPRAISER and the Division had used a cost of debt rate of %%%%. APPRAISER explained that they had followed Rule 62 which says, “The cost of debt should reflect the current market rate (yield to maturity) of debt with the same credit rating as the subject company.” PETITIONER does not have a debt rate, so the Division looked to PARENT COMPANY, which had a rate as reported by CORPORATION-1 of Ba3. The average yield for a Ba3 rated bond was %%%% and that is what the Division used for the cost of debt.¹³⁸ The Division also applied the capital structure of debt and equity from its two guideline companies, which was %%%% debt and %%%% equity.

88. After reaching the conclusion that the normalized cash flow was \$\$\$\$ and the cost of capital from the WACC method was 9.06%, the final factor in the yield capitalization formula $PV=CF/k-g$ is the “g” or growth factor. APPRAISER subtracted %%%% for growth so his calculation was $$$$$/%% - %%% = $$$$$. APPRAISER pointed out that Rule 62 states, “The growth rate is the expected future growth of the cash flow attributable to assets in place on the lien date and any future replacement assets.” Rule 62 states that if insufficient information is available to determine a growth rate, growth will be

¹³⁷ Transcript pp. 509-511: APPRAISER.

¹³⁸ Exhibits 30, 31; Transcript p. 412: APPRAISER; Citing Utah Admin. Rule R884-24P-62.

the expected inflationary rate in the gross domestic product price deflator obtained from Value Line.¹³⁹ APPRAISER used the Rule 62 COMPANY-13 inflationary rate, which was %%%%. APPRAISER also pointed out in his testimony that although price and volume comprise revenue, there is another factor other than just revenue that makes up cash flow and that is the expenses that are subtracted from revenue. He pointed out that expenses also change over time.¹⁴⁰

89. APPRAISERS' income indicator unit wide conclusion, including intangibles was \$\$\$\$\$. APPRAISER then had to make a further adjustment for exempt intangibles. APPRAISER developed a ratio from the booked values of PETITIONER's tangible property and the booked values of the intangibles from PARENT COMPANY's 10-K. In the original assessment, the Division had developed its ratio using the booked values of the intangibles directly from the PARENT COMPANY's 10-K. In his appraisal, APPRAISER realized he needed to apply the parent/subsidiary ratio of %%%% to adjust the book value of the PARENT COMPANY's intangibles to PETITIONER, the unit that is the subject of this appeal. This is the one difference between the original assessment and APPRAISERS' appraisal. APPRAISER added the net book value of the intangible property as adjusted by the parent/subsidiary ratio to the net book value of PETITIONER's tangible property to arrive at a net book value of total assets. Then he divided the tangible property by the total property to get a ratio of %%%% for the tangible property. His calculation is as follows:¹⁴¹

PARENT COMPANY. Goodwill	\$\$\$\$\$
PARENT COMPANY. Finite-Lived Intangible Assets	<u>\$\$\$\$\$</u>
Total PARENT COMPANY. Intangibles	\$\$\$\$\$
Parent/Subsidiary Ratio	%%%%%
Intangibles for PETITIONER	\$\$\$\$\$

Calculation of the Ratio

Net Book Value of PETITIONER Tangible Property	\$\$\$\$\$
Add: Net Book Value of PETITIONER Intangible Property	<u>\$\$\$\$\$</u>
Net Book Value PETITIONER Including Intangibles	\$\$\$\$\$

¹³⁹ Transcript p. 394: APPRAISER, citing Utah Admin. Rule R884-24P-62.

¹⁴⁰ Transcript p. 567: APPRAISER.

¹⁴¹ Exhibit 31 p. 000016, Transcript p. 397: APPRAISER.

Net Book Value of PETITIONER Tangible Property/Net Book Value of PETITIONER Including Intangibles = %%%%.¹⁴²

90. In the original assessment, the Division had not applied the %%%% parent/subsidiary ratio to the total PARENT COMPANY intangibles, using instead the \$\$\$\$ for the book value of the intangibles. This resulted in a lower ratio for the tangible assets.¹⁴²

91. Applying the %%%% ratio to APPRAISERS' unit income indicator conclusion of \$\$\$\$\$, results in an income indicator of value less the exempt intangibles of \$\$\$\$\$.¹⁴³

C. Reconciliation and Other Adjustments in Division's Appraisal

92. In reconciling his value conclusions, APPRAISER placed equal weight on his HCLD cost indicator and his yield capitalization income indicator. His reconciled system wide value, excluding exempt intangibles, was \$\$\$\$\$.¹⁴⁴

93. APPRAISER explained why he placed %%%% weight on his HCLD indicator. He noted it was a Rule 62 preferred indicator and that the costs are the actual costs PETITIONER had paid or at which it had booked the assets and that no value for intangibles was captured in the indicator. He did note the weakness of the indicator was that it did not capture any assemblage or enhancement value and booked costs may not equal current costs.¹⁴⁵

94. APPRAISER testified that his yield capitalization income indicator was also a Rule 62 preferred indicator and one that is commonly used to value income producing properties. This indicator does include the taxable assemblage or enhancement value. APPRAISER indicated a weakness of this indicator "is that it can be difficult to separate the enhancement value from the intangible value."¹⁴⁶

95. APPRAISER had also prepared in his appraisal two Stock and Debt Indicators of value, but he placed no weight in his reconciliation on either of these indicators. His conclusions from these had been a unit value of the tangible property of \$\$\$\$\$ and \$\$\$\$\$.¹⁴⁷

¹⁴² Transcript pp. 397-399: APPRAISER.

¹⁴³ Exhibit 31, p. 000016.

¹⁴⁴ Exhibit 31, p. 000027.

¹⁴⁵ Transcript p. 437: APPRAISER.

¹⁴⁶ Transcript p. 438: APPRAISER.

¹⁴⁷ Exhibit 31.

96. As his system wide value excluding exempt intangibles of \$\$\$\$\$ was a value of the tangible property of PETITIONER across North America, the Division then had to allocate the Utah portion. The Division had calculated a Utah allocation factor of -% % % % which was not an issue in dispute. Applying the Utah allocation factor of _% % % % to the system wide value, excluding exempt intangibles resulted in a Utah value of \$\$\$\$\$.

97. One final adjustment was made for motor vehicles which are taxed when registered. The Division followed Rule 61 in making this adjustment. Based on Rule 61, licensed vehicles are removed using a market-to-book ratio of the reconciled system value over the net book value of the tangible property. In this case, the market-to-book ratio was 1.05. The net book value of the motor vehicles was \$\$\$\$\$, which is multiplied by 1.05 resulting in the adjustment for the motor vehicles of \$\$\$\$\$.¹⁴⁸ The Division subtracted the \$\$\$\$\$ for motor vehicles, which was not in dispute. The final conclusion was a Utah assessed value as of the lien date DATE, 2016 of \$\$\$\$\$.¹⁴⁹

V. Division's Review Report

98. The Division submitted a Review Report of NAME-2's Valuation Report. The Review Report had been prepared by Property Tax Division, Senior Appraiser, APPRAISER-2, Utah Certified General Appraiser.¹⁵⁰

A. Cost Approach

99. In his Review Report, APPRAISER-2 expressed the opinion that NAME-2's argument that there is functional and economic obsolescence that the cost indicator does not capture is inappropriate. APPRAISER-2 cites to the 2015 Long-Lived Assets Impairment Analysis,¹⁵¹ which stated "[a] similar conduit network would likely be much more costly today than during PETITIONER's construction period and would take at least as long to construct." APPRAISER-2 notes that the conduit is not technological equipment, but it is the "first and essential step in creating a telecommunications network like PETITIONER." APPRAISER-2 points out PETITIONER was spun off from a construction company in 1998, so he concludes from this statement that it would take at least 18 years to duplicate the network. Further, APPRAISER-2 notes that PETITIONER has not shown a profit until

¹⁴⁸ Exhibit 31, 000028-000029.

¹⁴⁹ Exhibit 31, 000029.

¹⁵⁰ Exhibit 34. Certain sections were stricken on three pages of this report, pages 50, 51 and 52. Exhibit 17 shows which portions of these three pages were stricken and which portions were received into the record.

¹⁵¹ Exhibit 37.

2014. APPRAISER-2 states, “That means that in addition to the actual cost to build the property, a prospective builder of an equivalent network would likely be looking at about 16 or 17 years of financial losses before they could begin to enjoy the cash flows that PETITIONER is currently experiencing.”¹⁵² APPRAISER-2 also points out that PETITIONER had over \$\$\$\$\$ in losses during the time it was building its network. He criticized NAME-2’s argument that there was obsolescence in the cost approach because NAME-2 had failed to account for any of the lost income caused by undue delay.¹⁵³

B. Income Approach

100. Most of APPRAISER-2’s criticisms pertained to the income approach and one of those was a point regarding the capital structure. PETITIONER criticized the Division’s WACC because the Division had used only two guideline companies and one of the determinations the Division made from the guideline companies was the capital structure of %%% debt and %%% equity. NAME-2 had used a larger group of guideline, or as he referred to them “benchmark,” companies for his WACC. However, as noted by APPRAISER-2, NAME-2’s guideline companies indicated a capital structure on average around %%% debt and %%% equity. Yet NAME-2’s capital structure was %%% debt and %%% equity.¹⁵⁴ There were no guideline or “benchmark” companies that supported this %%% debt and %%% equity capital structure.

101. APPRAISER-2 also made some points about NAME-2’s cost of capital or discount rate. Both the Division and NAME-2 used the WACC method to calculate their cost of capital. For the cost of equity component of the WACC, NAME-2 had placed some undisclosed percentage of weight on his CAPM indicator and substantial weight on his DGM indicator arguing that the CAPM rate was low due to actions of the Federal Reserve. APPRAISER-2 responded to NAME-2’s argument that the CAPM model was indicating an artificially low rate because of the actions of the Federal Reserve, citing in his report an explanation from NAME-3, former Federal Reserve Chairman. NAME-3 had expressed the opinion “the state of the economy, not the Fed, is the ultimate determinant of the sustainable level of real returns.”¹⁵⁵ However, NAME-2 did argue that many people disagreed with this

¹⁵² Exhibit 34, p. 10.

¹⁵³ Transcript p. 691.

¹⁵⁴ Exhibit 34, p. 15.

¹⁵⁵ Exhibit 34, p. 26; citing NAME-4 Why are interest rates so low?, ORGANIZATION, March 30, 2015.

type of conclusion and it was his position that the Federal Reserve could move interest rates, stating “Just read the morning newspaper” and “It’s just that clear.”¹⁵⁶

102. APPRAISER-2 criticized NAME-2’s DGM model, pointing out that NAME-2 used in his average all the companies that had projections from both COMPANY-13 and COMPANY-17, regardless of whether any dividends were being paid. It was APPRAISER-2’s contention that investment analysts limit DGM calculations to companies that pay dividends. APPRAISER-2 points out that if NAME-2 had eliminated the two companies that were not projected to pay dividends, his average estimated return would decrease from %%%% to %%%%.¹⁵⁷

103. In his report where he presented his cost of equity, NAME-2 was clear that his CAPM conclusion was %%%%. His report was not clear regarding what he had concluded from his DGM indicator. In addition, NAME-2 did not state in his report how he weighted his CAPM and DGM indicators; he just stated his cost of equity conclusion was %%%%.¹⁵⁸ In reviewing NAME-2’s report, APPRAISER-2 pointed out that Rule 62 requires that the CAPM model be given at least %%%% weight and it was not clear in the report how NAME-2 could have given his CAPM model %%%% of the weight and reach the conclusion of %%%% for a cost of equity.¹⁵⁹ Additionally, APPRAISER-2 points out that NAME-2 did not use the 20-year Treasury Bond rate as required by Rule 62. He used instead the 30-year rate.¹⁶⁰

104. To his %%%% cost of equity conclusion, NAME-2 added an additional %%%% as an illiquidity adjustment. It was APPRAISER-2’s position that this was improper. APPRAISER-2 expressed the opinion that NAME-2’s valuation premise was not valuing the subject property as unitary,¹⁶¹ that NAME-2 was instead “valuing individual pieces of property.”¹⁶² APPRAISER-2 argues, since unit valuation involves valuing the entire unit as one thing and “such units as telecommunications companies trade ownership through the financial securities market,” NAME-2’s contention, that an illiquidity adjustment should

¹⁵⁶ Transcript pp. 865-866.

¹⁵⁷ Exhibit 34, p. 32.

¹⁵⁸ Exhibit 15, pp. 38-42.

¹⁵⁹ Exhibit 34, p. 35.

¹⁶⁰ Transcript p. 692: APPRAISER-2.

¹⁶¹ Transcript p. 619: APPRAISER-2.

¹⁶² Transcript p. 620: APPRAISER-2.

be made to the cost of equity because physical equipment is not as liquid as financial securities, is inappropriate.¹⁶³

105. To support this opinion, APPRAISER-2 pointed to the two transactions where PARENT COMPANY acquired two other telecommunications companies. He concluded from the transactions that “an illiquidity discount is not being applied when real transactions involving telecommunications companies are involved.” (SENTENCES REMOVED).¹⁶⁴ It was APPRAISER-2’s conclusion, “The market evidence would suggest that rather than causing a discount, the transactions involving units of telecommunications properties are going to sell at a premium, anywhere from 20 to 50 percent . . .”¹⁶⁵ Therefore, APPRAISER-2’s conclusion was that NAME-2’s illiquidity adjustment increasing his cost of equity from %%% to %%%, significantly undervalued PETITIONER under unitary concepts.¹⁶⁶

106. APPRAISER-2 provided the opinion that NAME-2’s tax adjusted weighted average cost of capital of 12.1% was too high and not appropriate. The Division’s WACC of %%% was not tax adjusted. To compare the two rates and show that there was a significant difference, APPRAISER-2 tax adjusted the Division’s cost of debt rate in the WACC. He points out that the after tax cost of capital using the Division’s other factors would be %%%. APPRAISER-2 also cited as support that NAME-2’s rate was too high, investment bankers’ analysis as reported in the Proxy statements regarding the acquisition of COMPANY-3, that assumed a range for a WACC of %%% to %%%.¹⁶⁷

107. Regarding the adjustment for the tax-deductibility of interest, APPRAISER-2 did not argue NAME-2’s method of tax adjusting the debt rate was inappropriate. APPRAISER-2 stated NAME-2’s method was a “widely recognized model” that was “often discussed in textbooks and classes.” However, APPRAISER-2 cautioned that the key was to make sure you matched that rate with the cash flow.¹⁶⁸

108. In his report, NAME-2 had projected declining cash flows. NAME-2’s projections indicated that cash flows would decline %%% every year for four years.

¹⁶³ Exhibit 34, p. 05863.

¹⁶⁴ Exhibit 34, pp. 05863-05864.

¹⁶⁵ Transcript p. 693: APPRAISER-2.

¹⁶⁶ Exhibit 34, p. 05865.

¹⁶⁷ Exhibit 34, p. 05867.

¹⁶⁸ Transcript p. 791.

APPRAISER-2 argued that this was improper because NAME-2 was restricting his property to the exact same pieces of property that are there on the lien date. APPRAISER-2's criticism was that NAME-2 was saying if you replace anything, it would be a duplicate of the original and not the current, more advanced, version, so the equipment will become older and older, less efficient and revenue will decline. APPRAISER-2 argued that this is an attack on the unit value, because buyers would not view the equipment as something frozen in time and Rule 62 contemplates that there will be capital expenditures that will replace the equipment with the modern equipment.¹⁶⁹ APPRAISER-2 pointed out that although price compression is a problem, increasing demand is also a real and constant factor. It was APPRAISER-2's conclusion that "revenue declines due to price decreases will likely be offset by increased unit sales." He also stated that he had reviewed documents produced by PETITIONER that "clearly show that the company has capacity on its existing network to allow additional traffic. And as more traffic passes over the same level of fixed assets the cost per unit declines." APPRAISER-2 points out that if NAME-2 had made a more realistic projection of cash flow, his income indicator would have more than doubled.¹⁷⁰

109. Regarding the adjustment for intangible property, APPRAISER-2 explained that Rule 62 has "some restrictions in order to inhibit the inclusion of intangible property in our valuation." He pointed out that one of those was limitations on growth. He testified that "all you can have at a maximum is a growth rate of inflation." He stated that you can look at the marketplace and analysts' projections and even if they indicate large growth rates the Division cannot use those because, "we know it includes things that the Commission has told us not to include." "So as a default, we can't look to the market to gather our growth rates. We have to fall back to this inflationary growth so that we can comply with Rule 62." APPRAISER-2 provided the opinion "the goal of Rule 62, at least that portion of it, is to reduce the chance that we have captured intangible property values."¹⁷¹

110. APPRAISER-2 testified that he had reviewed analysts' projections and PETITIONER's internal projections and they all projected the actual growth rate would be higher than inflationary growth, so he opined that the Division's limiting growth to

¹⁶⁹ Transcript pp. 631-632.

¹⁷⁰ Exhibit 34, p. 05873.

¹⁷¹ Transcript p. 817: APPRAISER-2.

inflationary growth was a constraint on the assessed value.¹⁷² NAME-2 pointed out that the analysis projections reviewed by APPRAISER-2 were for PARENT COMPANY., the parent company, and not PETITIONER.¹⁷³

VI. Commission's Value Conclusions

A. Cost Approach

111. Both parties presented an HCLD cost approach, which is a cost method approved by Rule 62 and the parties had reached similar conclusions using that approach. The Division's HCLD cost indicator had been \$\$\$\$ and NAME-2's a little higher, at \$\$\$\$\$. The difference between the two was that the Division discounted the construction work in progress as required by Rule 21, and NAME-2 did not do so. The Commission accepts the Division's HCLD cost indicator of \$\$\$\$ as the appropriate cost indicator in this matter.

112. At issue for the Tax Commission to consider is whether weight should be given to this indicator of value in the final value conclusion. As noted in the findings above, the Division has given this indicator %%% weight, arguing that the booked costs and booked depreciation are relevant to value, that there had been asset impairment by the company when the company deemed it was necessary, and periodic reviews by the company to evaluate for impairment and adjust depreciation schedules when warranted. The Division also provided the opinion that obsolescence is a form of depreciation and PETITIONER has not shown obsolescence above and beyond the original book depreciation. The Division, including APPRAISER-2, also made a point that there was a value to having a unit already operating and generating revenue as opposed to spending years building a new unit, even if that new unit would cost less.¹⁷⁴

113. As noted in the findings above, NAME-2 argued against giving any weight to the HCLD cost indicator on the basis that it did not account for all the functional or economic obsolescence in the property. NAME-2 provided the opinion as noted in the findings that there was obsolescence, but did not calculate an amount or an adjustment to subtract to account for that obsolescence, did not show that the obsolescence would be greater than the book depreciation or provide a basis regarding the lost income due to the

¹⁷² Transcript p. 823: APPRAISER-2.

¹⁷³ Transcript p. 846: NAME-2.

¹⁷⁴ Findings of Fact ##69-71, 100.

delay of constructing a new network.¹⁷⁵ NAME-2 had acknowledged in this matter, that he had testified in other PETITIONER proceedings in other states and no tribunal found PETITIONER to have economic obsolescence.¹⁷⁶ In fact, PARENT COMPANY, has itself described its network as “our advanced INFRASTRUCTURE.”¹⁷⁷ It is clear from the findings presented above that technology is changing rapidly in this industry, but not clear that there is obsolescence in addition to what has been accounted for in the HCLD that is so significant as to render this indicator meaningless.

114. The parties argued for either no weight, or %%% weight to the HCLD cost approach, they did not provide any basis for an amount in between. Rule 62 identifies the preferred valuation methodologies for appraising unitary property and these are a cost approach and the yield capitalization income indicator.¹⁷⁸ These preferred valuation methods are rebuttable presumptions and based on Rule 62, “Any party challenging a preferred valuation method must demonstrate, by a preponderance of evidence that the proposed alternative establishes a more accurate estimate of fair market value.”¹⁷⁹ Rather than try to determine an amount for the obsolescence that PETITIONER argues affects the subject property and provide an appropriate adjustment, PETITIONER argues no weight should be given to the cost indicator. Based on the evidence and findings presented in this matter, PETITIONER has not shown its proposed alternative establishes a more accurate estimate of fair market value. The Commission should, therefore, place %%% weight on the Division’s cost indicator of \$\$\$\$\$.

B. Income Approaches

115. As noted in the findings above, the Division in its original assessment and in its hearing appraisal had prepared a yield capitalization income indicator, which is the preferred income indicator pursuant to Rule 62.¹⁸⁰ The Division’s yield capitalization calculation indicated a unit value including intangibles of \$\$\$\$\$. After removing intangibles, the original assessment indicated a unit value excluding exempt intangibles of \$\$\$\$\$. After correcting the ratio for tangibles, the one change APPRAISER had made from the original

¹⁷⁵ Findings of Fact ## 28-29.

¹⁷⁶ Transcript p. 294: NAME-2.

¹⁷⁷ Exhibit 1, p. 000065.

¹⁷⁸ Utah Admin. Rule R884-24P-62(4)(b).

¹⁷⁹ Utah Admin. Rule R884-24P-62(4)(b)(iii).

¹⁸⁰ Utah Admin. Rule R884-24P-62(4)(b).

assessment, APPRAISERS' appraisal value indicated a unit value excluding exempt intangibles of \$\$\$\$\$. NAME-2 prepared a discounted cash flow indicator in his report and concluded a unit value including intangibles of \$\$\$\$\$ and after removing intangibles, a value of \$\$\$\$\$ for the unit value excluding exempt intangibles. The significant differences between these value conclusions arise primarily from differences in the WACC capitalization or discount rates used by the parties, including the fact that NAME-2 added a %%% illiquidity premium to his WACC and the differences in cash flows and growth factors. The ratio for tangible property was also a factor affecting the value. An additional issue was raised at the hearing regarding the appropriate manner to tax adjust the income approach, whether that should be done in the cash flows, which was how the Division had made the adjustment, or to tax adjust the debt rate, which was how NAME-2 made the adjustment.

1) WACC and Flotation

116. The difference between the Division's WACC, which was %%% or tax adjusted =%%, and NAME-2's, which was 12.1% tax adjusted, is a major cause of the significant value difference between the parties' income approach conclusions.

117. As noted in the findings above, the Division's WACC complied fully with Rule 62, while NAME-2's deviated from the rule. Rule 62 specifically requires that for determining the cost of equity, %%% of the weight be placed on a specific CAPM formula and that CAPM formula specifies that one of the factors, the risk free rate, be based on 20-year Treasury Bonds.¹⁸¹ NAME-2 did not use the 20-year rate, using instead the higher 30-year rate and concluding from his CAPM calculation a cost of equity of 10.9%, compared to the Division's which was 10.61%. In addition, it is not clear from NAME-2's report if %%% weighting was placed on this CAPM formula and even his testimony indicated that his conclusion was based on "appraiser judgment."¹⁸² As previously noted, NAME-2 is not an appraiser.¹⁸³

118. The other components of the weighted average cost of capital are the debt rate and the capital structure. The Division had concluded from its guideline companies a capital structure of %%% debt and %%% equity and a debt rate of %%%.

¹⁸¹ Utah Admin. Rule R884-24P-62(5)(b)(i)(B)(II).

¹⁸² Findings of Fact #50.

¹⁸³ Findings of Fact #24.

NAME-2 did not obtain his capital structure or debt rate from his guideline or benchmark companies, but instead made a judgment that it should be something different.¹⁸⁴ His conclusion was a capital structure of %%% debt and %%% equity, but a lower debt rate of %%%. The lower debt rate on its own would actually result in a higher value, but reducing the percentage of debt in the WACC would increase the cost of capital and lower the value, so the effect on value may be generally offset. Regardless, Rule 62, provides that the WACC “should reflect a typical capital structure for comparable companies within the industry.” Further, regarding the cost of debt the rule requires that it “should reflect the current market rate of debt with the same credit rating as the subject company.”¹⁸⁵ The Division has complied with these requirements of the rule and NAME-2 has not.

119. As noted previously, each tax year the Division prepares and publishes a Capitalization Rate Study for each industry that is centrally assessed. In the process of preparing that study, the Division holds an industry day to invite input from the industries. The concluded capitalization rate is then applied to all members of the industry. In this case, PETITIONER was considered to be in the COMPANY-18 category. There were seven or eight other properties in this category and the Division used the same WACC for all.¹⁸⁶ In calculating the cost of capital used in this matter, the Division has complied with Rule 62, which has some specific requirements regarding the WACC and NAME-2 has not. Considering all of the evidence presented by the parties, NAME-2 has not shown that his WACC conclusion establishes a more accurate estimate of value than the Division’s Rule 62 compliant and uniformly applied WACC. The Commission should accept the Division’s WACC of %%% subject to further adjustment as noted below.

120. An additional issue raised by NAME-2 was the argument that a %%% illiquidity premium should be added to the cost of equity which added to NAME-2’s much higher WACC. This raised NAME-2’s cost of equity from %%% to %%% and was a substantial contributor to his much higher WACC. These findings discuss NAME-2’s expert opinions for adding this illiquidity premium.¹⁸⁷ APPRAISER provided the opinion for the Division that as an appraiser he felt an illiquidity adjustment was not appropriate. He

¹⁸⁴ Findings of Fact ##54-56, 101-104.

¹⁸⁵ Utah Admin. Rule R884-24P-62(5)(b)(i)(B).

¹⁸⁶ See Findings of Fact #81.

¹⁸⁷ Findings of Fact ##51-53.

explained when these “companies are acquired by other entities, it’s through a stock purchase type transaction. Then they assume the debt.” He states, “In reality, that is how the property is owned, how the property is transacted.”¹⁸⁸ APPRAISER-2 states, “The telecommunications companies transact in the securities market. They don’t sell in a used equipment market.”¹⁸⁹ The Division’s opinions for why this adjustment is not appropriate are noted in the Findings above.¹⁹⁰ The Tax Commission has previously considered this issue in a prior telecommunication decision and previously declined to make this adjustment, noting that this adjustment would apply equally to many categories of centrally assessed properties and shift tax burdens. PETITIONER has not provided information at this hearing that would cause the Commission to overturn its previous conclusion.¹⁹¹

2) Cash Flow and Growth

121. The Division had used the Rule 62 preferred income indicator, which is the yield capitalization indicator. For this indicator a single year’s normalized cash flow is capitalized to obtain the present value. Expected growth rate of the cash flow is taken into account in the value as it is subtracted from the capitalization rate. The Division’s normalized cash flow of \$\$\$\$\$, was based in significant part on PETITIONER’s 2015 operating income with some adjustments, plus %%% for inflation and other estimates. The Division then subtracted %%% for growth, or the “g” in the $v=CF/(k-g)$ yield capitalization formula, which the Division points out is only the expected inflationary rate.¹⁹² The underlying premise of this approach is that the cash flow is expected to increase to the extent of inflation. NAME-2’s income approach was based on the opposing premise that cash flows would decline. NAME-2 prepared a discounted cash flow income approach, in which he forecasted four years of cash flows as well as estimated the normalized cash flow for the terminal value. In his approach, his cash flow forecast declined each year.¹⁹³

122. NAME-2 pointed out that Rule 62 states, “Cash flow is restricted to the operating property in existence on the lien date, together with any replacements intended to

¹⁸⁸ Transcript p. 550: APPRAISER.

¹⁸⁹ Transcript p. 613: APPRAISER-21.

¹⁹⁰ Findings of Fact ##105-106.

¹⁹¹ See *Utah State Tax Commission, Findings of Fact, Conclusions of Law and Final Decision, Appeal Nos. 13-1343, 14-1241, 13-1407 & 14-1243*, p. 54 (2016). This and other Tax Commission Decisions are available for review in a redacted format at tax.utah.gov/commission-office/decisions.

¹⁹² Findings of Fact ##72-79.

¹⁹³ Findings of Fact #30-34.

maintain, but not expand or modify existing capacity or function.”¹⁹⁴ It was his opinion that prices in the industry are falling and the only way there could be growth in revenue was if quantity was growing faster than prices were falling. It was NAME-2’s contention that he did not see any way that PETITIONER could increase revenue without adding new equipment. To determine his cash flow estimates he declined his forecasted revenue by %%% each year.¹⁹⁵

123. The Division’s witness, APPRAISER-2 provides the opinion that the declining cash flow premise is improper because NAME-2 was restricting his property to the exact same pieces of property that are there on the lien date and if the equipment was replaced it would be replaced with a duplicate of the original equipment and not the current, advanced version. The Division argues that for purposes of a unitary appraisal, buyers would not view the equipment as something frozen in time and Rule 62 contemplates that there will be capital expenditures that will replace the equipment with modern equipment.¹⁹⁶ In his appraisal, APPRAISER assumes replacement capital expenditure will need to equal depreciation to maintain existing capacity.¹⁹⁷

124. It is clear that although there has been price compression, there has also been increased demand and cost compression so the cost per unit is declining. The technology is rapidly changing in this industry so that capacity has been increasing and cost per unit has gone down.¹⁹⁸ Revenue is not the only component of cash flow; cash flow is based on net operating income in the yield capitalization approach. From the evidence presented, PETITIONER’s operating expenses are also going down and PETITIONER assumes in the long run that price compression and cost compression are equal.¹⁹⁹ Even NAME-2 recognized in his report that NOI is increasing due to the margins between price and cost widening, indicating increasing NOI for the four year period in his Discounted Cash Flow. Even considering the limitation that the cash flow is restricted to the operating property in existence on the lien date and any replacements intended to maintain the

¹⁹⁴ Utah Admin. Rule R884-24P-62(5)(b)(i)(A).

¹⁹⁵ Transcript pp. 837-838: NAME-2.

¹⁹⁶ Findings of Fact #109.

¹⁹⁷ Transcript p. 392: APPRAISER.

¹⁹⁸ Findings of Fact ##14-18.

¹⁹⁹ Findings of Fact #17.

property, the evidence presented at this hearing does not support the declining cash flows argued by NAME-2 in this matter.

125. For the yield capitalization income indicator, as noted in Rule 62, “Cash flow is to be projected for the year immediately following the lien date, and may be estimated by reviewing historic cash flows, forecasting future cash flows, or a combination of both.”²⁰⁰ The Division has followed this in its assessment and projected a cash flow for 2016 based primarily on PETITIONER’s 2014 and 2015 cash flows adjusted for inflation, but also looked at other projected cash flows. Being based in large part on the historic cash flows, the forecast is based on the operating property in existence on the lien date. The Division has forecasted an appropriate normalized cash flow of \$\$\$\$\$ to use in its yield capitalization income approach.

126. The yield capitalization income indicator is a single stage model. Cash flow is to be projected for only the one year and that is the year immediately following the lien date. Rule 62 prescribes that future growth is to be taken into account by subtracting the “g” from the cost of capital. Rule 62 provides that the “g” “is the expected future growth of the cash flow attributable to the assets in place on the lien date, and any future replacement assets.”²⁰¹ The Division is not in this matter subtracting an amount indicating there would be real growth above inflation and is instead subtracting %%% which is the expected inflationary rate in the Gross Domestic Product Price Deflator as reported in Value Line. As noted by the Division, this limitation on growth to only the rate of inflation is a constraint on the value.²⁰² The Division has followed the requirements of Rule 62 in developing its yield capitalization indicator in regards to normalized cash flow and growth.

3. Ratio of Tangible Property & Amortization

127. As the value resulting from the Division’s yield capitalization income indicator included a value for exempt intangibles, a reduction needs to be made for intangibles. The ratio of tangible property to all property in the original assessment had been %%%. In his appraisal, APPRAISER corrected what was basically a mathematical error made in the original assessment and the ratio of tangible property to all property increased to

²⁰⁰ Utah Admin. Rule R884-24P-62(5)(b)(i)(A).

²⁰¹ Utah Admin. Rule R884-24P-62(5)(b)(i)(C).

²⁰² Findings of Fact ##110-111.

%% %% %²⁰³ NAME-2 argued that the Division's ratio to remove intangibles was calculated improperly based not on the formula itself but instead on the numbers inputted. NAME-2 had used a similar formula as the Division to calculate his ratio, but his conclusion was %. The difference was that NAME-2 had used the data reported by PETITIONER. The Division had used data from PARENT COMPANY, the parent company, on its publicly reported financial statements and for the appraisal then applied a parent subsidiary ratio. NAME-2 argued his information was better "because the accountants had to go through some type of analysis to put that number on this page . . . probably using data that's not available to the rest of us."²⁰⁴ Regardless, it is not inappropriate for the Division to rely on the information from publicly reported sources and it is clear there had been an error in the original assessment which understated this ratio and incorrectly understated the value of the tangible property.

128. NAME-2's ratio for tangible property was based on the same formula as the Division. NAME-2 stated, "I removed intangibles the same way the Property Tax Division did by assuming that the intangibles captured in my income approach were proportional to the booked value of intangibles relative to total value."²⁰⁵ However, he acknowledged that his assumptions in his income approach were fundamentally different from the Division's. The Petitioning Counties argued in this matter that no deduction for intangibles was needed to be made to NAME-2's discounted cash flow, because it was not capturing a value for intangibles in the first place. However, this need not be addressed further as the Commission should find NAME-2's premise of declining cash flow not supported by the evidence submitted in this matter.

129. As noted previously, the Division had added amortization of exempt intangibles to operating income while determining the normalized cash flow. NAME-2 argued in his rebuttal report that the Division should not have added amortization of exempt intangibles to its NOI before making the tax calculation.²⁰⁶ However, PETITIONER later conceded the Division's treatment of amortization after reviewing prior Tax Commission decisions.

²⁰³ Findings of Fact ##90-91.

²⁰⁴ Transcript pp. 878-879.

²⁰⁵ Transcript p. 311: NAME-2.

²⁰⁶ Exhibit 16, p. 0990.

4) Proper Method to Tax Adjust Income Approach

131. At the hearing, PETITIONER raised the issue that the Division should not have adjusted for the tax-deductibility of interest in the cash flows, but should have instead tax adjusted the debt rate, which was how NAME-2 made the adjustment. For the subject tax year, 2016, doing the calculation in the manner argued by NAME-2 would lower the value. However, the Division pointed out that for PETITIONER and the following tax year that would switch and the method proposed by NAME-2 would result in a higher value than the method proposed by the Division. APPRAISER testified that depending on the method used, a taxpayer could get a higher value one year and it could switch for the next year and within a single year one method would result in a lower value for some taxpayers and a higher value for other taxpayers. APPRAISER testified that the Division had been making the tax adjustment in the cash flows in the same manner for many years. He provided the opinion that either method would be appropriate but saw no reason to change from how the Division had been doing it for years.²⁰⁷ APPRAISER-2 testified that NAME-2's method of adjusting the debt rate was a "widely recognized model."²⁰⁸ Tax adjusting cash flows for the interest expense, as the Division has done in this matter reduces the amount of the tax subtracted from the operating income to get the NOI, therefore resulting in a higher NOI, which all other facts staying the same would result in a higher value. Tax adjusting the debt rate instead, as NAME-2 proposes, lowers the debt rate, thereby lowering the WACC overall and all other factors being equal, also increasing the value.

132. If the tax adjustment were to be made to the debt rate, as argued by NAME-2, it is not merely a matter of applying the lower capitalization rate to the Division's normalized cash flow, it also requires taking the Division's adjustment back out of the cash flows. Although both APPRAISER-2 and NAME-2 provided how tax adjusting the cost of debt would affect the Division's WACC, which would be a reduction from %%% to %%%,²⁰⁹ neither party calculated out how this would affect the Division's normalized cash flow and change the Division's value.

133. NAME-2 testified that he has never seen any text that said to adjust for the tax deductibility of interest in the cash flow as is the Division's method, but he noted, "So as long as you match, you can conceptually do it. It's just almost impossible to get it to match"

²⁰⁷ Findings of Fact ##76-77.

²⁰⁸ Findings of Fact #108.

²⁰⁹ Exhibit 18, Findings of Fact #107.

However, NAME-2 provided the opinion that what APPRAISER had done was not the correct calculation. It was NAME-2's opinion that instead of using PETITIONER's actual 2015 interest expense, which was what APPRAISER had used in his calculation, the interest expense should be based on how a willing buyer would finance the purchase as the willing buyer would have to get their own debt and equity.²¹⁰ In his appraisal, APPRAISER had subtracted from his actual 2015 operating income plus amortization an amount of \$\$\$\$\$ for the actual interest expense in order to tax-adjust his net operating income. PETITIONER argued that APPRAISER's interest expense was inconsistent with his capital structure and his interest rate for PETITIONER, which using a %%% cost of debt and %%% debt in the capital structure, would indicate interest expense in the amount of \$\$\$\$\$ and not the \$\$\$\$\$ that APPRAISER had subtracted.²¹¹

134. However, APPRAISER explained the reason for this difference was that PETITIONER's embedded debt rate is higher than PETITIONER's current debt rate. APPRAISER explained in years past, PETITIONER had a lower credit rating which resulted in higher interest rates for bonds issued in those past years and PETITIONER is required to pay interest on the bonds according to the terms of when the bonds were issued.²¹² Therefore, the current actual interest expense paid by PETITIONER and used by APPRAISER in his appraisal to calculate his tax-adjusted net operating income²¹³ is an overall aggregate of all the bonds that have been issued, it is not based on his current debt rate.

135. In his Review Report, NAME-2 argued the tax amount should be based on what he concluded would be the corrected interest expense using the Division's debt rate and capital structure. NAME-2 notes in his report, "This error is the reason that finance texts recommend using the after-tax WACC calculation to adjust for the tax-deductibility of interest rather than trying to adjust the cash flows" NAME-2's conclusion was that the tax adjustment for 2015, which is subtracted from the 2015 operating income, was \$\$\$\$\$ as compared to the Division's conclusion for 2015 of \$\$\$\$\$.²¹⁴ This would reduce the Division's 2015 tax adjusted operating income by \$\$\$\$\$ and, in turn, lower the value. NAME-2 did not provide the calculation for how this would impact the value, but testified it would reduce the unit value by

²¹⁰ Transcript pp. 850-851: NAME-2.

²¹¹ Transcript pp. 484-489.

²¹² Transcript p. 560: APPRAISER.

²¹³ Exhibit 31, p. 000012.

²¹⁴ Exhibit 16, pp. 9-10.

about \$\$\$\$\$. ²¹⁵ Ultimately NAME-2 is not persuasive on this point because using the actual 2015 interest expense as well as the actual 2015 net operating income is consistent with trying to achieve a normalized cash flow based in large part on historical numbers.

136. Ultimately, the testimony in this matter was that APPRAISERS' calculation to adjust for the tax-deductibility of interest was the same calculation that the Division had been using for years for all taxpayers and also that there would be winners and losers depending on the method and that could change from one year to the next for the same taxpayer. The evidence indicates that a more precise way to make this adjustment, and the way proposed by experts and text books is the way NAME-2 has proposed by tax adjusting the WACC. However, this appears to be a change that needs to be applied uniformly and to all similarly situated centrally assessed taxpayers year after year. For this reason, it would be appropriate for the Tax Commission to consider making this change by administrative rule, rather than by appeal for individual taxpayers on the year when it benefited the taxpayer, but not on those years and for those taxpayers that did not contest the calculation to adjust for the tax-deduction of interest because the Division's method resulted in a lower value for that taxpayer for that year.

137. After reviewing the evidence submitted by the parties and the testimony of the experts in this matter, the Utah assessed value as of the lien date DATE, 2016, should be raised to the \$\$\$\$\$, which is the conclusion reached in APPRAISERS' hearing appraisal.

APPLICABLE LAW

Article XIII, Section 2(1) of the Utah Constitution provides as follows:

- (1) 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.

Utah Code §59-2-1101(3)(a) ²¹⁶ provides that certain property is exempt from property tax as follows:

²¹⁵ Exhibit 31, p. 000012; Transcript pp. 850-852: NAME-2.

²¹⁶ All citations to the Utah Code and the Utah Administrative Code are to the versions in effect in 2016.

The following property is exempt from taxation: . . . (viii) intangible property;

Statutory definitions regarding property tax assessment and exemptions are set out at Utah Code § 59-2-102(13) which provides as follows:

As used in this chapter and title:

* * *

(13) “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

* * *

(17)(a) “Goodwill” means:

(i) acquired goodwill that is reported as goodwill on the books and records that a taxpayer maintains for financial reporting purposes; or

(ii) the ability of a business to:

(A) generate income that exceeds a normal rate of return on assets and that results from a factor described in Subsection (17)(b); or

(B) obtain an economic or competitive advantage resulting from a factor described in Subsection (17)(b).

* * *

(21) “Intangible property” means:

(a) property that is capable of private ownership separate from tangible property, including:

(i) money;

(ii) credits;

(iii) bonds;

(iv) stocks;

(v) representative property;

(vi) franchises;

(vii) licenses;

(viii) trade names;

(ix) copyrights; and

(x) patents;

(b) a low-income housing tax credit;

(c) goodwill;

(d) a renewable energy tax credit or incentive. . .

* * *

(34) “Real estate” or “real property” includes:

(a) the possession of, claim to, ownership of, or right to the possession of land;

- (b) all mines, minerals, and quarries in and under the land, all timber belonging to individuals or corporations growing or being on the lands of this state or the United States, and all rights and privileges appertaining to these; and
- (c) improvements.

Utah Code §59-2-201 (2016) provided that the Tax Commission assess certain property as follows:

- (1)(a) By May 1 of each year the following property, unless otherwise exempt under the Utah Constitution or under Part 11, Exemptions, Deferrals, and Abatements, shall be assessed by the commission at 100% of fair market value, as valued on DATE, in accordance with this chapter:
 - (i) . . . all property which operates as a unit across county lines, if the values must be apportioned among more than one county or state;

Utah Code §59-2-1007 as in effect for tax year 2016, provided that a property owner or county may appeal a property assessment as follows:

- (1)(a) Subject to the other provisions of this section, if the owner of property assessed by the commission objects to the assessment, the owner may apply to the Commission for a hearing on the objection on or before the later of: (i) June 1; or (ii) 30 days after the date the commission mails the notice of assessment in accordance with Section 59-2-201.

* * *

- (2) Subject to the other provisions of this section, a county that objects to the assessment of property assessed by the commission may apply to the commission for a hearing on the objection:
 - (a) for an assessment with respect to which the owner has applied to the commission for a hearing on the objection under Subsection (1), if the county applies to the commission to become a party to the hearing on the objection no later than 30 days after the date the owner applied to the commission for the hearing on the objection; or
 - (b) for an assessment with respect to which the owner has not applied to the commission for a hearing on the objection under Subsection (1), if the county:
 - (i) reasonably believes that the commission should have assessed the property for the current calendar year at a fair market value that is at least the lesser of an amount that is:
 - (A) %%% greater than the value at which the commission is assessing the property for the current calendar year; or
 - (B) %%% greater than the value at which the commission assessed the property for the prior calendar year; and
 - (ii) applied to the commission for a hearing on the objection no later than 30 days after the last day on which the owner could have applied to the commission for a hearing on the objection under Subsection (1).

...

(11) At the hearing on an objection under this section, the commission may increase, lower or sustain the assessment if: (a) the commission finds an error in the assessment; or (b) the commission determines that increasing, lowering, or sustaining the assessment is necessary to equalize the assessment with other similarly assessed property.

Utah Code §59-2-1017 addresses the presentation of evidence in property tax appeals as follows:

...

(2) Subject to the other provisions of this section, a person may:

(a) present evidence in a property tax appeal on behalf of another person after obtaining permission from that other person; or

(b) provide property tax information to another person.

(3) For purposes of Subsection (2):

(a) only a licensed appraiser or a certified appraiser may present or provide an opinion of value; and

(b) a licensed appraiser or a certified appraiser may not present or provide a price estimate.

(4) A licensed appraiser or certified appraiser may, in accordance with Subsection (2), provide services regarding a property tax appeal as follows:

(a) present or provide an opinion of value; or

(b) provide consultation services, including presenting evidence or providing tax information.

(5)(a) A licensed appraiser or a certified appraiser who presents or provides an opinion of value in accordance with Subsection (2) shall comply with all applicable laws and regulations, including Sections 61-2g-304, 61-2g-403, 61-2g-406, and 61-2g-407.

...

(c) A person who is not a licensed appraiser and not a certified appraiser who presents evidence or provides property tax information in accordance with Subsection (2): (i) is subject to Section 61-2g-407; and (ii) if the person charges a contingent fee, is subject to Section 61-2g-406.

...

(7) A county board of equalization or the commission may evaluate the reliability or accuracy of evidence presented or property tax information provided in accordance with this section.

In a proceeding before the Tax Commission, the burden of proof is generally only on the petitioner to support its position. However, where the respondent is requesting a value higher than the value originally assessed, Utah Code §59-2-109(2) places the burden of proof on the respondent to support its position, as follows:

(2) Notwithstanding Section 59-1-604, in an action appealing the value of property assessed by an assessing authority, the assessing authority has the burden of proof before a board of equalization, the commission, or a court of competent jurisdiction, if the assessing authority presents evidence or otherwise asserts that the fair market value of the assessed property is greater than the value originally assessed by the assessing authority for that calendar year.

To prevail in the instant case: 1) the Petitioner must show error in the subject property's current value, while the Respondent must show error in the property's originally assessed value; and 2) either party must provide the Commission with a sound evidentiary basis for changing the value to the amount proposed by the party. The Commission relies in part on *Nelson v. Bd. Of Equalization of Salt Lake County*, 943 P.2d 1354 (Utah 1997); *Utah Power & Light Co. v. Utah State Tax Comm'n*, 590 P.2d 332 (Utah 1979); *Beaver County v. Utah State Tax Comm'n*, 916 P.2d 344 (Utah 1996); and *Utah Railway Co. v. Utah State Tax Comm'n*, 5 P.3d 652 (Utah 2000).

Utah Admin. Rule R884-24P-62 provides guidance and identifies preferred valuation methodologies to be considered in the assessment and appraisal of unitary property as follows:

- (1) Purpose. The purpose of this rule is to:
 - (a) specify consistent mass appraisal methodologies to be used by the Property Tax Division (Division) in the valuation of tangible property assessable by the Commission; and
 - (b) identify preferred valuation methodologies to be considered by any party making an appraisal of an individual unitary property.
- (2) Definitions:
 - (a) "Cost regulated utility" means any public utility assessable by the Commission whose allowed revenues are determined by a rate of return applied to a rate base set by a state or federal regulatory commission.
 - (b) "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. Fair market value reflects the value of property at its highest and best use, subject to regulatory constraints.
 - (c) "Rate base" means the aggregate account balances reported as such by the cost regulated utility to the applicable state or federal regulatory commission.
 - (d) "Unitary property" means operating property that is assessed by the Commission pursuant to Subsections 59-2-201(1)(a) through (c).
 - (i) Unitary properties include:
 - (A) all property that operates as a unit across county lines, if the values must be apportioned among more than one county or state; and
 - (B) all property of public utilities as defined in Section 59-2-102.

(ii) These properties, some of which may be cost regulated utilities, are defined under one of the following categories.

(A) "Telecommunication properties" include the operating property of local exchange carriers, local access providers, long distance carriers, cellular telephone or personal communication service (PCS) providers and pagers, and other similar properties.

* * *

(3) All tangible operating property owned, leased, or used by unitary companies is subject to assessment and taxation according to its fair market value as of DATE, , and as provided in Utah Constitution Article XIII, Section 2. Intangible property as defined under Section 59-2-102 is not subject to assessment and taxation.

* * *

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

(a) The assemblage or enhanced value attributable to the tangible property should be included in the assessed value. See *Beaver County v. COMPANY-2, Inc.*, 995 P.2d 602 (Utah 2000). The value attributable to intangible property must, when possible, be identified and removed from value when using any valuation method and before that value is used in the reconciliation process.

(b) The preferred methods to determine fair market value are the cost approach and a yield capitalization income indicator as set forth in Subsection (5).

(i) 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.

(ii) 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 given to such methods in the reconciliation process, as set forth in Subsection (5)(d).

(iii) Preferred valuation methods as set forth in this rule are, unless otherwise stated, rebuttable presumptions, established for purposes of consistency in mass appraisal. Any party challenging a preferred valuation method must demonstrate, by a preponderance of evidence, that the proposed alternative establishes a more accurate estimate of fair market value.

(c) Non-operating Property. Property that is not necessary to the operation of unitary properties and is assessed by a local county assessor, and property separately assessed by the Division, such as registered motor vehicles, shall be removed from the correlated unit value or from the state allocated value.

(5) Appraisal Methodologies.

(a) 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).

(i) "Depreciation" is the loss in value from any cause. Different professions recognize two distinct definitions or types of depreciation.

(A) 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.

(B) 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:

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

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

(III) 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.

(ii) Replacement cost is the estimated cost to construct, at current prices, a property with utility equivalent to that being appraised, using modern materials, current technology and current standards, design, and layout. The use of replacement cost instead of reproduction cost eliminates the need to estimate some forms of functional obsolescence.

(iii) Reproduction cost is the estimated cost to construct, at current prices, an exact duplicate or replica of the property being assessed, using the same materials, construction standards, design, layout and quality of workmanship, and embodying any functional obsolescence.

(iv) Historic cost is the original construction or acquisition cost as recorded on a firm's accounting records. Depending upon the industry, it may be appropriate to trend HCLD to current costs. Only trending indexes commonly recognized by the specific industry may be used to adjust HCLD.

(v) RCNLD may be impractical to implement; therefore the preferred cost indicator of value in a mass appraisal environment for unitary property is HCLD. A party may challenge the use of HCLD by proposing a different cost indicator that establishes a more accurate cost estimate of value.

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

(i) 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.

(A) 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.

(I) NOI is defined as net income plus interest.

(II) 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.

(III) Cash flow is to be projected for the year immediately following the lien date, and may be estimated by reviewing historic cash flows, forecasting future cash flows, or a combination of both.

(Aa) If cash flows for a subsidiary company are not available or are not allocated on the parent company's cash flow statements, a method of allocating total cash flows must be developed based on sales, fixed assets, or other reasonable criteria. The subsidiary's total is divided by the parent's total to derive the allocation percentage to estimate the subsidiary's cash flow.

(Bb) If the subject company does not provide the Commission with its most recent cash flow statements by March 1 of the assessment year, the Division may estimate cash flow using the best information available.

(B) The discount rate (k) shall be based upon a weighted average cost of capital (WACC) considering current market debt rates and equity yields. WACC should reflect a typical capital structure for comparable companies within the industry.

(I) The cost of debt should reflect the current market rate (yield to maturity) of debt with the same credit rating as the subject company.

(II) The cost of equity is estimated using standard methods such as the capital asset pricing model (CAPM), the Risk Premium and Dividend Growth models, or other recognized models.

(Aa) 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 %%% in the correlation.

(Bb) The CAPM formula is $k(e) = R(f) + (\text{Beta} \times \text{Risk Premium})$, where $k(e)$ is the cost of equity and $R(f)$ is the risk free rate.

(Cc) The risk free rate shall be the current market rate on 20-year Treasury bonds.

(Dd) The beta should reflect an average or value-weighted average of comparable companies and should be drawn consistently from COMPANY-13 or an equivalent source. The beta of the specific assessed property should also be considered.

(Ee) The risk premium shall be the arithmetic average of the spread between the return on stocks and the income return on long term bonds for the entire historical period contained in the Ibbotson Yearbook published immediately following the lien date.

(C) 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.

(I) If insufficient information is available to the Division, either from public sources or from the taxpayer, to determine a rate, "g" will be the expected inflationary rate in the Gross Domestic Product Price Deflator obtained in Value Line. The growth rate and the methodology used to produce it shall be disclosed in a capitalization rate study published by the Commission by February 15 of the assessment year.

(ii) A discounted cash flow (DCF) method may be impractical to implement in a mass appraisal environment, but may be used when reliable cash flow estimates can be established.

(A) A DCF model should incorporate for the terminal year, and to the extent possible for the holding period, growth and discount rate assumptions that would be used in the yield capitalization method defined under Subsection (5)(b)(i).

(B) Forecasted growth may be used where unusual income patterns are attributed to:

- (I) unused capacity;
- (II) economic conditions; or
- (III) similar circumstances.

(C) Growth may not be attributed to assets not in place as of the lien date.

(iii) Direct Capitalization is an income technique that converts an estimate of a single year's income expectancy into an indication of value in one direct step, either by dividing the normalized income estimate by a capitalization rate or by multiplying the normalized income estimate by an income factor.

(c) Market or Sales Comparison Approach. The market value of property is directly related to the prices of comparable, competitive properties. The market approach is estimated by comparing the subject property to similar properties that have recently sold.

(I) Sales of comparable property must, to the extent possible, be adjusted for elements of comparison, including market conditions, financing, location, physical characteristics, and economic characteristics. When considering the sales of stock, business enterprises, or other properties that include intangible assets, adjustments must be made for those intangibles.

(II) Because sales of unitary properties are infrequent, a stock and debt indicator may be viewed as a surrogate for the market approach. The stock and debt method

is based on the accounting principle which holds that the market value of assets equal the market value of liabilities plus shareholder's equity.

(d) Reconciliation. When reconciling value indicators into a final estimate of value, the appraiser shall take into consideration the availability, quantity, and quality of data, as well as the strength and weaknesses of each value indicator. Weighting percentages used to correlate the value approaches will generally vary by industry, and may vary by company if evidence exists to support a different weighting. The Division must disclose in writing the weighting percentages used in the reconciliation for the final assessment. Any departure from the prior year's weighting must be explained in writing.

* * *

CONCLUSIONS OF LAW

1. Utah Const. art. XIII, §2(1) provides that, “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.” In addition, Utah Code §59-2-103(1) provides, “All tangible taxable property located within the state shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on DATE, unless otherwise provided by law.” It is the Property Tax Division’s responsibility to assess at 100% of fair market value “all property which operates as a unit across county lines, if the values must be apportioned among more than one county or state.” Utah Code §59-2-201(1)(a)(i). Under Utah Code §59-2-1101(2016) intangible property is not assessed. The Division has issued its assessment of the subject property pursuant to these provisions.

2. In this appeal, all parties conceded error in the original assessment. PETITIONER argues a number of errors and asserts a value much lower than the original assessment. The Division and Counties acknowledge an error in the original tangible property ratio and request a value about %%%% higher than the original assessment. Pursuant to Utah Code Subsection 59-2-109(2) the Division has the burden of proof regarding its higher requested value because it is asserting a greater value than the originally assessed value. However, because PETITIONER also requests a change in value for the subject property, PETITIONER must also provide a sound evidentiary basis to support the value it proposes.

3. In addition to the case law provisions that indicate PETITIONER must provide a sound evidentiary basis, there are specific provisions set out in Utah Admin. Rule R884-24P-62

(Rule 62), if a party were to depart from Rule 62. Rule 62 sets out some preferred methods for determining fair market value and provides “Preferred valuation methods as set forth in this rule are, unless otherwise stated, rebuttable presumptions, established for purposes of consistency in mass appraisal. Any party challenging a preferred valuation method must demonstrate, by a preponderance of evidence, the proposed alternative establishes a more accurate estimate of fair market value.” See Utah Admin. Rule R884-24P-62(4)(b)(ii). The Division’s higher appraisal value does follow the “preferred valuation methods” of Rule 62. PETITIONER’s valuation departs from the rule. Therefore, although the Division has its own burden under Utah Code Subsection 59-2-109(2), for those areas where PETITIONER has departed from Rule 62, PETITIONER must still demonstrate by preponderance of the evidence that its alternatives to Rule 62 establish a more accurate estimate of fair market value.

4. Under Rule 62(4)(b) the preferred methods to determine fair market value are the cost approach and the yield capitalization income indicator. Rule 62(5)(a)(v) provides the preferred cost indicator in the mass appraisal environment is the HCLD indicator and a “party may challenge the use of HCLD by proposing a different cost indicator that establishes a more accurate cost estimate of value.” Rule 62(5)(a) explains why the cost is relevant to value. It 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.”

5. The issues argued at this hearing are mostly issues of appraisal judgment or factual determinations and are addressed and decided in the Findings of Fact. To the extent that some issues may be mixed questions of fact and law these are also addressed in these Conclusions of Law. As noted in the Findings, the Division’s HCLD indicator is the appropriate cost indicator and complies with Rule 62. PETITIONER also presented an HCLD cost indicator and did not propose a different cost indicator. However, PETITIONER proposes an alternative to relying on the HCLD cost indicator, and that is that no weight should be placed on the HCLD cost indicator. It is clear from Rule 62 that the cost indicator is a preferred indicator. As held in the Findings, PETITIONER has not demonstrated that its proposed alternative establishes a more accurate estimate of fair market value.

6. In addition to the cost approach, Rule 62 provides that the other preferred method is the yield capitalization method. Rule 62 is specific as to how the preferred yield capitalization method is to be calculated using the formula value $=CF/(k-g)$; where “CF” is the normalized

annual cash flow expected from the assets in place on the lien date, “k” is the nominal risk-adjusted discount or yield rate, and “g” is the expected annual growth rate of the cash flow going forward into perpetuity. See Rule 62(5)(b)(i). Rule 62(5)(b)(i) provides a number of specific criteria for its yield capitalization method. At Rule 62(5)(b)(i)(B) are requirements that, “The discount rate (k) shall be based upon a weighted average cost of capital (WACC) considering current market debt rates and equity yields.” It also specifies that the “WACC should reflect a typical capital structure for comparable companies within the industry.” Further, it specifies that current market debt rates “should reflect the current market rate . . . of debt with the same credit rating as the subject company.” It provides that the capital asset pricing model (CAPM) is the preferred method to estimate the cost of equity and %%% weight should be given to the Rule 62 CAPM. See Rule 62(5)(b)(i)(B)(II)(Bb). The Division followed these requirements of Rule 62.

7. PETITIONER did not submit a yield capitalization income approach and instead submitted in this matter a discounted cash flow (DCF) method. Rule 62(5)(b)(ii) indicates that a DCF may be used when reliable cash flow estimates can be established and also at Rule 62(5)(b)(ii)(A) that the DCF model “should incorporate” “growth and discount rate assumptions that would be used in the yield capitalization method” In his DCF, NAME-2 did use a WACC method to determine his discount rate, but as noted in the Findings departed from the requirements of Rule 62 in developing his cost of equity, cost of debt and capital structure. The result was a much higher WACC than used by the Division and PETITIONER did not establish that this proposed alternative established a more accurate estimate of fair market value. Additionally, the evidence did not support the negative cash flows that NAME-2 had estimated in his DCF. By overstating his WACC and understating his cash flows, NAME-2 has come to a valuation conclusion significantly below market value for the subject property.

8. One reason that NAME-2’s WACC was so much higher than the Division’s was that he had added a %%% illiquidity premium to his cost of equity. At the hearing, NAME-2 provided the information and opinion supporting this adjustment and the Division provided evidence as to why the Division felt it was inappropriate. The Commission has previously rejected adjusting the WACC for illiquidity in *Utah State Tax Commission, Findings of Fact, Conclusions of Law and Final Decision Appeal Nos. 13-1343 & 14-1241* and *Appeal Nos. 13-1407 and 14-1243* (2016). The Division has not added in its assessments the illiquidity

adjustments argued by PETITIONER in this matter. In *Appeal Nos. 13-1343 & 14-1241* and *Appeal Nos. 13-1407 and 14-1243* the Commission held “the arguments for and against allowing these apply equally among many categories of centrally assessed properties. If the Commission concluded it was appropriate to add these adjustments, it would result in reduced taxes for some centrally assessed properties and shifted tax burdens, but may not achieve the requisite constitutional finding of fair market value for these properties.” There was not a basis provided in this matter to overturn that prior decision.

9. The Division’s original Utah assessment had been \$\$\$\$\$. At the hearing, the Division pointed out an error in the original assessment, offered an appraisal and requested the value be raised to the appraisal value of \$\$\$\$\$. It is clear that there is a dual burden in this case as the Division is asserting a higher value, regardless that the Division’s change was not a change in position, use of a different model or re-weighting of indicators. It was merely to correct an error in the calculation of the tangible to total property ratio. As noted in the Findings, the Division had developed this ratio from the booked values of PETITIONER’s tangible property and the booked values of PARENT COMPANY’s 10-K. In the original assessment, APPRAISER failed to adjust the booked value of PARENT COMPANY’s intangibles by the parent subsidiary ratio. This overstated the ratio of the intangibles. APPRAISER made the correction in his appraisal. It was undisputed that this was an error in the application of the method used to adjust for intangibles. PETITIONER did argue instead that APPRAISER should have just used what was reported by PETITIONER for its intangibles on PETITIONER’s books, instead of going to the parent corporation’s 10-K. This would have resulted in a lower tangible to total property ratio, so a larger deduction for intangibles. However, NAME-2’s own description of the PETITIONER information suggests best the reason for obtaining the numbers instead from the parent corporation’s audited and published 10-K. For PETITIONER’s books, NAME-2 had noted “the accountants had to go through some type of analysis to put that number on this page . . . probably using data that’s not available to the rest of us.”²¹⁷ The Division chose to use the audited financial data from the parent corporation rather on information it deemed less reliable. The Division has met its burden to show that there was an error in the original assessment and the evidence supports that correction of the error is necessary and results in a higher value.

²¹⁷ See Findings of Fact #128.

10. The final issue is the proper method to adjust for the tax-deductibility of interest. The parties each have a method; the Division's is to make the adjustment in the cash flow and PETITIONER argues it should be done by tax adjusting the cost of debt. There is no guidance in Rule 62 on this issue. Whichever method is chosen, there will be winners and losers among the taxpayers and whether or not a taxpayer will benefit from one method may change year over year. The primary reason for retaining the Division's method is consistency. This is how the Division has made this adjustment for all other similarly situated taxpayers and how it has been done for years. The primary reason for changing to PETITIONER's method is that it is the textbook method, more known among experts outside of the Division and is an easy straight forward calculation. After considering these options, the calculation made by the Division may benefit PETITIONER for the subject year, but not for the subsequent tax year which is still an open appeal. The Commission should consider making this change by rule so that it is applied consistently to all Taxpayers starting in a specified tax year and going forward, rather than making this change for individual taxpayers who happen to still have open appeals on a case by case basis, when argued by a taxpayer because it is the method that results in a lower value, or possibly by the Division when it results in a higher value.

After consideration of the facts and the law in this matter, the Utah taxable value for the subject property for the lien date at issue in this appeal should be based on the Division's hearing appraisal which was a system wide value excluding exempt intangibles of \$\$\$\$\$. Applying the Utah allocation factor of %%% to the system wide value excluding exempt intangibles, results in a Utah value of \$\$\$\$\$. Subtracting the \$\$\$\$\$ adjustment for motor vehicles, the final conclusion is a Utah assessment value as of the lien date DATE, 2016 of \$\$\$\$\$.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission finds the Utah assessment value as of the lien date DATE, 2016 is \$\$\$\$\$. It is so ordered.

The Property Tax Division is ordered to adjust its records in accordance with this order and calculate the final adjustments to the values apportioned to tax districts as a result of this order and to deliver that information to the affected counties. The auditors of the affected counties are ordered to use the information so provided to adjust their tax roles in accordance with this order.

DATED this _____ day of _____, 2019.

Appeal No. 16-904

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Rebecca L. Rockwell
Commissioner

Lawrence C. Walters
Commissioner

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