

Alert | State & Local Tax



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Airport Concessionaire’s Exclusive Operating Right is Tax-Exempt Intangible Asset, and Assessor Had Burden of Removing Value of Asset in Making Property Tax Assessment

This *GT Alert* addresses the recent Court of Appeal decision in *DFS Group LP v. County of San Mateo* (Calif. Ct. App., 1st Dist., January 31, 2019, 31 Cal.App.5th 1059; Petition for Review denied by Calif. Supreme Ct., April 24, 2019), which held that local assessors and assessment appeals boards must address intangible assets in their assessment of property for property tax purposes, including intangibles relating to exclusive operating rights at an international airport.

Intangible assets are exempt from property tax assessment in California. The exemption extends to cash, government permits, intellectual property, assembled workforce, working capital, favorable contracts, naming rights, training and instruction manuals and, in *DFS Group*, an exclusive concession to operate a business on government-owned property. In short, California assessors can assess the real property on which a business is located, and the personal property used by the business, but cannot assess “business enterprise” or other intangible assets.

The statutory exemption for intangible assets, even though codified (*Rev. & Tax. Code* Sections 110(d) and 212(c)), has long remained a source of controversy between taxpayers and assessors. In recent years, California’s appellate courts have resolved several issues relating to the intangibles exemption. In 2013,

the California Supreme Court broadly ratified the intangibles exemption in *Elk Hills Power, LLC v. Board of Equalization* 57 Cal.4th 593, finding that emission reduction credits were intangible assets and tax-exempt, and explaining how the exemption was to be addressed in the assessment process. More recently, the Court of Appeal found the assessor's method of removing intangibles by deducting the expenses associated with an intangible in an income approach to be unlawful. (*SHC Half Moon Bay, LLC v. County of San Mateo* (2014) 226 Cal.App.4th 471. *DFS Group* continues and extends this line of case authority.

Firstly, the appellate court's decision in *DFS Group* refuted the taxing authority's position that, to sustain its burden of proof, a taxpayer is required to prove both that a tax assessment subsumes the value of non-taxable intangible assets and the value of those assets. The Court of Appeal expressly held that a taxpayer need only show that the assessment subsumes the value of intangible assets; having done so, the burden shifts to the assessor to prove by a preponderance of the evidence that such value has been removed. (31 Cal.App.5th at 1073-75.) This holding has practical implications. For example, the assessor and assessment appeals boards cannot sustain an assessment by rejecting a taxpayer's evidence of comparable sales because they are not sufficiently "comparable," conclude that the taxpayer has failed to prove the value of the intangible asset, and then sustain the assessment.

Secondly, *DFS Group* also applied language from *Elk Hills Power* to expressly hold that, while an assessor may assume the presence of intangible assets needed to put taxable property to beneficial and productive use (also referred to as "highest and best use") under *Revenue and Taxation Code* section 110(e), that does not allow an assessor to ignore the tax-exemption for intangibles. The value of the non-taxable intangible assets must still be removed from the assessment. (31 Cal.App.5th 1075.)

Lastly, after examining the evidence presented by the parties, the Court of Appeal held that DFS Group's exclusive right to sell duty-free goods at the San Francisco International Airport (SFO) was a valuable intangible right. The appellate court went on to find that the assessor's method of capitalizing the *entire* concession fee that DFS Group paid for the exclusive right to sell duty-free goods at SFO subsumed the value of DFS's intangible right to sell on an exclusive basis, making the assessor's method of valuation unlawful under *Revenue and Taxation Code* section 110(d)(3). (31 Cal.App.5th at 1078, 1084-85, 1088.) The court also rejected the assessor's argument that the exclusive right to sell duty-free goods at SFO was a taxable attribute of the real property under *Revenue and Taxation Code* section 110(f). (31 Cal.App.5th at 1086-88.) Greenberg Traurig's State and Local Tax (SALT) practitioners are available to help with the analysis and help you get the most out of these programs.

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