# IDENTIFYING EXEMPT INTANGIBLE ASSETS IN STATE PROPERTY TAX: URGING STRICTER APPLICATION OF BURDEN OF PROOF

*K.E. Powell**

*Large-scale property tax litigation places a significant financial burden on taxpayers, revenue departments and communities. Complex, multi-billion-dollar tax valuation cases can take over a decade to resolve through litigation, leaving litigants and communities struggling to manage costs. While there are many challenges to reducing property tax litigation for multi-jurisdictional properties, this Article specifically addresses judicial use of "enhancement value," which has so far failed to limit high cost and persistent property tax litigation. This Article first provides a brief background of multi-jurisdictional corporate entities' property taxation, with an accompanying discussion of the exemption of intangible assets in unit value states. The Article then reviews state courts' use of the term "enhancement." Enhancement, as a judicial term, encompasses value that is otherwise not measured under law. The Article argues that judges can and should reject tax exemption arguments if specific identification and valuation data for exempt assets has not been provided. The Article concludes by noting that state law currently requires taxpayers to provide the same specificity in defining and valuing exempt intangible assets in property tax as is already tracked for income tax purposes.*



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## INTRODUCTION

Large-scale property tax litigation places a significant financial burden on taxpayers, revenue departments and communities. Complex, multi-billion dollar tax valuation cases can take over a decade to resolve through litigation, leaving litigants and communities struggling to manage costs.[1] While there are many challenges to reducing property tax litigation for multi-jurisdictional properties, this Article specifically addresses judicial use of "enhancement value," which has failed to limit high cost and persistent property tax litigation.[2]

This Article first provides a brief background of multi-jurisdictional corporate entities' property taxation, with an accompanying discussion of the exemption of intangible assets in unit value states. The Article then

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[1] *See, e.g.*, NYS Department of Taxation and Finance, UNIFORM ASSESSMENT STANDARDS (Dec. 28, 2015), https://www.tax.ny.gov/research/property/reports/ratio/uniformassmntstd/valuation.htm.

[2] *See, e.g.*, Dep't of Revenue v. Pac. Power Light Co., 558 P.2d 454, 457 (Mont. 1976); Beaver Cnty. v. Wiltel, Inc., 995 P.2d 602, 609 (Utah 2000); RT Commc'ns, Inc. v. State Bd. of Equalization, 11 P.3d 915 (Wyo. 2000); Elk Hills Power, L.L.C. v. Bd. of Equalization, 304 P.3d 1052, 1056 (Cal. 2013); Gold Creek Cellular of Mont. v. Dep't of Revenue, 310 P.3d 533, 536 (Mont. 2013); MONT. CODE ANN. § 15-6-218 (2019); CAL. REV. & TAX. CODE §§110, 212; UTAH CODE ANN. § 59-2-1101 -§ 57-7-101 (West 2020); WYO. STAT. ANN. § 39-11-101, §39-15-101 (West 2019), WASH. REV. CODE § 84.36.070. *See also* John Stromnes, *PPL Plans to Protest Dam Taxes*, MONT. STANDARD, Jan. 6, 2003, http://www.greatfallstribune.com/story/news/local/2016/10/20/tax-settlement-utility-causes-local-issues/92489134/; Washington Tax Fairness Coalition report 2008 (reporting exemption of intangible assets roughly matching funding for Washington public schools) Washington Department of Revenue, Property Tax Exemption of Intangible Assets, Report of the Department of Revenue, December 2000.

reviews state courts' use of the term "enhancement." Enhancement, as used by state courts, references some amount of amorphous taxable value. This term is used by state judges to describe a portion of the taxable value that is greater than tangible assets, less than market value, yet does not included exempt intangible assets. Enhancement, as a judicial term, encompasses value that is not otherwise measured under law. Because of the lack of measurement in enhancement value, use of the term has not curbed tax litigation.

The Article argues that judges can and should reject tax exemption arguments if specific identification and valuation data for exempt assets has not been provided. The Article concludes by noting that state law currently requires taxpayers to provide the same specificity in defining and valuing exempt intangible assets in property tax as is already tracked for income tax purposes. Requiring taxpayers to identify exempt intangible assets will limit future litigation without unduly harming taxpayers. The Article also proffers that such specific identification and valuation data for intangible assets is already available within the taxpayer's own tax accounting records, and therefore there is no additional burden to taxpayers to provide such disclosure in the course of property tax litigation. If such evidence is not available, legislative safeguards already exist to allow the submission of other evidence.

## I. THE CATASTROPIC COSTS OF PROPERTY TAX LITIGATION

A small-town school district in rural Montana receives a $50,000 donation from a multi-national wind farm to pay for a local teacher's salary. Heartwarming? Hardly. The same multi-national wind farm's property tax protests, which amount to $6.24 million of an $8.8 million dollar tax bill, are 18.6% of the entire county budget.[3] Much of these protested tax funds had been earmarked by the local jurisdiction for road maintenance, emergency services, and funding local schools.[4] But instead of putting the funds to such public use, the protested funds are held by the state pending a decision on the property tax challenge, which quite possibly will not be finalized for years.[5] Until then, the school district

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[3] Kristen Inbody, *Schools Feeling Pinch from NaturEner Tax Protest*, GREAT FALLS TRIB., Jan. 10, 2018, http://www.greatfallstribune.com/story/news/2018/01/10/schools-feeling-pinch-naturener-tax-protest/1022856001/.

[4] *See id*. For general information about school districts and property taxes, see Corey Turner et al., *Why America's Schools Have a Money Problem*, NPR (Apr. 18, 2016), https://www.npr.org/2016/04/18/474256366/why-americas-schools-have-a-money-problem. The problem is magnified in rural schools with a single centrally assessed taxpayer bearing the majority of the school tax burden.

[5] Briana Wipf, *Protest: School districts tightening belts,* Shelby Promoter (Jan. 3, 2018), http://www.cutbankpioneerpress.com/shelby_promoter/news/article_f558c6c8-ef30-11e7-ac2c-e392e284f819.html.

faces extreme budget shortfalls. With such a large amount of tax revenue now virtually inaccessible, the school is forced to lay off educational staff.[6] While the school district can technically access the funds under a loan process, such a prospect is not without substantial risk.[7] If the district accesses such a loan, and if any protested taxes are returned to the taxpayer, the school district is responsible for repaying those accessed funds.[8] Several months later, the Montana Department of Revenue settles with the wind farm, refunding approximately $2.1 million of the $4.8 million held in protest.[9]

This story mirrors the woes of many rural school districts, road maintenance funds, and fire departments across the country; this specific case is not the first time rural taxing districts have faced severe shortfalls due to property tax appeals.[10] Property tax protests from multi-national entities with property located in rural areas of primarily western states affect budgets for many years.[11] In 2003, the utility provider PPL protested about $8.6 million in Montana property taxes.[12] Under the law at the time, the protested funds were placed in a protest fund inaccessible by local governments. For some local jurisdictions,[13] those protested funds represented almost 40% of school funding. The funds were accessible to the local jurisdictions only upon completion of the property tax litigation; a process[14] which took almost ten years. While the burden on rural jurisdictions is heightened, the effect is substantial on more populous areas as well. In a recent state of Oregon example, settlement of a

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[6] *Id.*

[7] *See, e.g.*, MONT. CODE ANN. § 15-1-402(2018)(6)(d)(i)(A) (2019); (requiring either repayment of protested tax funds by local jurisdictions or the surrender of those funds to the state) now amended by 15-1402(2018)(6)(d)(i)(B).

[8] Wipf, *supra* note 5.

[9] Jennifer Van Heel, *NaturEner and State Resolve Tax Disputes*, SHELBY PROMOTER, Apr. 11, 2018, http://www.cutbankpioneerpress.com/shelby_promoter/news/article_bd1b41f2-3c63-11e8-90b7-73daaba7ec6e.html.

[10] *See, e.g.*, Stromnes, *supra* note 2. *See generally* DAPHNE A. KEYNON, *The Property Tax-School Funding Dilemma*, LINCOLN INST. LAND POLICY, (2007), https://www.lincolninst.edu/sites/default/files/pubfiles/the-property-tax-school-funding-dilemma-full_0.pdf; Turner et al., *supra* note 4.

[11] Before the new intangible asset rules, Utah noted similar issues with property tax burdens to centrally assessed properties. Bob Bernick, Jr., *Some May Feel Impact of Tax Ruling More than Others*, DESERET NEWS (May 13, 1997), https://www.deseretnews.com/1997/5/13/19311967/some-may-feel-impact-of-tax-ruling-more-than-others.com. The effect of property tax litigation seems to be greater in the less densely populated Western states.

[12] Stromnes, *supra* note 2.

[13] *Id.*

[14] Montana law has now been amended to allow local governments to access a portion of those funds. *See, e.g.*, MONT. CODE ANN. § 15-1-402. *See also* WASH. DEP'T REVENUE, PROPERTY TAX EXEMPTION OF INTANGIBLE ASSETS (Dec. 2000), https://dor.wa.gov/sites/default/files/legacy/Docs/reports/intang.pdf.

decade long property tax litigation by Comcast returned $155 million in protested tax revenues to 10 counties.[15]

Economics outside the control of local jurisdictions play a large part in these shifting budget shortfalls. In the past, large utility, telecommunication, and industrial facilities in rural areas provided a significant tax base to rural jurisdictions.[16] Increased obsolescence in tangible assets located in these factories, transmission lines, and technologies, however, drives companies to maintain fewer tangible assets and properties to cut costs, leaving fewer tax dollars for local jurisdictions. Shifting consumer policies also drive increased economic obsolescence for certain types of utility and industrial facilities.[17]

State property taxation of multi-state businesses provides a significant percentage of funding for many rural state governments, and state tax agencies face increasing pressure to keep corporate property tax revenues constant.[18] But as these economic and corporate policy shifts occur, state tax revenues drop.[19] In addition, as businesses rely more and more

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[15] Tom James, Comcast settles Oregon Tax Lawsuit, Will Pay $155 million, Associated Press (June 4, 2018), https://www.kdrv.com/content/news/Comcast-Settles-Oregon-Tax-Lawsuit-Will-Pay-155-Million-484523451.html

[16] *See* Mont. Dep't of Rev., *Centrally assessed Property Company Values*, (2013), https://mtrevenue.gov/wp-content/uploads/2018/01/2013-CAP-Allocation-Summary.pdf. *See also* Mont. Dep't of Rev., *Class 12 tax rate – Tax Year 2013*, (2013), https://mtrevenue.gov/wp-content/uploads/2018/01/2013-Class-12-Tax-Rate.pdf. *See* Mont. Dep't of Rev., *Property Classes*, (2020), https://mtrevenue.gov/property/property-classes-and-codes/.(noting the centrally assessed utility codes.)

[17] Washington state has been a leader in driving environmental policies, including requiring renewable energy requirements for large utility producers. This directly affects legacy coal-fired energy production facilities. *See* Energy Independence Act (EIA or I-937), WASH. STATE DEP'T COMMERCE, https://www.commerce.wa.gov/growing-the-economy/energy/energy-independence-act/ (last visited Feb. 17, 2020). *See also A Dwindling Role for Coal*, UNION CONCERNED SCIENTISTS (Oct. 10, 2007), https://www.ucsusa.org/clean-energy/coal-and-other-fossil-fuels/coal-transition.

[18] The majority of the litigation relates to utility companies and telecommunication companies in the Western United States. This is likely due to the higher portion of intangible assets, and depreciating value of the tangible assets. For information on States using unitary value for property tax purposes, see *Survey of Railroad and Utility Tax Practice Among the States: 2005 Update*, N.Y. DEP'T TAX'N & FIN., https://www.tax.ny.gov/research/property/reports/rr/index.htm (last updated July 17, 2018). *See also* Megan Moore, *SJ 23 study of Taxation of Centrally Assessed and Utility Property Draft Final Report*, Revenue and transportation Interim Committee (July 2018), https://leg.mt.gov/content/Committees/Interim/2017-2018/Revenue-and-Transportation/Meetings/July-2018/sj-23-centrally-assessed-draft-final-report.pdf.

[19] For example, in 2016, the Montana Department of Revenue estimated $392 million in tax from centrally assessed properties. MONT. DEP'T OF REVENUE, CENTRALLY ASSESSED PROPERTY SUMMARY FOR TAX YEAR 2017, http://mtrevenue.gov/wp-content/uploads/2018/01/2017-CAP-Allocation-Summary.pdf. For prior years, see MONT. DEP'T OF REVENUE, CENTRALLY ASSESSED PROPERTY COMPANY VALUES, https://mtrevenue.gov/property/property-types/centrally-assessed/. For Montana, over $21 million was under protest in 2017, as reported to Revenue Oversight Committees at http://revenue.mt.gov/Portals/9/CA%20Prop%20-%20Current%20Protested%20Taxes%20in%20Appeal%20Status%20-%20as%20

on intangible assets such as licenses, franchise agreements, goodwill, and other more complex intangible assets, the exemption of such intangible assets from a taxation value which sets tax revenue becomes more controversial, leading to increasing state litigation.[20]

The financial effects of massive tax litigation for the local communities, centrally assessed taxpayers, and revenue departments (on behalf of state governments) are substantial, with millions of tax dollars at issue. Complex, multi-billion dollar tax valuation cases can take years—indeed, sometimes a decade or more—to resolve through litigation. These cases not only cost the litigants an excess amount of time and money, but local services funded by tax revenues are also deeply affected.

The majority of these complex tax litigation suits are ultimately decided by state courts of general jurisdiction, which typically have limited expertise over the complex issues and technical details of tax matters. State court jurisprudence on such matters is often inconsistent, and therefore these decisions provide little certainty for future litigants.[21] This Article addresses one aspect[22] of the challenges to reducing state tax litigation for multi-jurisdictional corporate entities.

## II. HISTORY AND CURRENT PROPERTY TAX LAW FOR MULTI-JURISDICTIONAL COMPANIES

Taxation is one of those areas where the states have retained independent powers.[23] The Tenth Amendment of the U.S. Constitution reserves the power of taxation to the states, as well as the federal government.[24] Thus, American individuals and companies (as well as domestic companies operating in the United States) are subject to federal taxation as well as state and local taxation systems.[25] The federal taxation system

of%2011_21_17.pdf. This is in line with prior years. There are many reasons for shrinking tax revenues, and states address budget issues in many different ways. Karen Pierog, *U.S. States Stung by Drop in April Income Tax Revenue*, Reuters (May 25, 2016), https://www.reuters.com/article/us-usa-state-taxation-idUSKCN0YG2K1.

20 Additional examples of the fiscal conflict between taxpayers and revenue departments, as well as fiscal effects, can be found in Gary C. Cornia, David J. Crapo, & Lawrence C. Walters, *The Unit Approach to the Taxation of Railroad and Public Utility Property*, *in* INFRASTRUCTURE & LAND POLICIES 126, 136–38 (Gregory K. Ingram & Karin L. Brandt eds., 2013), https://www.lincolninst.edu/sites/default/files/pubfiles/unit-approach-to-taxation-of-railroad-public-utility_0.pdf.

21 *See generally id.* at 147–48.

22 Other challenges include apportionment formulas, functional and economic obsolescence, and related matters.

23 *See* Robert T. Manicke, *Federalism in State Taxation*, 54 WILLAMETTE L. REV. 531, 532 (2018).

24 *See id.*; *see also* U.S. CONST. art. X.

25 Many local jurisdictions are allowed to implement their own taxing policies under state purview, subject again to Constitutional oversight. For example, some local jurisdictions

is focused on income taxes and excise taxes, leaving property and sales tax largely to individual states.[26] Most states also require an income tax, so taxpayers pay both state and federal income tax.[27]

State property tax has been a key funding element for governmental units since early in U.S. history, financing local education, local infrastructure, and public safety.[28] Local jurisdictions tax both individual residential homes and commercial properties, but they also tax multi-jurisdictional corporations with a nexus to the local jurisdiction.[29] The influx of funds from property taxation of these multi-jurisdictional[30] corporations is a key element of local government budgeting, while individual residential and commercial ventures benefit from a certain level of local road, education, and emergency services funded by property tax of large facilities in the jurisdiction.[31] Jurisdictions with large-scale indus-

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subject residents to local income tax (Ohio, New Jersey), as well as sales tax implemented at the state and local level, and property tax (48 states).

26 States generally implement income tax, with the definition of income derived from federal law.

27 Tax Pol'y Ctr., *The State of State (and Local) Tax Policy*, TAX POL'Y CTR. BRIEFING BOOK (May 2020), https://www.taxpolicycenter.org/sites/default/files/briefing-book/what_are_the_sources_of_revenue_for_state_governments_1.pdf.

28 In 1902, property taxes provided over 50 percent of the total federal, state, and local tax collections. Even as late as 1940, almost 35 percent of total tax collections were property tax. Beginning with World War II, federal tax collections exploded, and property tax soon provided significantly less of total tax revenue. *See* William A. Fischel, *Municipal Corporation, Homeowners, and Benefit View of the Property Tax*, *in* Property Taxation and Local Government Finance 37 (Wallace E. Oates ed., 2001), JOAN YOUNGMAN, LEGAL ISSUES IN PROPERTY VALUATION AND TAXATION: CASES AND MATERIALS 4 (2006).; Billy D. Walker, *The Local Property Tax for Public Schools: Some Historical Perspectives*, 9 J. EDUC. FIN. 265, 268 (1984). This Article does not address state and local sales and income taxes, which provide approximately two-thirds of state and local government funding.

29 The Commerce clause authorizes Congress to regulate commence among the states. With respect to taxation, this principle extends to requiring state taxes to be applied to an activity with substantial nexus with the taxing state, fairly apportioned, and not discriminatory to interstate commerce. Beyond these limits, states are quite free to devise their own taxation systems. *See* Complete Auto Transit v. Brady, 430 U.S. 274, 279 (1977). See also the recent decision in South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2091 (2018), limited only by the broad notions of nexus. Consider state nexus and minimum connections in Miller Bros. v. Maryland, 347 U.S. 340, 344-45 (1954). Note that the continuity of those constitutional concerns continued through Nat'l Bellas Hess v. Dep't of Revenue, 386 U.S. 753, 756 (1967), and Quill Corp. v. North Dakota, 504 U.S. 298, 312-13 (1992).

30 While states are not permitted to tax the income of non-residents on value earned outside the taxing state borders, unitary businesses can be taxed. *See* ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 317-18 (1982); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354, 364 (1982). For information on States using unitary value for property tax purposes, see *Survey of Railroad and Utility Tax Practice Among the States: 2005 Update*, NY DEP'T TAXATION & FIN., https://www.tax.ny.gov/research/property/reports/rr/index.htm (last updated July 17, 2018); Mont. Revenue & Transp. Interim Comm., *Study of Taxation of Centrally Assessed and Utility Property Draft Final Report*, S. 65-23, at 45 (2018), https://leg.mt.gov/content/Committees/Interim/2017-2018/Revenue-and-Transportation/Meetings/July-2018/sj-23-centrally-assessed-draft-final-report.pdf.

31 *See* Cornia et al., *supra* note 20; YOUNGMAN, *supra* note 28.

trial or utility plants have often used those industrial facilities as a key feature of their tax base.[32]

Valuation of corporate real property for state property tax works fairly efficiently for single properties taxable in only one jurisdiction. A corporation, like a homeowner, is taxed on the fair market value of the property owned.[33] However, valuing multi-jurisdictional properties—those properties such as railroads and telegraph lines which cross jurisdictional lines and whose value is directly tied to their interconnectivity—is more challenging.

U.S. state property tax policy in "unit value" states is to value the full railroad company and allocate a percentage of that company to a state for taxation.[34] Such a tax method is known as "unit valuation" or "central assessment," referencing the corporate entity as a full unit, and allocating a portion of taxable value to a local jurisdiction. Today, multi-jurisdictional companies subject to unit valuation include most utility companies and telecommunications properties, such as electric and other power-generating utility companies, railroads, and airlines—and this list could soon include internet companies.[35] Long upheld by the U.S. Supreme Court and many state courts, legislative decisions to apply a "unit valuation" method, apportioning to each state its proportion of value,[36] continue to be the practice in many unit value states. In coordination with the unit value tax policy, states also now exempt intangible assets such as

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32 While states are not permitted to tax the income of non-residents on value earned outside the taxing state borders, unitary businesses can be taxed. *See* ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315–16 (1982); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354, 364 (1982). For a list of states using unitary value for property tax purposes, see *Survey of Railroad and Utility Tax Practice Among the States: 2005 Update*, NY Dep't of Taxation & Fin., https://www.tax.ny.gov/research/property/reports/rr/index.htm (last updated July 17, 2018).

33 YOUNGMAN, *supra* note 28, at 23.

34 As noted in Youngman's book, *supra* note 28, at 9–10, a 1990 study found that only 22 states (or their subdivisions) levy any taxes on intangibles. For additional background, see generally James A. Amdur, *Property Taxation of Regulated Industries*, 40 TAX LAW. 339 (1987).

35 Cecilia Kang, *Court Backs Rules Treating Internet as Utility, not Luxury*, N.Y. TIMES (June 14, 2016), http://www.nytimes.com/2016/06/15/technology/net-neutrality-fcc-appeals-court-ruling.html.

36 The U.S. Supreme Court cases of the late 1880's firmly established the legal principle that a state has the power to tax a public utility upon its enterprise value and not merely a value of the tangible assets. *See, e.g.*, W. Union Tel. Co. v. Taggart, 163 U.S. 1, 18–19 (1896) (telegraph line mileage case); Pullmans Palace Car Co. v. Pennsylvania, 141 U.S. 18, 26 (1891) (track mileage case); State Railroad Cases, 92 U.S. 575, 608 (1875) ("[A] railroad must be regarded . . . as a unit. The track . . . is but one track from one end of it to the other, and, except in its use as one track, is of little value."). The concept of unit value expanded to the development of the unitary business rule used in state corporate income tax. The unitary business rule allows for valuation of a corporation and apportioning tax amongst multiple jurisdictions. *See, e.g.*, Fargo v. Hart, 193 U.S. 490, 499 (1904). While litigation occurs over apportionment, this Article does not address that issue.

goodwill, software and intellectual property, and currency from taxation.[37] As the value of exempt intangible assets increases, property tax revenues will generally decrease, leading to controversy.

### A. *Unit Valuation Laws and Going Concern Mutli-Jurisdictional Properties—A Long History*

For over 120 years, U.S. state tax policy has supported property taxation of multi-jurisdictional corporations by valuing the entire company and allocating a relevant portion of that value to a particular jurisdiction.[38] Unit value[39] addresses the concept of determining the total value of a multi-jurisdictional company as a going concern, then allocating a portion of said value to each specific jurisdiction where unit property is located. A going concern is an established and operating business with an indefinite future life.[40] Going concern value incorporates intangible enhancement value, which is produced by "the assemblage of the land, building, labor, equipment and marketing operation. This process creates an economically viable business that is expected to continue."[41] Thus, the going concern value refers to the total value of a property, including both real property and intangible personal property attributed to business value.

From a tax policy perspective, the concept of unit valuation theoretically addresses equalization of value and taxation across jurisdictions, capturing the value of the complete system, and providing a fairly consistent method to capture and allocate assets across jurisdictions. Early Supreme Court cases, such as the 1876 and 1880 railroad and telegraph decisions, firmly establish the legal principle that a state has the power to tax a public utility upon its going concern or enterprise value, and not merely a tangible value.[42] To date, this legal framework for valuation of

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37 Peter R. Merrill, *Tax Reform and Intangible Property*, 84 TAXES 97 (Mar. 2006).

38 YOUNGMAN, *supra* note 28, at 9–10. Amdur, *supra* note 34, at 342–44.

39 As noted above, the unitary business model is used in a number of states to determine and allocate business income to a particular jurisdiction. For example, review the *Uniform Division of Income for Tax Purposes Act* developed by the Uniform Law Commission, *W. Union Tel. Co.*, 163 U.S. at 18–19 (telegraph line mileage); *Pullman's Palace Car Co.,* 141 U.S. at 26 (track mileage); *State Railroad Tax Cases*, 92 U.S. at 608.

40 APPRAISAL INST., THE APPRAISAL OF REAL ESTATE 63–64 (14th ed. 2013). The going concern value of a company is considered more than just "sticks and bricks"; it is the tangible and intangible assets operating together. *See* Los Angeles Gas & Electric Corp. v. Railroad Comm'n, 289 U.S. 287, 313 (1933).

41 *See generally* APPRAISAL INST., THE APPRAISAL OF REAL ESTATE (10th ed. 1992). Unit valuation, going concern value, and centrally assessed properties refer to the same concepts of legal definition discussed in this section.

42 *See, e.g.*, *W. Union Tel. Co.*, 163 U.S. at 18–19 (telegraph line mileage case), *Pullmans Palace Car Co.*, 141 U.S. at 26 (track mileage case), *State Railroad Cases,* 92 U.S. at 608 ("[A] railroad must be regarded . . . as a unit. The track . . . is but one track from one end of it to the other, and, except in its use as one track, is of little value."). The concept of unit

centrally assessed properties still upholds the unitary business principle and formulary apportionment.[43]

Beginning with the 1876 State Railroad Tax Cases, the Supreme Court upheld the use of the enterprise value (as measured by the stock and bond method).[44] The U.S. Supreme Court later noted, however, that property tax was based on the value of the property, not its earnings.[45] Justice Brewer held "the value of the property results for the use to which it is put and varies with the profitableness of that use, present and prospective, actual and anticipated."[46]

These multi-jurisdictional going concern companies tend to be specialty businesses. For example, utility operations and telecommunication assets are complex, multi-jurisdictional entities.[47] Special use properties are challenging to value, with multiple considerations including obsolescence as well as market valuation methodologies.[48] To determine a fair market value for tax purposes, these going concern properties with tangible and intangible assets generally are valued using several approaches, including the cost approach, the sales comparison approach, and the income capitalization approach.[49] California's *Shubat* case provided a simplified discussion of valuation methods illustrative for discussion purposes. In discussing intangibles and unit valuation, the Court stated that:

> The computation of property value normally involves one or more of three general methods of valuation. The 'market' approach looks at recent sales of comparable property, including that being valued. The 'income' or discounted cash flow approach looks at the present value of a projected stream of income from use of the property. This present value depends upon not only the mag-

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value expanded to the development of the unitary business rule used in state corporate income tax. The unitary business rule allows for valuation of a corporation and apportioning tax among multiple jurisdictions. *See, e.g.*, Fargo, 193 U.S. at 499 (1904). For discussion of state apportionment as it relates to intangibles in income tax, see Walter Hellerstein, *State Taxation of Corporate Income from Intangibles: Allied-Signal and Beyond*, 48 TAX L. REV. 739 (1993).

43 While litigation regarding apportionment occurs in various states, state property tax apportionment issues are not addressed in this Article. Note, however, that while the Supreme Court was so holding, it was also developing a different legal framework for rate standards. JAMES C. BONBRIGHT, THE VALUATION OF PROPERTY: A TREATISE ON THE APPRAISAL OF PROPERTY FOR DIFFERENT LEGAL PURPOSES 614 (1965).

44 *See* State Railroad Tax Cases, 92 U.S. 575 (1876). At that time, a type of property tax known as the capital stock tax was the dominant form of state taxation, and the railroads were some of the few industries that operated routinely in several states.

45 *See* Cleveland, C., C. & St. L. Ry. Co. v. Backus, 154 U.S. 439, 445 (1894).

46 *Id.* at 445. This foreshadows state courts' attempts to differentiate between valuing an enterprise and improperly including the value of excludable intangible assets.

47 *See* APPRAISAL INST., *supra* note 40, at 705–10.

48 *Id.*

49 *See* id. at 707–10.

> nitude and duration of the projected income stream but also the discount rate used. The higher the discount rate, the lower the present value of the property. The third method of valuation, the 'cost' approach, looks at the cost of replacing the property less accrued depreciation.[50]

Cost, market and income approaches use significantly different data sets, and rarely, if ever, produce the same market value. In part, this is because tangible assets are singular, and quickly depreciated, leading to a low cost basis.[51] Both market and income approaches include value far above a simple cost approach, as the market indicators include all intangible valuation, whether tracked on the books or not.[52] An ongoing business, by nature, is more valuable than the sum of its individual items of tangible property, such as pollution control equipment or railroad cars. The additional value arises from the interconnectedness of the business operations, as demonstrated by a higher income valuation.

For complex, high valuation properties, determining fair market value should include one or more of the three traditional appraisal approaches, including cost, income, and sales approaches to valuation. When sales data is unavailable, then generally cost and income approaches to value are used.[53] Some state valuation cases involve only one method of valuation: the cost approach.[54] The cost approach values only the tangible assets, while the income and sales approaches include exempt intangible property, as those approaches value the full fair market value of the business.[55]

The U.S. Supreme Court in *Adams Express Co. v. Ohio* held that use of unit valuation for property tax purposes does not violate the Com-

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50 Shubat v. Sutter Cnty. Assessment Appeals Bd., 17 Cal. Rptr. 2d 1, 2–3 (1993). *See generally* CAL. CODE REGS. tit. 18 (2019). The subject of valuation methodologies is greatly oversimplified here. For a discussion of valuation concepts, specifically related to intangibles, see STEELE & SILVERSTEIN, *infra* note 81.

51 *See* APPRAISAL INST., *supra* note 40, at 711.

52 *See id.*

53 The nuances of valuation methodology are complex and beyond the scope of this Article. Several appraisal organizations such as the International Association of Assessors Officers (IAAO), the Appraisal Institute, and others have extensive training programs for appraisers.

54 *See e.g.*, T-Mobile USA, Inc. v. Utah State Tax Comm'n, 254 P.3d 752, 763 (Utah 2011) (supporting a historic cost approach directly following sale); *RT Commc'ns, Inc.*, 11 P.3d at 919, 926 (supporting a historic cost approach following sale). The California Appraisal Manual prohibits the addition of intangible assets to the cost approach, and the court categorically states that by failing to deduct the fair market of ERC's, the Board directly taxed Elk Hill on intangible rights in violation of section 212(c). *See Elk Hills Power, L.L.C.*, 304 P.3d at 1066.

55 *See* APPRAISAL INST., *supra* note 40, at 707–10.

merce Clause, and is a constitutionally permissive method of taxation.[56] In *Adams Express*, the cost approach for valuation of separate property totaled four million dollars, while the market-based approach, as an assembled property, totaled sixteen million.[57]

In upholding the use of a unit value for tax purposes, the U.S. Supreme Court noted:

> In the complex civilization of today, a large portion of the wealth of a community consists of intangible property, and there is nothing in the nature of things or in the limitations of the federal Constitution which restrains a state from taxing such intangible property at its real value. Whenever separate articles of tangible property are joined together not simply by a unity of ownership, but in a unity of use, there is not unfrequently developed a property, intangible though it may be, which in value exceeds the aggregate of the value of the separate pieces of tangible property.
>
> Whatever property is worth for the purposes of income and sale it is worth for the purposes of taxation, and if the state comprehends all property in its scheme of taxation, then the goodwill of an organized and established industry must be recognized as a thing of value, and taxable.
>
> The capital stock of a corporation and the shares in a joint stock company represent not only its tangible property, but also its intangible property, including therein all corporate franchises and all contracts, privileges, and goodwill of the concern, and when, as in the case of the express company, the tangible property of the corporation is scattered through different states by means of which its business is transacted in each, the situs of this intangible property is not simply where its home office is, but is distributed wherever its tangible property is located and its work is done.
>
> No fine-spun theories about situs should interfere to enable these large corporations, whose business is of ne-

56 Petition for rehearing denied; see companion cases Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, 226 (1897); Weir v. Norman, 166 U.S. 171 (1897); Adams Express Co. v. Ohio State Auditor, 166 U.S. 185 (1897). The legal concepts were limited in Fargo v. Hart, where the Supreme Court held that Indiana could not tax the value of bonds held in another state that were not part of the "organic unity" of the unit. 193 U.S. 490, 499–500 (1904). *See also* W. Air Lines, Inc. v. Michunovich, 428 P.2d 3, 5 (Mont. 1967).

57 *See Adams Exp. Co.*, 166 U.S. at 223.

> cessity carried on through many states, from bearing in each state such burden of taxation as a fair distribution of the actual value of their property among those states requires.[58]

The Court further noted that the "[s]ubstance of right demands that, whatever be the real value of any property, that value may be accepted by the state for purposes of taxation, and this ought not to be evaded by any mere confusion of words."[59]

The Court allowed states to determine multi-state or multi-jurisdictional corporations' total values, and then apportion income by jurisdiction.[60] The Supreme Court defines a unitary business as a firm with functional integration, centralization of management, and economies of scale, and this approach to taxation applies not only for continuous property, but also for operational unity.[61]

After the Court's holding in *Adams Express*, taxpayers have, to date, had little success challenging the use of some derivative of enterprise value in public utility property taxation.[62] Centrally assessed properties are still valued by their unit value or going concern value.[63]

There are few legal rules establishing which approaches to value can be used to determine fair market value under the unit value methodology. The Supreme Court cases do limit the unit value to "get to the true value of the things within the state, when they are part of an organic system of wide extent, that gives them a value above what they would otherwise possess."[64]

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58 *Adams Exp. Co.*, 166 U.S. at 219–21, 225.

59 *Id.* at 221.

60 *See* Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 120–21 (1934); *See also* Butler Bros. v. McColgan, 315 U.S. 501, 507–08 (1942); Container Corp. v. Franchise Tax Bd. 463 U.S. 159, 164 (1983). *See also* Tax Management Multistate Tax Portfolios (BNA) 1190; *see generally* Walter Hellerstein, *State Taxation of Corporate Income from Intangibles: Allied-Signal and Beyond*, 48 TAX L. REV. 739 (1993).

61 *See Adams Exp. Co.*, 165 U.S. at 224; *Weir*, 166 U.S. at 182; Mobil Oil Corp. v. Comm'r of Taxes 445 U.S. 425, 438 (1980). For a discussion of the unitary model in light of corporate property tax, *see* Hellerstein, *supra* note 60.

62 *See*, *e.g.*, 46 AM. JUR. 2d *State and Local Taxation* §13 (2015) (noting that unit valuation has been upheld against extraterritorial exertion of a state's taxing power, constitutional challenges regarding equality of taxation, and Commerce Clause challenges, citing related cases). *See also* BONBRIGHT, *supra* note 43.

63 While the concept of property tax valuation is the same in all unit valuation states, the process occurs by different state assessors in each state under a separate set of state statutes and court precedent. The federal 4R Act (Railroad Revitalization and Regulatory Reform Act of 1976) as minimal federal oversight, prevents over-taxation for certain cross-jurisdictional entities such as railroads and airlines. 45 U.S.C. § 801 (2018).

64 Wallace v. Hines, 253 U.S. 66, 69 (1920) (disallowing North Dakota's attempt to include the railroad states and bonds in apportionment). *See also* Fargo v. Hart, 193 U.S. 490, 500 (1904) (indicating that Indiana attempted to include $15.5 million in bonds in NY).

Since the holding in *Adams Express*, a majority of western states,[65] as well as a number of other states, implement a unit rule for valuing centrally assessed (or multi-jurisdictional) corporations; these unit rules use some form of sales, income, and cost methods to determine the fair market value of the corporation, and allocate a portion of the determined value to the local jurisdiction for property tax purposes. Today, centrally assessed properties include not only public utilities, but also more broadly multi-jurisdictional properties such as railroads; telegraph, telephone, and telecommunications companies; pipelines; and airlines.[66] Such centrally assessed properties are still taxed by a local jurisdiction on a proportion of the unit value or going concern value. The going concern value

> includes an intangible enhancement of the value of an operating business enterprise which is produced by the assemblage of the land, building, labor, equipment and marketing operation. This process creates an economically viable business that is expected to continue. Going concern value refers to the total value of a property, including both real property and intangible personal property attributed to business value.[67]

[65] The Western States Association of Tax Administrators (WSATA) (on behalf of tax assessors) and the Western States Association of Tax Representatives (WSATR) (on behalf of taxpayers) provide representation to the states and taxpayers subject to unit valuation. The fourteen states affiliated with WSATA include Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Texas, Utah, Washington, and Wyoming. State courts have also upheld unit value, as discussed in this Article. For example, thirty years ago in DOR v. Pacific Power and Light, 171 Mont. 334, 340 (1976), the Court held the actual cost of the physical plant within Montana alone does not equal the value of the allocated portion of a utility company. The unitary method determines not only the appropriate share of the entire enterprise which may be taxed by each state but also determines the "enhanced value" attributable to the equipment used by virtue of its being a component part of the system. The unitary method assumes the value of the entire system, as a going concern, is somewhat greater than the total fair market value of its equipment. *Id.*

[66] While much of early case law relates to challenges in railway valuation, the federal government intervened in railway valuation for property tax purposes when the government passed the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act). Regulatory reform for railroads occurred as the industry was facing collapse. As part of the Act, state and local taxation of railroads was restricted to prevent states from taxing railroads at a higher assessed percentage or tax rate than other industries within the state, with appeal rights directly to a U.S. district court. 45 U.S.C. § 801 (2018). *See also* CSX Transportation, Inc. v. Ga. State Bd. of Equalization, 552 U.S. 9, 128 (2007). Airlines were later included in the 4R legislation; *see* 45 U.S.C. §§ 801–854.

[67] Going concern value includes "an intangible enhancement of the value of an operating business enterprise which is produced by the assemblage of the land, building, labor, equipment and marketing operation. This process creates an economically viable business that is expected to continue. Going concern value refers to the total value of a property, including both real property and intangible personal property attributed to business value." APPRAISAL INST., *supra* note 40, at 23–24.

Such valuation makes logical sense—a railroad company is more than the value of the ties and the lines. The value is in the ability of the railway to travel over those ties and lines between and across jurisdictions. Unit valuation for tax purposes has been recognized in law for over 100 years.[68]

### *B. The Process for Calculating Unit Value in State Property Tax*

Most jurisdictions require a company owning real property to file a property tax return as of a particular date annually.[69] The due date of the annual property tax filing is generally quite early in the year, often before annual filings are due to the SEC, utility regulators, and state and federal income tax agencies.[70] Taxpayers report taxable assets and regulators determine a fair market value for tax purposes, using versions of the three methods of valuation (cost, market and income).[71] During the tax valuation process, an appraiser will often apply more than one approach to determining a value. For example, both a cost approach and a comparison sales approach might be used, and the approaches will yield different valuation indicators of fair market value.

Resolving those differences in valuation indicators is described in the appraisal industry as reconciliation.[72] The state assessor or appraiser may determine that the data setting a market approach to valuation is particularly compelling, while cost and income data was less reliable; perhaps weighting the market value at 50%, with the cost and income at 25%. This correlates the indicators of value to determine an ultimate market value.[73] Thus, the correlation process determines an ultimate

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68 After Congress instituted a federal corporate income tax in 1909, the states soon followed, and by the 1920's the same unitary business principle and formulary apportionment concepts developed in the property tax arena were being applied in the context of state corporate income tax. Consider states' adoption of the Uniform Division of Income for Tax Purposes Act. *See*, *e.g.*, UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT §§1–21 (NAT'L CONF. COMM'RS UNIF. STATE L.).

69 The failure of state legislatures to provide specificity and consistency with respect to both methodology and timing issues, however, exacerbates controversy in valuation. Both taxpayers and revenue departments share partial blame for continued contentious litigation. Taxpayers refuse to provide sufficient internal income data with the intangible calculations used for internal valuations or federal tax calculations. Tax assessors subject taxpayers to unreasonably short time frames for reporting information, and often use valuation methods or calculations not set out in statute or rule, causing concern to taxpayers. For example, the capitalization rates used by states are perpetually much higher than taxpayers consider to be reasonable for the industries. Expert opinions regarding valuation are rarely exchanged prior to litigation, and courts are left to balance the expert valuations designed specifically for litigation.

70 This issue, not directly addressed in the Article, can cause evidentiary disclosure issues in litigation. *See, e.g.*, QwestCorp v. Dep't Revenue, No. SPT 2008-2 (Mont. B.T.A. Nov. 30, 2009), https://mtab.mt.gov/Portals/64/docs/decisions/Qwest_2008.pdf.

71 CORNIA ET AL., *supra* note 20, at 140.

72 APPRAISAL INST., *supra* note 40, at 641.

73 Cornia et al., *supra* note 20, at 140

market value when the appraiser applies a particular weight (typically by percentage) to each of the cost, sale, and income approaches, and removing any assets not subject to taxation.[74] This process is considered a key area for "appraiser judgment," which dictates that valuation cannot be a mechanical process by set formula but requires the analysis and professional judgment of an appraiser or assessor.[75] After valuation has been set, the taxing department allocates a portion to a jurisdiction.[76] There is no formula or average used to reconcile values, but rather an appraiser must use their appraisal judgment to balance and reconcile differing valuations and determine a final opinion of value.[77] While the final opinion might include either a range of values, or a value relative to a benchmark (no more than x or no less than x), for tax purposes, a single figure must be applied.[78]

When approaches to value are reconciled, the final opinion generally gives more or less weight to the different valuation approaches. Each method or approach, however, might capture some differing level of asset exempt from property tax.[79] In the last two decades, corporate taxpayers successfully lobbied state legislatures to exempt certain items from taxation.[80] While some of the exemptions are fairly straightforward, such as tangible pollution control assets, other exempt assets such as the

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[74] To illustrate the valuation process, California's *Shubat* court provided a simplified framework: "The computation of property value normally involves one or more of three general methods of valuation. The 'market' approach looks at recent sales of comparable property, including that being valued. (CAL. CODE REGS., tit. 18, § 4.) The 'income' or discounted cash flow approach looks at the present value of a projected stream of income from use of the property. This present value depends upon not only the magnitude and duration of the projected income stream but also the discount rate used. The higher the discount rate, the lower the present value of the property. (CAL. CODE REGS., tit. 18, § 8(d).) The third method of valuation, the 'cost' approach, looks at the cost of replacing the property less accrued depreciation. (CAL. CODE REGS., tit. 18, § 25(c).)."

[75] Cornia et al., *supra* note 20, at 145.

[76] For more information on property valuation basics, see APPRAISAL INST., *supra* note 40.

[77] This is a significant point of conflict in expert opinions of value, even if the experts use the same base data. *Id.* at 641. For more information on reconciliation, see *id.* at 641–47. *See also* THE APPRAISAL FOUNDATION, UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE 20 (2018) (requiring appraisal reports to be clear, accurate, not misleading and to contain sufficient information).

[78] APPRAISAL INST. *supra* note 40, at 646.

[79] A 1990 study by Virginia Commonwealth University professors found that only 22 states (or their subdivisions) levy any taxes on intangibles. YOUNGMAN, *supra* note 28, at 9 n.23.

[80] *See, e.g.*, DAVID SJOQUIST, A BRIEF HISTORY OF THE PROPERTY TAX IN GEORGIA (2008) (as of 1996, intangible assets are entirely exempt in the state of Georgia); REVENUE & TRANSP. INTERIM COMM., SJ23 STUDY OF TAXATION OF CENTRALLY ASSESSED AND UTILITY PROPERTY DRAFT FINAL REPORT (Mont. 2018) (centrally assessed businesses and utility properties were not being taxed according to state law and the legislature later exempted intangible assets from property taxes).

generic 'intangible asset' category, have caused controversy in the manner of identification and valuation.[81]

Thus, for tax purposes, exempt intangible assets must be separately identified and valued to be properly exempted from tax valuation. At issue are the challenges in identifying, valuing, and exempting intangible assets from property tax of going concern entities. For property tax purposes, taxpayers argue that a larger percentage of value should be removed as intangibles not subject to tax, sometimes a percentage up to 30-50% of value.[82] This is due to taxpayer contention that only "tangible assets" should be valued using the cost approach when the market value of the going concern is so much higher than the tangible assets.[83] Taxpayers then argue that the remainder of value must be "intangibles" exempt from taxation.[84] In contrast, revenue appraisers claim that all value is taxed for property tax purposes, and that any notion of "intangible assets" exempt from property tax are extremely limited, and not properly removed from a unit valuation.[85]

Intangible assets, as a class, are generally exempt from state property tax. Certain intangible assets are specifically listed in various state statutes as exempt from property tax, yet the statutes also allow for other unlisted exempt intangible assets. For example, statutes generally specify that cash on-hand, licenses, and transmission contracts are intangible assets exempt from taxation.[86] However, the value of the depreciated tangible assets plus the easily quantifiable intangible assets is a substantially different (and generally lower) value than the full market value of a particular company.[87] Some intangible assets are not specifically exempted in statute.[88] The true controversy is how broadly the definition and valuation of intangible assets can be applied for tax exemption purposes, and

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81 Unit valuation of centrally assessed properties has engendered much litigation beyond the scope of this Article. For additional discussion of other types of litigation, see *RT Commc'ns, Inc.*, 11 P.3d 915 (Wyo. 2000) (citing Amdur, *supra* note 34); THOMAS H. STEELE & AMY SILVERSTEIN, PROPERTY TAXES: THE EXEMPTION FOR INTANGIBLES (1995).

82 *See, e.g.*, Richard G. Smith, *Is the Unit Approach Viable?: A Legal Perspective*, 10 J. PROP. TAX ASSESSMENT & ADMIN. 45, 53 (2013) (a taxpayer argued that intangibles should not be valued in the appraisal).

83 *Id.*

84 *Id.*

85 *See, e.g.*, CAL. STATE BD. EQUALIZATION, ASSESSOR'S HANDBOOK 150–58 (1998) (intangible property is not included for tax purposes but must be included in the overall assessment).

86 *See, e.g.,* WYO. STAT. ANN. § 39-11-105 (West 2018) (intangible assets are identified and exempted).

87 Marshall Hargrave, *Goodwill*, Investopedia (Apr. 30, 2020) https://www.investopedia.com/terms/g/goodwill.asp.

88 *See, e.g.,* WIS. STAT. ANN. § 70.112 (West 2008) (intangible assets are exempt but specific intangible assets are not specified in statute).

at what point such intangible assets should be removed from valuation for tax purposes.[89]

In sum, the unit value approach rests on the idea that the value of the whole is greater than the sum of its parts; and longstanding precedent indicates this additional amount *is* taxable. However, when some of the "parts" are exempted (removed) from the calculation, there remains a question about what amount is taxable. As an example of how this might work for a particular company, the following scenario is provided. To calculate property tax owed to a state, the going concern value of a multi-jurisdictional electric utility "company" and an allocation of a portion of that value to state X and state Y must be determined. For simplicity, imagine such a "company" operates in two states only.[90] Its electric generation facilities are located in state X and its customer base is in state Y. The full fair market value of the company is 100x.[91] The company pays a variety of taxes, including corporate income tax, sales tax, and property tax, as appropriate, in both state X and Y.

For property tax purposes, the property tax is based on the 'unit value' or fair market value of the entire operation in states X and Y, with a relevant portion allocated to X and to Y. When appraising a property to determine a fair market value, three common approaches to determine valuation of a going concern business are considered: cost (the "sticks and bricks" of a business), income (what income stream can be capitalized to determine what an investor would pay for the company), and sales (comparing sales of similar properties and adjusting the valuation).[92] Both state X and state Y will determine the corporation's fair market value, in theory removing from the valuation any property which is tax exempt. In our example, the company is valued at 100x in a sale or by investors in the market. Those power generation facilities may have a very low book or salvage value, due to depreciation or age, but generate all of the electricity for the very profitable company. Thus, the salvage or book value of the electric generation facilities may be 5x, though the value of the full company is 100x. The remainder of the value of the

89 These additional assets are tracked, for income tax purposes, at the federal, international, and state levels. While those assets are tracked for income tax purposes, such asset allocation does not occur for property tax valuation. Instead, state X values the company at 100x for property tax purposes. The company claims its tangible assets are merely 5x, and that the remaining value (95x) is intangible and exempt from taxation. The taxing authority disagrees that the full 95x is exempt from taxation and litigation ensues.

90 Many companies subject to central assessment operate in multiple jurisdictions, have international holdings, and may have a world-wide presence. While allocation issues also generate litigation, allocation issues are not addressed in this Article.

91 The company value is known because it is publicly traded or a recent sale has occurred.

92 For a basic overview of the methodologies relating to the three indicators of value, see Cornia et al., *supra* note 20. *See also* APPRAISAL INST., *supra* note 40.

company lies is its connectivity to a customer base in state Y, its ability to legally transport electrical service to a customer base in the form of licenses or transmission contracts, its customer base, workforce in place, management structure, goodwill, cash on hand, and any other intangible assets which create profitability for a business.

In state X, the cost approach might be 5x, considering the depreciated value of the tangible assets. As the sales price is 100x, state X might find a fair market value to be 70x, with the appraiser placing the most weight on the sales price and considering that only booked items are exempt from taxation. With the same or similar data, state Y's appraisers might value the company at only 40x, deeming that increased exempt intangible assets, including booked and not-booked goodwill, customer base, and workforce are properly removed from the fair market value for tax purposes. Thus, the same company may pay significantly different property taxes to two neighboring states. This, not surprisingly, generates contentious and costly litigation.

This Article does not argue that property tax litigation can or should be completely eliminated. Revenue department assessors' and taxpayer appraisers' expert judgments on the value of intangible assets will always conflict, and it is critical to have an independent review procedure. Even if the statutory framework was more consistent or precise, taxpayers and the departments of revenue are unlikely to come to complete consensus on valuation for tax purposes. This Article argues, however, that limiting the scope of controversy by requiring specificity for what is defined as an intangible asset exempt from taxation will limit current costly litigation.

## III. DEFINING, VALUING, AND EXEMPTING INTANGIBLE ASSETS

Intangible value has always been a key in multi-jurisdictional company valuation. However, precisely quantifying what might be exempt from taxation has vexed policymakers and appraisers. Generally, property is considered to be any external thing over which the rights of possession, use, and enjoyment are exercised.[93] This can include real property, tangible property, and intangible property. In broad terms, intangible property is property that lacks a physical existence. Intangible property is defined in a variety of contexts including commercial, economic, appraisal, and legal. Examples include bank accounts, goodwill, stock options, and contracts. In a commercial context, definitions for valuation and accounting purposes can be found in Financial Accounting Standards Board (FASB) and International Accounting Standards Board

[93] *Property*, BLACK'S LAW DICTIONARY (11th ed. 2018).

(IASB) publications, various accounting[94] and appraisal[95] practice guides, and most state and federal law for tax[96] and other regulatory purposes.

Intangible assets are tracked, valued, and transferred in global corporations for purposes of sales, sales tax, transfer taxes, corporate income tax, and other valuation purposes.[97] In the last two decades, federal and state income tax laws have allowed for categorization, allocation, amortization, or exemption of intangible assets.[98]

In most states, intangible property is exempt from property taxation.[99] In the real property appraisal community, appraisal value determinations and intangible asset valuation are considered to be largely a matter of professional judgment.[100] The Uniform Standards of Professional Appraisal Practice notes that "[w]hen personal property, trade fixtures, or intangible assets are included in the appraisal, the appraiser must analyze the effects on value of such non-real property items."[101] National appraisal standards do not require a specific allocation between tangible and intangible assets, yet many appraisals submitted for financial and governmental reporting, including taxation, require a specific allocation of intangible and tangible assets within a valuation determination.[102]

In litigation, taxpayers' appraisers have argued that all "intangibles" are exempt, and thus only tangible assets are subject to property tax. Conversely, regulators' assessors argue that an extremely limited set of assets (those listed and capable of separate ownership) are the only intangible assets exempt from tax. State legislators as policymakers have provided insufficient specificity to prevent consistent and expensive litigation. The policymakers have neither narrowed the broad definitional

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94 *See, e.g.*, IAAO SPECIAL COMMITTEE ON INTANGIBLES, UNDERSTANDING INTANGIBLE ASSETS AND REAL ESTATE: A GUIDE FOR REAL PROPERTY VALUATION PROFESSIONALS 1 (Nov. 12, 2016), https://www.iaao.org/library/2017_Intangibles_web.pdf. *See also* APPRAISAL INSTITUTE, *supra* note 40.

95 *See* APPRAISAL INST., *supra* note 40.

96 *See*, *e.g.*, 26 U.S.C. § 197 (2018) (federal rules relating to amortization of certain intangible assets).

97 Consider the OECD Transfer Pricing regime as an example. Various jurisdictions subscribe to a coordinated valuation approach via the transfer pricing regime and processes set out in tax treaties. For more information, see OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017).

98 *See, e.g.*, 26 U.S.C. § 197 (2018).

99 The exemption occurs in either the Constitution (such as California and Utah), or by statute (such as Montana and Wyoming).

100 But also note that disputes of fact in litigation are often subject to expert opinions. This Article attempts to provide some methods judicial officers to analyse evidence and consider relevant factors for weighing the value of differing opinions.

101 APPRAISAL INST., *supra* note 40, at 703.

102 *See id.* at 62–63.

legislative structure, nor supported either the taxpayers' or revenue departments' positions.

Courts in various cases have upheld the use of the unit valuation method with some level of enhanced value from intangible assets not subject to property tax.[103] The extent to which the fair market value has properly reflected intangible assets as part of the valuation is consistently litigated, as courts have also rejected inclusion of certain intangible assets deemed to be exempt from taxation.[104] To date, state tax judges weight the credibility of the appraisers in determining a fair market value, rather than requiring taxpayers to bring proof of tax exempt property.[105]

## IV. JUDICIAL SOLUTION TO CONTROVERSY TOO BROAD

The failure of state policy and law to require specific evidence to identify, value, and exempt intangible assets from unit valuation drives frequent and expensive state property tax litigation. Such property tax conflicts leave many western states such as Wyoming, Montana, Utah, and Oregon with ongoing local and state budgetary shortfalls.[106]

While each state has a different process for tax appeals, the property tax appeal process generally directs those conflicts to tax boards with appeal rights to state courts of general jurisdiction.[107] State judges are presented with fairly settled legal theory relating to unit value and exempt intangible assets; however, the courts have little guidance in how to determine the numerical specificity and nuances of setting value for specific intangible assets, and how to practically remove exempt assets from a multi-billion dollar valuation of a multi-state entity in its entirety.[108]

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[103] *See, e.g.*, ITT World Commc'ns, Inc. v. County of Santa Clara, 101 Cal. App. 3d 246 (1980), Fla. E. Coast Ry. Co. v. Dep't of Revenue, 620 So. 2d 1051 (Fla. Dist. Ct. App. 1st Dist. 1993), Mich. Wis. Pipe Line Co. v. Iowa State Bd. of Tax Review, 368 N.W.2d 187 (Iowa 1985), Mich. Bell Tel. Co. v. Dep't of Treasury, 518 N.W. 2d 808 (Mich. 1994). In Colorado, part of the value of affiliated entities was allowed in unit valuation. *See generally* United Parcel Serv. of America, Inc. v. Huddleston, 981 P.2d 223 (Colorado Ct. App. 1999).

[104] *See* Shubat v. Sutter Co. Assessment Appeals Bd., 13 Cal. App. 4th 794 (1993); Burlington N. R.R. Co. v. Bair, 815 F. Supp 1223 (S.D. Iowa 1993) (upholding violation of the 4–R Act, 49 U.S.C. § 11503); Boise Cascade Corp. v. Dep't of Revenue, 12 Or. Tax 263 (1991); Beaver Cnty. v. Wiltel, Inc., 995 P.2d 602 (Utah 2000).

[105] *See* Caracci v. Comm'r, 456 F.3d 444 (5th Cir. 2006); *see also* Appeal of Net Realty Holding Tr., 519 A.2d 313 (N.H. 1986).

[106] *See* Fredrick Nicely et al., *The Best and Worst of International Property Tax Administration*, COUNCIL STATE TAX'N (Sept. 2014), https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/the-best-and-worst-of-international-property-tax-administration—-scorecard.pdf.

[107] *See, e.g.*, *Board of Property Tax Appeals (BoPTA)*, WASH. CNTY. OR. (Sept. 2 2020), https://www.co.washington.or.us/AssessmentTaxation/AppraisalAppeals/PropertyTaxAppeals/board-of-property-tax-appeals.cfm

[108] IAOO, *supra* note 94.

State courts are composed of judges in general jurisdiction courts, with little depth of tax litigation experience. Multi-jurisdictional property tax cases come with years of trial preparation, a week or more of trial, multiple financial experts, thousands of financial documents, and many nuanced financial arguments about income capitalization models and the difference in determining the proper inputs for the yield capitalization model.[109] The valuation differences are often in the billions of dollars, but the litigation revolves around specific valuation of complex subpieces of the market.[110] Courts of general jurisdiction have no appetite for complex tax cases and often issue decisions lacking precedential value that would help to prevent future litigation.[111]

While state courts are required to set a specific taxable value in their decisions, those state courts are further limited by the complex appraisals provided to them, a lack of data, and taxpayers' and revenue departments' failure to provide sufficient accounting and income tax information to determine which intangible assets are already categorized, tracked, and valued within the company.[112] This conundrum allows for ongoing and unnecessary litigation and reinforces a general jurisdiction judge's abhorrence of tax matters. While court decisions have provided a fair market value as a form of equity decision-making, those same decisions often fail to provide a sufficient rule or standard that can be applied to future valuation matters.

### A. *State Court Use of the Term Enhancement*

In judicial decision-making, state courts have not consistently sided with either the taxpayers or the regulators in determining valuation of centrally assessed property. Instead, courts have found a "middle ground" often finding a value between that presented by the taxpayer and that presented by the revenue department.[113] Several state judicial bodies and courts have embraced the term "enhancement" to address this value difference between tangible assets, knowable or concrete intangible assets, and the valuation of the total company.

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[109] *See, e.g.*, N.Y.S. Dep't. of Taxation and Finance, UNIF. ASSESSMENT STANDARDS (Dec. 28 2015), https://www.tax.ny.gov/research/property/reports/ratio/uniformassmntstd/valuation.htm.

[110] YOUNGMAN, *supra* note 28, at 8.

[111] As an anecdote, the author has heard two state general jurisdiction judges say to litigants that they would do anything to never hear another tax case in their judicial careers.

[112] James J. Tucker, *The decision to litigate: a choice of forum*, CPA J. ONLINE (Feb. 1993), http://archives.cpajournal.com/old/13808649.htm.

[113] *See, e.g.*, Jeff Martin, *Draft Overview Of Selected States Methods For Valuing Centrally Assessed Property*, REVENUE & TRANSP. INTERIM COMM. (Dec. 2011), https://leg.mt.gov/content/Committees/Interim/2011-2012/Revenue-and-Transportation/Meeting-Documents/December%202011/unitaryassess_otherstates_nov2011.pdf.

The term "enhancement" appears in state tax court cases from Wyoming, Utah, California, Montana, and Kansas.[114] The key concept behind the judicial term enhancement is both that the use of unit valuation is proper, and that certain intangible assets are exempt from taxation.[115] Thus, the fair market value of a going concern entity *minus* the value of defined tangible and intangible assets *equals* an enhancement value.[116] State courts hold that the "enhancement value" is properly subject to taxation.[117] The term enhancement is used when a fair market valuation is set, but the value includes some type of value above exempt intangible assets and tangible assets.

Courts have attempted to draw some type of distinction between some exempt intangible assets which may be removed from valuation, and other intangible "enhancements" which can affect valuation, such as view shed or prime corner location.[118] The courts seem to find these taxable intangible "enhancements" are perhaps intangible values but the enhancements are not able to be separately valued or identified to be exempted from property tax. Judicial use of the concept of enhancement appears to be the direct result of both taxpayers and revenue departments failing to present comprehensible and comprehensive satisfactory evidence relating to defining and describing tax-exempt intangible assets.[119]

While use of the term "enhancement" allows the court to issue a decision in a particular case, this Article argues that "enhancement" is too broadly used, and thus provides no assistance to settle future tax valuation challenges. The court's equitable determination of an ultimate value for tax purposes may be a correct fair market valuation and makes for an equitable decision in a particular matter, but reference to "enhancement" is not sustainable or replicable.[120]

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114 *See id.* at 12; GTE Sprint Commc'ns Corp. v. County of Alameda, 26 Cal. App. 4th 992, 992–995 (1994); Appeal of W. Res., Inc., 919 P.2d 1048, 1049 (Kan. Ct. App.1996); Robertus v. Candee, 670 P.2d 540, 543 (Mont. 1983); *RT Commc'ns, Inc.*, 11 P.3d at 925.

115 *See id.* at 992.

116 *See id.* at 916.

117 *See id.* at 917.

118 *See* DuPage Co. v. Ill. Property Tax Bd., 708 N.E. 2d 525 (Ill. 1999).

119 *RT Commc'ns, Inc.*, 11 P.3d 915; Beaver v. Wiltel, 995 P.2d 602 (Utah 2000).

120 While state courts have provided unsatisfactory court decisions to reconcile unit valuation and removal of to continue to litigate at a high cost to the taxpayer, the state, and the public. *See, e.g.*, Dep't of Revenue v. PPL, 558 P.2d 454, 457 (Mont. 1976); *Beaver*, 995 P.2d at 609; *RT Commc'ns, Inc.*, 11 P.3d 915; *Elk Hills Power, L.L.C*, 304 P.3d at 1056; Gold Creek Cellular of Mont. v. Dep't of Revenue, 310 P.3d 533, 536 (Mont. 2013); MONT. CODE ANN. § 15-6-218; CAL. REV. & TAX. CODE §§ 110, 212; UTAH CODE ANN. § 59-2-1101 - § 57-7-101; WYO. STAT. ANN. § 39-11-101, § 39-15-101, WASH. REV. CODE § 84.36.070. *See also* Stromnes, *supra* note 2; Washington Tax Fairness Coalition report (2008) (reporting exemption of intangible assets roughly matching funding for Washington public schools); Washington Department of Revenue, Property Tax Exemption of Intangible Assets, Report of the Department of Revenue (Dec. 2000).

For example, in 2013, the Wyoming Supreme Court articulated a fairly broad vision of enhancement value in state property tax of a centrally assessed property. The court in *RT Communications*,[121] took a liberal view of "enhancement value," noting the Wyoming Department of Revenue treatment of intangibles, including an "acquisition adjustment," does not amount to direct taxation of intangibles.[122] The court cited several law review articles discussing the impossibility of distinguishing intangible rights from tangible rights,[123] and ultimately found that the Board did not err in determining the intangibles "were merely considered by the Department in enhancing the value of Petitioner's property."[124] Such a liberal view of enhancement value allowed the court to restrict exempt intangible assets from taxable value, concluding with the following:

> The unitary method is a rational means of determining the fair market value of a public utility. Intangible personal property, although generally exempt from taxation, may be considered in valuing utility property to the extent that the property enhances the value of the taxable, tangible property. This is an appropriate methodology to determine the fair market value of utility property. However, the Department of Revenue shall, to the extent possible, remove the value of intangible personal property that is separable and identifiable.[125]

The Court later held that the burden of proving exempt intangible assets fell to the taxpayer.[126] In a later case, *Airtouch Communications*, the Wyoming Supreme Court noted that even if the intangible assets at issue were intangible property validly exempt from taxation, the burden fell on the taxpayer to prove the value of that property was identifiable and separable from the enhanced value of the business determined through the unitary method.[127]

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121 *RT Commc'ns, Inc.*, 11 P.3d at 920–23.

122 *Id.* at 925.

123 *See* Amdur, *supra* note 34; U.S. Transmission Sys., Inc. v. Bd. of Assessment Appeals, 715 P.2d 1249 (Colo. 1986).

124 *RT Commc'ns, Inc.*, 11 P.3d at 923.

125 *Id.*

126 *Id.*

127 Airtouch Commc'ns, Inc. v. Dep't of Revenue, 76 P.3d 342, 356 (Wyo. 2003) at ¶ 38, noting that the taxpayer had the information when they filed their annual report to the DOR, as well as to the SEC, but then didn't give it to DOR until a year after certification. Also, note the extensive discussion about the customer list information also not being provided. The Wyoming Department of Revenue makes an "economic enhancement adjustment" to reflect that the rate of return received by the taxpayers was higher than the capitalization rate for the cellular industry in general.

As a comparison, Utah state regulations take a more conservative view of enhancement and an expansive definition of exempt intangibles.[128] However, even with Utah's specific identification, valuation, and removal of intangible assets, the concept of enhancement has a place in unit valuation. Utah courts still note that some type of enhancement exists in fair market valuation for property tax purposes. For example, in *Beaver County v. Wiltel*, the Utah Department of Revenue taxed Wiltel, a provider of long-distance telecommunication services under the central assessment statutes, requiring a unit value method, because it operates "as a unit across county lines."[129] Utah law considers intangible property, intangible assets, and intangibles as synonymous, and all intangibles are tax-exempt.[130] While the Commission, upholding the taxpayer's argument, attempted to include only intangible assets which can be separately owned, the Utah Supreme Court disagreed.[131]

The Utah Supreme Court acknowledged the "enhanced value" concept and noted that "even excluding intangibles, the network structure of Wiltel's physical transmission facilities makes them worth far more on the open market than mere wires, trenches, and transformer stations could command."[132] The court further noted that fair market value reflects the benefit stream created by unitary operations of tangible property and that the statutory and constitutional fair market value requirements recognize some element of value that is not "attributable to either intangibles or simple cost and that this enhanced value is taxable."[133]

Under the Utah Constitution, however, if property is taxed under the property tax statutes, then the income cannot subsequently be taxed.[134] In the later *T-Mobile* case,[135] the Supreme Court specifically endorsed the

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128 *See T-Mobile USA, Inc.*, 254 P.3d at 761–63 (rejecting an interpretation of enhancement value that included non-property intangibles).

129 *Beaver*, 995 P.2d at 604.

130 *Id.*

131 The parties consistently disagreed about the application of the unit value rule and the exemption of intangible assets. Because, the parties failed to provide (comparable, agreed, reasonable) valuation to the Commission, the Commission's "final decision attempted to balance removing the intangibles and capturing the enhanced value of tangibles operating as a unit by 'using a yield capitalization approach minus any growth factor and a time-adjusted historical cost indicator.'" *Id.* at 605.

132 *Id.* at 610.

133 *Id.* at 611 (upholding the Commission ruling that it is not required to assess merely using a cost basis).

134 UTAH CONST. art. XIII, § 2, cl. 5.

135 *See generally T-Mobile USA, Inc.*, 254 P.3d 752. The counties challenged the Commission's assessment on four grounds. The Utah Supreme Court upheld the Commission's findings. The tax court concluded that two of the appraisals provided to the court were incorrect, and thus the court was required to rely on two non-erroneous appraisals, and ultimately found the value of the company to be a blended value of these two appraisals. The court also exempted accounting goodwill from taxation, based on a review of Utah law. The 1998 Utah

concept of enhancement, noting that, to the extent T-Mobile's goodwill account included enhancement value, value would be captured through the valuation of the tangible property itself.[136]

In California, an enhancement doctrine has essentially been codified into California law in Revenue & Tax Code Section 110.[137] The relevant section states: "[t]axable property may be assessed and valued by assuming the presences of intangible assets or rights necessary to put the taxable property to beneficial or productive use." Prior to the statute, the breakthrough California case of *ITT World Communications v. County of Santa Clara* stated, "while intangible property is exempted from property taxation, such property may enhance the value of taxable tangible property, and this effect may be reflected in valuation of tangible property."[138] Subsequent cases supported the enhancement doctrine, which the legislature eventually codified.[139]

### *B. Judicial Use of Enhancement is Too Broad to Curb Future Litigation*

As demonstrated, the judicial use of the "enhancement" concept allows courts to acknowledge some enhanced value of a company above the defined tangible and intangible assets described in tax law. While the theory of "enhancement" is a useful concept, the use of the enhancement theory can and should be greatly narrowed to provide more direction to future litigants and limit costly litigation. This can be done by requiring specificity in identifying, defining, and valuing intangible assets. If state courts required more specificity from evidentiary presentations, the use of the judicial concept of enhancement would cause less ongoing litigation.

Taxpayers generally advocate for a unit valuation using only a stripped down cost approach, focusing on the tangible assets.[140] Revenue departments, in contrast, focus on valuation using an income stream ap-

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Act defines exempt intangible property as "property that is capable of private ownership separate from tangible property . . ." The statutes for exempt goodwill were subsequently changed in 2006 to include goodwill as a separate category. The court notes that the goodwill was not exempt as of the 1998 statute, and thus can be taxed for property tax purposes.

136 *Id.* at 764. Note that, again, the tax court is forced into an enhancement value because both parties failed to bring reasonable valuations to the court, thus leaving the court with no option but to create its own value.

137 CAL. REV. & TAX. CODE § 110(e) (West 2020).

138 *ITT World Commc'ns, Inc.,* 101 Cal. App. 3d at 254. For an expansive discussion of intangibles and property tax in California, *see generally* STEELE & SILVERSTEIN, *supra* note 81.

139 *See, e.g.*, *Shubat*, 13 Cal. App. 4th at 805-08; County of Orange, 13 Cal. App 4th at 534; L.A. SMSA Ltd. v. State Bd. of Equalization, 11 Cal. App. 4th 768, 781 (1992).

140 *See, e.g.*, *L.A. SMSA Ltd.*, 11 Cal. App. 4th at 774–75 (tax-payer petitioner arguing for the assessment of only tangible property); *Beaver Cnty.*, 995 P.2d at 604 (tax-payer petitioner arguing against the assessment of intangibles).

proach or sales comparison approach, which include all manner of intangible assets.[141] Essentially, judges are reconciling these two revenue department approaches (income stream and sales comparison), finding a value somewhere between the two values, and labeling any difference between this result and the taxpayer's cost approach as a form of "enhancement" or enhanced value above the tangible asset value. While equitable, reasonable, and useful for devising a solution in litigation, such decisions fail to provide certainty to future litigants.

The judicial use of enhancement parallels the concept of reconciliation in appraisal methodology. Reconciliation, as noted previously, is a process of resolving the differences between two value indicators and requires appraiser judgment.[142] The reconciliation process is not formulaic and far from a mere average of the valuation figures calculated according to two (or more) approaches to value. Rather, the reconciliation must consider the strengths and weaknesses of the various approaches to value and use appraiser judgement to determine a final opinion of value. This is, of course, similar to a judicial decision which does not fully endorse either the valuation of the taxpayer or the valuation of the revenue departments.

As a broad measure, the general failure to endorse either taxpayer or revenue department positions fails to provide guidance to any future litigants. The judiciary uses the term "enhancement" to describe the incorporation of taxable value not otherwise described in statute. While enhancement properly reflects the balance between exempt intangible property and a unit valuation, it provides no legal theory or framework to prevent future litigation; it is merely a notion of equity describing a valuation decision that sits between the value requested by the taxpayer and that requested by the revenue departments.

In many cases, the judge's reference to enhancement provides an understandable valuation decision. However, decisions using enhancement as a justification can also be internally inconsistent. Because enhancement is a catchall term, it fails to adequately address the process of describing and exempting intangible asset value from fair market value. The California *Elk Hills* litigation demonstrates how the judicial use of enhancement can be internally inconsistent.[143] In *Elk Hills*, the decision failed to provide guidance to future litigants, but also failed to provide direction to the court on remand.[144]

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141 *See, e.g.*, *Elk Hills Power, LLC*, 304 P.3d at 1058 (Assessment board used income-capitalization approach); Bd. of Educ. of Ridgeland v. Prop. Tax Appeal Bd. 975 N.E.2d 263, 265 (Ill. App. Ct. 2012). ("the sales-comparison approach I the preferred method. . . .").

142 APPRAISAL INST., *supra* note 40, at 642.

143 *See Elk Hills*, 304 P.3d at 1069.

144 Some state valuation cases involve only one method of valuation, often the cost approach. *See, e.g.*, *T-Mobile USA, Inc.*, 254 P.3d at 766. (historic cost approach directly follow-

Elk Hills Power, LLC, the owner-operator of a power generation facility, challenged the taxation of emission reduction credits in its valuation for property tax purposes.[145] The lower tax appeal board, as finder of fact, used two different methods to value the subject property: a replacement cost approach and an income approach.[146]

The California Supreme Court held in *Elk Hills* that, under the replacement cost approach, the Board was required to deduct the market value of emission reduction credits (ERCs) from the assessment as required by statute.[147] However, under an income capitalization approach, the Court held that the Board was not required to attribute a portion of the power plant's income to ERCs and deduct that amount from the plant's projected income stream; and, finally, ERCs were not subject to assessment as intangible attributes of real property that related directly to the real property involved.[148]

California has a long and rich history of law relating to the nuances of valuing intangible assets for tax purposes generally. California's constitution prohibits taxation of intangible property.[149] Additionally, by statute, California prohibits the direct taxation of certain intangible assets and rights, including the emission reduction credits at issue in the *Elk Hills* case.[150] However, in assessing taxable property under Section 110(e), the Board may "assum[e] the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use."[151] In valuing these types of multi-jurisdictional properties, buyers and sellers are most concerned with a corporate going concern value calculated based on a standardized income stream.[152] Specifically, buyers consider what income stream is in place currently and what income stream is available in the future. The valuation of the income stream can only be considered when a willing buyer can review the books of the corporation and understand the regulatory scheme, what income generation and allowances other regulators (such as FCC or PUCs) have allowed, and the value of the tangible and intangible assets for depreciation

ing sale); *RT Commc'ns, Inc.*, 11 P.3d at 919 (historic cost approach following sale). The California appraisal manual prohibits the addition of intangible assets to the cost approach, and the court categorically states that, in failing to deduct the fair market value of the ERC's, the Board directly taxed Elk Hills' intangible property rights in violation of section 212(c). *Elk Hills*, 304 P.3d at 1066.

[145] *Elk Hills*, 304 P.3d at 1052.

[146] *Id.* at 1056.

[147] *Id.* at 1066.

[148] *Id.* at 1052.

[149] CAL. CONST. art. XIII, § 2.

[150] *See Elk Hills*, 304 P.3d at 1052.

[151] CAL. REV. & TAX. CODE § 110(e) (West 2020).

[152] In comparison, the fair market value of a residential property is typically derived not from income stream, but from the value of its use as a home.

purposes (affecting income stream). No purchase will happen without significant review and analysis of income data, often through third parties hired solely for valuation by both sellers and buyers.[153] Thus, for property tax purposes, sales value is especially relevant and accurate. An independent sale of the going concern exactly meets the fair market value as determined by a willing buyer and willing seller.[154]

For tax purposes, an appraiser correlates or reconciles those cost, income, and market indicators of value. In *Elk Hills*, the court directed that one approach to value remove intangible assets and the other approach to value did not.[155] Thus, correlation is then impossible.

The *Elk Hills* holdings directly highlight the essential conflict of reconciliation as it relates to exempting intangible assets from taxation. As a cost approach is merely the depreciated tangible assets, while the income approach includes all valuable assets (tangible and intangible). The approaches to value are fundamentally different, and any averaging or balancing of those approaches cannot be designed to account for accurately including or excluding specific assets for property tax purposes.[156] Thus, though the *Elk Hills* court recognizes that accounting only for tangible assets will not create the full fair market value, and that the full market value includes exempt intangible assets, the court nonetheless provides no direction on reconciling these two methods when it remands the case to the lower courts.[157] Hence, the *Elk Hills* case upholds the current unit value legal framework, but provides no implementation direction for exempting intangible assets not subject to tax.

Further, the *Elk Hills* court makes an artificial distinction between ERCs and "intangible assets that the plaintiff requested to be removed including 'customer base; assembled workforce; favorable broadband leases of transmission capacity from other carriers; favorable property leases; advertising agency relationships; favorable debt financing contracts; inventory of advertising materials' and goodwill."[158] There is little justification to make such a distinction. In point of fact, the accounting distinctions lead in favor of finding a specific value for the ERCs, as noted in the discussion relating to federal definitions of intangible assets.[159] Unlike several items on the court's list, the ERCs have a value on

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153 *See* Jackson Gore Inn v. Town of Ludlow, 228 A.3d 643, 658 (Vt. 2020).

154 *Id.*

155 *See Elk Hills*, 304 P.3d at 1067.

156 In one sense, such approximation is exactly the concern with judicial use of enhancement. Montana attempted to exempt an average percentage of intangible assets, which was struck down by the court in *Gold Creek Cellular v. Montana Department of Revenue.* Gold Creek Cellular of Mont. v. Montana 310 P.3d 533, 538 (Mont. 2013).

157 *Elk Hills*, 304 P.3d at 1069.

158 Exempt from taxation as intangibles under CA statute 107.7(d). *Id.* at 1068.

159 *Id.* at 1060.

a secondary market, and they can be valued and likely depreciated by the business both for "net books value" and for federal income tax purposes.

Unfortunately, while the California Supreme Court addressed the conflicting nature of unit valuation and intangible property, it ultimately failed to provide any guidance as to how to reconcile the cost approach (without intangible assets calculated within the value) and income method (which includes tangible and intangible assets) in valuing the property for tax purposes.

As a second point, there is no discussion provided as to why specific ERCs or other intangible assets are included or excluded as exempt intangible assets. Thus, the *Elk Hills* court decision remands the case to the lower court, yet the court failed to provide direction in defining, valuing, and exempting intangible assets.[160] Instead, the court merely remands the matter to the lower court to make valuation decisions based on inconsistent indicators of value.[161] The decision in *Elk Hills* is the most stark example of problematic judicial decision making as it relates to exemption of intangible assets, and highlights the concerns with lack of specificity.

## V. USING THE BURDEN OF PROOF TO REDUCE LITIGATION

The term "enhancement," in practice, is too broad to curb litigation; it does not fit the need for consistency, specificity, and administrability. This Article argues that enhancement, as currently used by state courts, provides insufficient direction to prevent future litigation over intangible assets. In fact, intangible assets exempt from property tax can be more precisely identified, calculated, and removed from taxable value. Specifically, better use of procedural rules of litigation will limit the litigation controversies.[162] This Article suggests that courts can and should require evidence relating to specific and defined valuation of exempt intangible assets; and the proper burden of proof for such submissions rests on the taxpayer. By properly requiring taxpayers to more precisely quantify exempt intangible assets, litigation will be more properly focused, reducing compliance costs for both taxpayers and jurisdictions. To do so, implementing the proper burden of proof is consistent with general tax law principles, as well as federal and state income tax law. It is not a burden

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[160] *Id.* at 1069.

[161] *Id.*

[162] While the best solution for this controversy is for policy makers to directly address the policy conflict between use of unit value and proper identification and removal of exempt intangible assets, state legislators have done little to even mitigate the conflict in the past several decades. Thus, complex property tax litigation will continue to be heard by general jurisdiction judges.

to taxpayers as it merely requires that the parties provide evidence already available to taxpayers.

### A. *Income Tax Law and its Treatment of Intangible Assets*

Implementing definitional stability from federal and state tax laws can help general jurisdiction judges evaluate and better manage identification and subsequent valuation of exempt intangible assets in state property tax litigation.

When the railroad cases were first brought to the U.S. Supreme Court, no distinction was made between property tax and income tax treatment of intangible assets, as there were no federal income tax laws.[163] Since that time, the legal strands have diverged. In state property tax, valuation is performed at a state or local level, with any review option specific to the jurisdiction.[164] Thus, property tax valuation and subsequent legal review are quite specific to an individual jurisdiction, which need not look beyond its own borders. The decision makers are courts of general jurisdiction, and part of an independent state judicial authority.[165] There has been little if any reason for consistency amongst and across jurisdictions.

Definition and valuation for income tax purposes, however, has developed from federal statute and regulations, with judicial review to a centralized and specialized federal tax court. Those federal tax law definitions generally flow to state tax law, as federal income tax law is often the basis for state income tax rules.[166] While states may have some inconsistencies in applying federal income tax rules, the federal rules, for the most part, provide a consistent platform for definitional certainty and settled methodology for valuation. In part, this is due to the centralized income tax system at the federal level. There is a centralized federal definition and rule set that is ultimately applicable to all businesses operating in the United States.[167] State income tax law, while theoretically independent of federal law, generally draws on federal law and federal returns for the basis of taxation.[168] Therefore, in practice, there is a general

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[163] Taylor v. Secor, 92 U.S. 575, 616 (1875).

[164] *See, e.g.,* OFFICE OF REAL PROPERTY TAX SERVICES, N.Y.S. DEP'T TAX & FIN., https://www.tax.ny.gov/pdf/publications/orpts/grievancebooklet.pdf.

[165] *Id.*

[166] Walter Hellerstein, *Selected Topics in State Business Taxation*, 39 VAND. L. REV. 1033, 1038–41 (1986).

[167] *Id.*

[168] Even when states deviate from federal law, the basis for taxation generally derives from federal rules defining gross income. For some discussion about federal and state conformity, loss of autonomy for state taxation, and compliance benefits for taxpayers, see Walter Hellerstein, *Selected Topics in State Business Taxation*, 39 VAND. L. REV. 1033, 1038–41 (1986).

commonality of definitional usage in income tax across both state and federal tax jurisprudence.[169]

The federal standards used in depreciation of intangible assets in the income tax context were developed more than twenty-five years ago.[170] The development of federal laws, rules, and case law—as well as considerable legal scholarship on the subject—over this long period means that the status of reportable depreciable intangible assets is stable; moreover, valuations of such assets are already booked and reported for income tax purposes by every centrally assessed business subject to property tax.

From a legal perspective, definitions of intangible assets in federal and state income tax law are fairly well settled. As of 1993, the federal tax code allows taxpayers to depreciate certain booked intangible assets.[171] The federal statute provides a general definition of intangible assets which allows booked goodwill, going concern, workforce in place, information base, patents, customer based intangibles, certain licenses, permits, and covenants not to compete to be amortized for depreciation over a fifteen-year schedule.[172] Other financial interests, certain computer software, and interests in corporations cannot be depreciated.

Since the implementation of Section 197 in 1993,[173] corporations have been tracking and depreciating a variety of intangible assets. Since implementation, the statutory section relating to depreciation of intangible assets has been amended.[174] Both taxpayers and the federal government have robustly litigated definitions and valuation of intangible assets subject to capital asset treatment.[175] Further, proper treatment of the broader intellectual property discussion generates legal, academic, litigation, and transactional analysis on an on-going basis.

From a practical perspective, business tax lawyers and corporate accountants are already intimately familiar with federal and state income

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169 This Article is not arguing for a federalist approach; instead, it urges consistency based on the definitions already in place for taxation in the federal and state level.

170 *See e.g.,* 26 U.S.C. § 197 (2018).

171 The IRS, after the 1993 federal legislative change, allowed for acceleration of depreciation on purchased intangibles under Section 197 of the Internal Revenue Code. *See* 26 U.S.C. § 197(f)(7) (2018).

172 26 U.S.C. § 197(d)(1) (2018).

173 *See* 26 U.S.C. § 197 (2018) (amending Pub. L. 103-66, Title XIII, §13261(a) (1993)).

174 PL 108-357 (2004) amended two sections of the law, indicating active review by Congress.

175 Litigation has occurred relating to section 197 of the Internal Revenue Code. A sample of the cases includes: valuation of a subscriber base and purchase price allocation (Meredith Corp. v Comm'r, 102 T.C. 406 (1994); covenants not to compete (Frontier Chevrolet Co. v Comm'r, 329 F.3d 1131 (Cal. 2003); Recovery Group, Inc. v. Comm'r, 652 F.3d 122 (1st Cir. 2011), and related decisions; Becker v. Comm'r, T.C. Memo 2006-264 (2006)); intangible assets of proprietorship (Broz v. Comm'r, 137 T.C. 46 (2011); Rudnick v. Comm'r, T.C. Memo 2009-133 (2009)); and customer-based intangibles (Wind I Owner Lessor v. United States, 897 F.3d 1365 (2018)).

tax codes for business income, including intangible assets. The federal tax code provides accounting certainty to business structures, even in areas with uncertain rules, because identification and valuation for reporting purposes occurs every year.[176] Thus, while identifying and valuing intangibles lacks specificity in property tax, identifying those intangible assets is relatively straightforward in reporting on federal and state income tax forms.

Further, if intangible assets are properly and consistently identified and valued and then proffered to the decisionmaker as exempt from property tax, then removal of those exempt assets eliminates the reconciliation issues this Article identifies in the *Elk Hills* case. Specifically identified exempt property can be removed from either each approach to value, or removed after reconciliation, with the same mathematical effect.

### *B. Limitations of Federal Statutory Definitions No Barrier*

This Article does not contend that identifying and tracking intangible assets is simple or without substantial complexities and challenges. Indeed, the opposite is true. Large corporations spend a great deal of time and effort on identifying and tracking both tangible and intangible assets for a variety of valuation and regulatory purposes, subject to the competing desires and regulatory structures of shareholders, securities regulators, public utility regulators, and tax departments.[177] While federal tax return information is confidential under law, the relevant documents are available to state regulators through tax sharing agreements.[178] Alternatively, the base financial and audit documentation is also available to state regulators.

Taxpayers may argue that not all intangible assets exempt under property tax laws are categorized for depreciation purposes under Section 197 of the Internal Revenue Code.[179] Most prominent in this categorization are self-created intangible assets. Certain self-created intangible assets are unavailable for depreciation whereas booked intangible assets

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[176] *See, e.g., Guide to Understanding the Property Tax Process*, HARRIS CNTY. APPRAISAL DIST., https://hcad.org/hcad-help/hcad-understanding-the-property-tax-process/guide-to-understanding-the-property-tax-process/.

[177] While not a focus of this Article, there is a variety of publicly available information about the valuation of publicly traded companies as required by the SEC and/or state disclosure laws. For a discussion of the historical effects of such disclosure, see Richard D. Pomp, *The Disclosure of State Corporate Income Tax Data: Turning the Clock Back to the Future*, 22 CAP. U. L. REV. 373 (1993).

[178] I.R.C. § 6103(a) (2018) (noting tax return information is confidential). For a discussion of tax disclosure, *see* Pomp, *supra* note 177 at 424. *See also* Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 U. KAN. L. REV. 1065, 1144 (2002–03) (arguing for increased reporting of tax compliance matters).

[179] I.R.C. § 6103(a)–(b).

are depreciable if a taxpayer acquires them through purchase.[180] For example, purchased intangible assets might include certain types of purchased software but not self-created software.

U.S. Treasury Regulation 1.167(a)-3 states that "an intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation . . . No deduction for depreciation is allowable with respect to goodwill."[181] Further, certain licenses, trademarks, copyrights, franchises, FCC licenses, and other intangible assets may have value, but may or may not be recorded for depreciation purposes.[182]

Several policy options arise to address those intangible assets not identified and valued for depreciation under federal tax law. First, states can merely require that taxpayers, for reporting purposes, mirror the identification and valuation noted in the federal tax reporting, whether it be for depreciation purposes, transfer pricing purposes, or other reporting reasons. This is the simplest tax reporting position, because federal tax law is the basis for much of the state income tax law.[183] From a policy perspective, the state property tax policy makers can be assured that the identification and valuation is vetted according to rules established by more than twenty years of tax filings and policy. Compliance costs for both taxpayers and revenue departments would be the lowest with this option.

Second, treatment of intangible assets can be handled in ways other than those noted under current federal law. Taxpayers successfully lobby for tax changes each year, and it would be more efficient to lobby Congress to expand the amortization schedule than to have differing definitions of exempt intangible assets in each state's property tax laws. If taxpayers contend that intangible assets such as goodwill not booked and self-created software are unfairly treated because they are not quantified for tax exemption, those taxpayers can report the asset as set out in transfer pricing laws or lobby for a change in state and federal law.[184] For example, in 2015, the Australian government announced legislative changes to the depreciation of intangible assets as part of its National Innovation and Science agenda.[185] Under these changes, businesses can self-assess the tax-effective life of acquired intangible assets—such as patents—to better align the tax treatment of the asset with the actual number of years it provides an economic benefit, and continue to have

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180 *Id.*

181 26 CFR § 1.167(a)(3); Except when booked; *see* I.R.C. § 197.

182 I.R.C. § 197(d)(1).

183 Hellerstein, *supra* note 60, at 1038.

184 See, for example, Australia's treatment of self-created software tax for fairness.

185 AUSTRALIAN TAXATION OFFICE, INTANGIBLE ASSET DEPRECIATION, https://www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-for-businesses/Intangible-asset-depreciation/.

the option to use the existing statutory effective life to depreciate intangible assets.[186]

As a legislative change, states could provide for limited expansion to the definitions in Section 197 to include non-booked goodwill or other intangibles not currently depreciable under federal law.

As an alternative legislative option, legislators and policy makers could create their own more specific definitional structure for intangible assets exempt from property tax. As an example, a working paper prepared by the International Association of Assessing Officers (IAAO) Special Committee on Intangibles puts forth a definitional structure that the IAAO argues solves the majority of intangible asset valuation problems.[187] Specifically, the paper provides a four-part test to determine when an asset is an intangible asset.[188] First, an intangible asset should be identifiable.[189] Second, an intangible asset should have evidence of legal ownership (that is, documents that substantiate rights).[190] Third, an intangible asset should be capable of being separate and divisible from the real estate.[191] Fourth and finally, an intangible asset should be legally transferrable.[192] Such a test could be implemented by a taxing authority by regulation, by the legislature as a legislative change, or by a court in reviewing evidence outside the Section 197 context. Model legislation could be drafted by policymakers, or taxpayers could use such definitions to argue that certain unbooked evidence complies with IAAO definition and thus should be exempted from property tax.

Finally, state statutory exemptions of intangible assets from taxation do not prevent the taxpayer from bringing in any additional "relevant evidence" of intangible assets not captured in the above definitional structure.[193] Requiring specificity in the burden of proof to gain a tax exemption will narrow litigation while still allowing for additional, potentially relevant evidence to be presented by the taxpayer.[194]

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186 *See* AUSTRALIAN TAXATION OFFICE, GUIDE TO DEPRECIATION 2001, https://www.ato.gov.au/Forms/Guide-to-depreciation-2001/?page=24. *See also* AUSTRALIAN TAXATION OFFICE, IN-HOUSE SOFTWARE, https://www.ato.gov.au/business/depreciation-and-capital-expenses-and-allowances/in-detail/depreciating-assets/in-house-software/ (specifying direction on amortization of in-house software). The announcement of this change is available at INTANGIBLE ASSET DEPRECIATION, *supra* note 185.

187 IAAO SPECIAL COMMITTEE ON INTANGIBLES, *supra* note 94, at 1.

188 *Id.* at 2.

189 *Id.*

190 *Id.*

191 *Id.*

192 *Id.*

193 Carl Hoemke, *A Full Breakdown of Property Tax Exemptions*, CROWDREASON BLOG (Mar. 7, 2018, 9:22 AM), https://www.crowdreason.com/blog/property-tax-exemptions.

194 This type of evidentiary rule already exists in property tax, safe harbor rules in international transfer pricing and a variety of areas.

### C. *Specific Identification and Valuation of Intangible Assets No Additional Burden to Taxpayer*

Federal, state, and international tax law and policy directly provide definitional specificity for intangible assets in income tax laws and this framework is already used by the same corporations subject to property tax schemes.[195] As previously discussed, taxpayers, however, currently fail to provide specific, measurable valuation of intangible assets for exemption from property taxation, instead claiming broad-based percentages of intangible value.[196] On the other hand, state departments of revenue allow for minimal, if any, exempt intangible assets when valuing.[197] This wide disparity of claimed exempt intangible assets between taxpayers and revenue departments leads to substantial conflict over the taxable valuation of unit value properties during litigation.

If states utilized a reference to the federal definition for excludable "intangible" assets, calculation of an "intangible assets" for property tax purposes could be quite simple. Because companies already track, value, and report intangible assets for income tax purposes, such assets can be tracked, valued, reported, and exempted for property tax purposes.[198] Taxpayers would report Section 197 intangible assets and any other properly excluded intangible assets to a state department of revenue, and such assets would be removed from the cost approach in unit valuation. It is the taxpayer who knows the facts related to the taxable property at issue, and taxpayers are generally required to keep records for tax purposes.[199] Thus, implementing a taxpayer requirement for reporting this information for tax purposes is not an onerous process, nor is it an unreasonable burden to place on the taxpayer.

## VI. BURDEN OF PROOF IN TAXATION

Requiring specificity of exempt intangible assets can be accomplished through requiring the taxpayer to provide such information. Under federal and state law, income tax is determined based on the net income of a taxpayer.[200] The burden is on the taxpayer to keep records

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195 It is, of course, a policy decision as to whether and when states should harmonise their tax laws with those of the federal government. *See, eg.*, Darien Shanske, *States Can and Should Respond Strategically to Federal Tax Law*, 45 OHIO N.U. L. REV. 543, 546 (2019).

196 *See, e.g.*, Airtouch Commc'ns, Inc. v. Dep't of Revenue, 76 P.3d 342, 355-56 (Wyo. 2003); QwestCorp v. Dep't Revenue, No. SPT 2008-2 (Mont. B.T.A. Nov. 30, 2009), https://mtab.mt.gov/Portals/64/docs/decisions/Qwest_2008.pdf.

197 *Id.*

198 James M. Pines, *Federal Income Taxation of Intangible Assets*, 8 Tax L. Rev. 231, 238 (1953).

199 I.R.C. § 6001 (2018). The burden can shift to the government, with credible evidence from the taxpayer. *See* I.R.C. § 7491 (2018); Welch v. Helvering, 290 U.S. 111, 115 (1933).

200 Commissioner v. Tellier, 383 U.S. 687, 691 (1966).

for tax purposes.[201] Moreover, the burden of proof to demonstrate an exemption from taxation properly sits squarely on the shoulders of the taxpayer requesting the exemption.[202] While this standard is well settled in income tax cases, there has been less focused discussion on the burden of proof in property tax cases.[203] The burden of proof is especially important in questions of fact relating to tax exempt property.[204]

Specifically, requiring taxpayers to properly identify intangible assets for property tax valuation can immediately help to focus litigation matters.[205] The burden of proof to demonstrate an exemption from tax is generally put to the taxpayer in all tax matters.[206] This is not only because it is the taxpayer who has access to the materials, but arguably, taxpayers understand that governments have only third-party materials available to them, which allows the taxpayer to "game the system" for underreporting purposes.[207] In applying the duty of production and maintenance to the taxpayer, the Supreme Court has noted that the "purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished."[208]

In some instances, taxpayers who have claimed anything more than tangible assets are exempt from taxation or have claimed a blanket percentage of exemption for intangible assets. In other instances, taxpayers in property tax matters have been denied relief when the taxpayer fails to bring the proper evidence. For example, the court in the *Airtouch* case noted that the taxpayer had income information when they filed their annual report to the Wyoming Department of Revenue, as well as to the

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201 *See* I.R.C. § 6001 (2018). Sometimes, this burden of proof can shift to the government with credible evidence. *See* I.R.C. § 7491 (2018), and the government is presumptively correct. *See* Welch v. Helvering, 290 U.S. 111, 115 (1933). *See also Airtouch*, 76 P.3d at 37; QwestCorp v. Dep't Revenue, No. SPT 2008-2, slip op. at 21 (Mont. B.T.A. Nov. 30, 2009), https://mtab.mt.gov/Portals/64/docs/decisions/Qwest_2008.pdf.; *RT Communications*, 11 P.3d at 925; *ANR Pipeline*, 276 Kan. at 706.

202 See, for example, Montana tax burden of proof statute, MONT. CODE ANN. §15-2-301. This can be distinguished from a presumption that the department of revenue is correct, but revenue bears the burden to provide documented evidence. *See* Devoe v. Department of Revenue, 866 P.2d 228, 236 (Mont. 1993). For a general discussion of burden of proof, see Karen E. Powell, *A Historical Perspective on Montana Property Tax: 25 Years of Statewide Appraisal and Appeal Practice*, 70 MONT. L. REV. 21 (2009). For federal burden of proof, see I.R.C. §7481 (2018).

203 Helvering v. Bliss, 293 US 144, 150-51 (1934); *see also* Samuel Friedland Foundation v. U.S. 144 F.Supp. 74, 84 (D.N.J. 1956).

204 In comparison to the burden of proof in questions of law, where ambiguity can shift to the taxpayer's benefit.

205 Consider the ill-advised Cohen principle, as discussed in David J. Herzig, *Something from Nothing: Taxing Assets Accurately*, 2011 MICH. ST. L. REV. 1057, 1060–61 (2011).

206 *See* I.R.C. § 7454(a) (2018); Wickwire v. Reinecke, 275 U.S. 101, 105 (1927).

207 Herzig, *supra* note 205, at 1059.

208 Comm'r v. Lane Wells, 321 U.S. 219, 223 (1944).

Securities and Exchange Commission, but did not release that information to the Wyoming Department of Revenue for more than a year.[209] The Montana Tax Appeal Board also noted a similar failure by the taxpayer Qwest to disclose income information which the taxpayer had in its possession.[210] In *RT Communication*, the court notes that parties must describe exempt property.[211] Yet, property tax matters have not required taxpayers to provide specific evidence of all property they claim is exempt.[212] Rather, taxpayers argue that much of the exempt property is general intangible assets. State courts have been inconsistent or silent in setting forth any direction for future property tax litigation.

Princeton University's property tax exemption case demonstrates how a state judge can address the burden of proof in property tax exemption matters.[213] Local residents filed suit to revoke Princeton's property tax exemption, arguing that Princeton University was not a tax-exempt organization for property tax purposes.[214] Upon motions, the judge decided that the burden of proof fell to Princeton University to demonstrate its tax-exempt status.[215] Princeton settled the case for $18 million dollars, with payments to both local property owners and also the local borough government.[216] While admittedly this example addresses exemption from property tax altogether (as compared to partial exemption of certain property), the case demonstrates that the burden of proof in state exemption[217] from property tax matters can compare favorably with the federal income tax burdens of proof.[218]

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209 Airtouch Commc'ns, Inc. v. Dep't of Revenue, 76 P.3d 342, 355–56 (Wyo. 2003).

210 QwestCorp v. Dep't Revenue, No. SPT 2008-2 (Mont. B.T.A. Nov. 30, 2009), https://mtab.mt.gov/Portals/64/docs/decisions/Qwest_2008.pdf.

211 *RT Commc'ns*, 11 P.3d at 924.

212 In re ANR Pipeline Co., 79 P.3d 751, 758 (Kan. 2003).

213 Elise Young, *Princeton Will Pay $18 Million to Settle Residents' Tax Case*, BLOOMBERG (Oct. 14, 2016), https://www.bloomberg.com/news/articles/2016-10-15/princeton-will-pay-18-million-to-settle-residents-tax-case.

214 *Id.*

215 *Id.*

216 *Id.* The judge previously issued a ruling that the burden of proof was on Princeton University to demonstrate its right to the tax exemption. There have been a number of cases challenging tax exemptions for hospitals. Note also, on a federal level, massive underreporting by a taxpayer has significant negative effect on tax liability. *See, e.g.*, I.R.C. § 6501 (2018). There is movement to require more consistent reporting from taxpayers in the transfer pricing models as well. *See* Treas. Reg. § 1. 482. Also consider Pacific Association of Tax Administrators (PATA) and the option for advance pricing agreements. Treas. Reg. § 1.482-4(a), allowing for advance pricing agreements with multiple jurisdictions.

217 There are many state cases relating to charitable organisations claiming exemption from property tax. This Article does not address charitable organisations. For more details, see, e.g., Evelyn Brody, *All Charities Are Property Tax Exempt, but Some Charities Are More Exempt than Others*, 44 NEW ENG. L. REV. 621, 622 (2010).

218 *See* I.R.C. § 7454(a); Wickwire v. Reinecke, 275 U.S. 101, 105 (1927). For state examples, see MONT. CODE ANN. § 15-2-301 (2019) and Devoe v. Dep't of Revenue of Mont., 866 P.2d 228, 236 (1993), shifting the burden to the Department of Revenue. For Wyoming,

Most judges profess some level of discomfort with tax litigation.[219] However, a better understanding of the availability and reliability of doctrinal federal tax law, and strong application of evidentiary burdens should encourage state judges to properly apply the correct burden of proof for a taxpayer to demonstrate a claimed exemption from taxation. In his recent book, *How Judges Think*, Judge Posner argues that the principle force stabilizing judicial decision making is ideological consensus "in fields such as torts and contracts."[220] There is little doubt that tax law also benefits from such stability of decision making. State courts can and should reject requested tax exemptions when specific identification and valuation data has not been provided. This Article proffers that not only is such specific identification and valuation data readily available within the taxpayer's own tax accounting records, but also taxpayers have the burden of proof to show what assets are exempt from taxation.

Implementation of the correct burden of proof for a tax exemption only requires disclosure of existing identification and valuation of intangible assets and would substantially narrow the use of the term "enhancement" in judicial decisions, thus signaling the bounds of valuation to the parties and lessening litigation.

However, current caselaw demonstrates that applying the general burden of proof to the taxpayer has been insufficient to lessen property tax appeal matters relating to intangible assets.[221] Instead, state judicial decision making should consider better alignment with the broader tax law decision making, providing for more predictable results. More predictability will lead to less litigation and lower compliance costs.

### A. *The Failure to Bring Specificity for Intangible Assets Increases Litigation*

If using the definitions and framework provided by income tax statutes is beneficial, and the taxpayer has the burden of proof, why has it

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review *Pacificorp, Inc. v. Dep't of Revenue*, 31 P.3d 64, 65 (Wyo. 2001), requiring the Department of Revenue to use the same ratio for determining the intangible asset percentage as used in setting the allocation to Wyoming from total value. There is a presumption that the department of revenue is correct but the department bears the burden to provide documented evidence. *See* Devoe, 866 P.2d. at 235–36. While the overall value of the property may be subject to the less stringent preponderance of the evidence standard, the burden of proof to demonstrate an exemption from taxation should properly sit squarely on the shoulders of the taxpayer requesting a tax exemption. For general burden of proof discussion, see Powell, *supra* note 202, at 46.

219 Note the famous story of Supreme Court Justice Rehnquist assigning tax cases to Justices who refused to sing at the Christmas party.

220 RICHARD POSNER, HOW JUDGES THINK 373 (2008).

221 *See, e.g.*, Airtouch Commc'ns, Inc. v. Dep't of Revenue, 76 P.3d 342, 356 (Wyo. 2003); RT Commc'ns v. State Bd. of Equalization of Wyo., 11 P.3d 915, 920, 925 (Wyo. 2000); *In re* ANR Pipeline Co., 79 P.3d 751, 755 (Kan. 2003).

not been argued more extensively by revenue departments, directed by regulation or law, or required by judicial directive in property tax matters? Quite simply, both the taxpayers and the departments of revenue have no incentive to limit the complex, costly litigation, regardless of the cost to other taxpayers and to communities. To date, case law has allowed both the litigating taxpayers and the assessing officers to claim some level of victory and thus argue it is beneficial to continue to litigate cases. For example, in Kansas, the Courts has upheld the use of unit value and approved the exemption of certain intangible assets while also holding that intangible property "may be used to the extent that it creates an 'enhanced' value of tangible property."[222] Regardless of the court cases discussing "enhancement" in property tax valuations, litigation continues in the attempt to determine what intangible assets may be exempt from property tax. In Kansas's *ANR Pipeline,* the Court case addressed whether certain installation costs and overhead were exempt intangible assets or enhancement to the value of tangible property.[223] In determining what intangible assets are exempt from property tax valuation, the court in *ANR* references the lack of consistent terminology, noting that no other taxing jurisdiction, including the IRS, uses the terms used in Kansas, which leads to ongoing definitional struggles.[224]

Further, with no settled rules or definitions, there is no incentive for either party to negotiate to reduce litigation costs. Efforts to engage legislators and policy makers on an "obscure" and complex area of law find little common ground. Consumers and the general public, while affected by the funds ultimately paid and the costs and delays to the local tax base, are generally disconnected from any discussion of property tax for multijurisdictional corporations—they are not involved as parties, nor can the public affect or influence tax amounts, settlements, or other impacts. But, as demonstrated in the stories referenced in this Article, the fiscal effects are ongoing and extensive.

Further, general jurisdiction judges have little ability to prevent multi-year complex tax litigation filed in their courts. Tax cases are specialized, and most general jurisdiction judges will not see more than one case in a career.[225] There is little opportunity for a general jurisdiction judge to become a specialist in the area, or, specifically, to know what data is available to the parties to a tax litigation matter (unlike special-

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222 *In Re* ANR Pipeline Co., 79 P.3d at 767 (citing *In re* W. Res., Inc., 919 P.2d 1048, 1055 (Kan. Ct. App. 1996)).

223 *Id.* at 769.

224 *Id.* at 768.

225 Most tax cases are filed across various state courtrooms in differing counties, and take several years to litigate; thus, a state judge of general jurisdiction is unlikely to see more than one during their career. There are typically only two to three property tax cases which go to a state Supreme Court over a particular decade.

ized tax judges). Litigation is expensive for the taxpayer, the revenue departments, and the public. Consider the positive effects to state and local budgeting if the Montana windfarm case litigated only half the amount of property taxes previously at issue, or the state of Oregon had half as much tax funding at issue in its case with Comcast.[226] Not only is it economically inefficient to have tax protest funds unavailable for ten years of litigation, the funds are arguably better used in any other manner (in the hands of the taxpayers, the state, or the local jurisdiction).

Tax law, for implementation on an annual basis, works best for both taxpayers and assessing agents when terms are specific, measurable, and reduceable to a numerical value. This applies to both tangible and intangible assets: there is no difference in defining and calculating intangible assets exemptible in property tax.[227] And, further, intangible assets are neither amorphous nor unmeasurable.[228] There is no indication in the record of any of the cited property tax cases that taxpayers have provided the easy-to-understand income tax filings relating to previously identified intangible assets. If the assessor and the taxpayer were both required to specifically exempt the intangible assets as set out in federal statute, the likely outcome would be a value in between the taxpayer's tangible value and the revenue department's enhanced value.

## CONCLUSION

Identifying and valuing intangible assets based on income tax definitions does not eliminate the use of the term "enhancement" or prevent property tax litigation. It does, however, provide additional specificity with respect to both the definition and the valuation estimates, which will significantly narrow the range of valuation conflict. Placing the burden of proof on the taxpayer to demonstrate specificity in defining and valuing exempt intangible assets will provide more certainty in property tax valuation, which will reduce litigation and narrow the scope of litigated claims. Definitions of intangible asset valuation under income tax law provide a useful reference in the context of state tax litigation for several reasons.[229]

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226 *See* Inbody, *supra* note 3; James, *supra* note 15.

227 *See* Michael Shaff, *Taxation of Intellectual Property*, STUBBS, ALDERTON & MARKILES (Nov. 22, 2013), https://stubbsalderton.com/taxation-of-intellectual-property-by-michael-shaff/.

228 This is not to say that the valuation of intangibles is simple or easily calculated. Many areas provide significant challenges; for example, intellectual property valuation challenges, which are well beyond the purview of this Article, are extremely complex. *See id.*

229 "The essence of a rule is that it limits the range of admissible facts." POSNER, *supra* note 220, at 178 (arguing that limiting the discretion of a judge leads to certainty). For example, consider the requirements of implementation of federal sentencing guidelines regardless of judicial preference between rules and standards. *Id.*

While property, income, and sales tax are formally separate tax processes and procedures, the valuation of intangible assets in each of these three systems is framed by sale and income determinations.[230] Business investors and internal valuation metrics consider a property's fair market value as set by investors looking at income streams, as discussed previously.[231] Intangible assets are also already tracked for federal tax purposes. Placing the burden of proof on the taxpayer to define and identify intangible assets before exempting such property is both procedurally improper and an unreasonable standard. The predicted reduction in compliance costs would be a benefit to the economy generally, to litigants themselves, and to the larger category of public institutions such as school districts and local governments, and the general public served by such institutions.

This Article argues that the burden of identifying exempt intangible assets rests with the taxpayer. A legal definition and tax accounting system exists in federal income tax law for identification and valuation of intangible assets. Requiring the taxpayer to properly identify intangible assets, based on federal income tax definitions, for exemption from property tax will greatly enhance the tax process by lowering litigation and compliance costs for taxpayers, revenue departments, and communities.

This Article further argues that courts can and should require taxpayers to demonstrate that their claimed exempt intangible assets in fact meet the definitional constructs under federal income tax law, in order to assist with narrowing the scope of tax litigation relating to intangible asset controversies. State tax judges can and should confidently hold both revenue departments and taxpayers to their burden to provide targeted identification and valuation of exempt intangible assets. The application of federal definitions of intangible assets in state property tax conflicts will assist with managing, as best as possible, massive litigation in state courts, thus providing more streamlined cases for judges, as well as predictable standards for taxpayers and revenue departments in future cases.

There are, quite simply, more precise legal standards available for defining exempt intangible assets. Requiring proof of specific intangible assets exempt from property tax provides a simple method for calculation of exempt assets without the need for additional policy decisions. The implementation of this process of identifying and valuing specific intangible assets does not place any greater burden on the taxpayers, because

230 Shubat v. Sutter Ctny. Assessment Appeals Bd., 17 Cal. Rptr. 2d 1, 2–3 (Ct. App. 1993).

231 Gary C. Cornia, David J. Crapo, & Lawrence C. Walters, *The Unit Approach to the Taxation of Railroad and Public Utility Property*, *in* INFRASTRUCTURE & LAND POLICIES, *supra* note 20, at 140, 142.

these taxpayers already use federal definitions and valuation methodologies for federal and state income tax reporting. Further, the buyers and sellers who ultimately drive the fair market value of the going concern business also review this same data for sales purposes—and this process is consistent with income and sales approaches to value. The above approach allows for continuity of law; it upholds both the unit value methodology as well as identifies intangible assets exempt from property taxation.

State tax courts can thus streamline property tax litigation by rejecting claims for intangible asset exemption when there is insufficient identification of intangible assets. While litigation in unit value cases is complex, state courts can require more specificity under evidentiary expectations and limit the broad nature of property tax appeals, which will lead to better consistency, more transparency, and ultimately less litigation.