Case No. A150162

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DFS GROUP, L.P.,
Petitioner and Appellant,

v.

COUNTY OF SAN MATEO,
Defendant and Respondent.

[PROPOSED] AMICUS BRIEF OF THE CALIFORNIA STATE ASSOCIATION OF COUNTIES IN SUPPORT OF DEFENDANT AND RESPONDENT COUNTY OF SAN MATEO

San Mateo County Superior Court
Case No. CIV531813
The Honorable Steven L. Dylina

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Amicus California State Association of Counties submits this brief to oppose Appellant DFS Group, L.P.'s ("DFS") attempt to effect a sweeping change in the law governing property tax assessment. The Board and trial court properly placed on DFS the burden of proving entitlement to a reduction in the assessment due to a property tax exemption.

I. Relevant Procedural and Factual Background

DFS entered into a lease agreement to lease space and operate duty-free concessions at the San Francisco International Airport.[1] The lease requires DFS to pay a Minimum Annual Guaranteed ("MAG") rent for the space regardless of DFS's income or profits from the operation of the concessions. The lease also requires DFS to pay additional amounts if it meets certain sales thresholds, and imposes other obligations on DFS.

The San Mateo County Assessor assessed the possessory interest conveyed to DFS by the lease. To determine the value of the possessory interest, the Assessor capitalized the MAG rent. DFS challenged the assessment to the San Mateo County Assessment Appeals Board ("Board"), contending it improperly included the value of an intangible asset, which is statutorily exempt from taxation. Namely, DFS argued the assessment included the value of its exclusive right to operate the duty-free concessions. The Board heard evidence and affirmed the assessment, finding (1) MAG rent was an appropriate measure of economic rent and (2) that rent did not include the value of nontaxable intangible assets.

DFS then filed suit to recover taxes in San Mateo County Superior Court, arguing again the assessment improperly included the value of an intangible asset—its exclusive right to operate the duty-free concessions. The trial court affirmed the Board's decision, agreeing that the MAG rent

[1] All facts in this section are set forth in the trial court's Statement of Decision Following Trial. (AA0463-467.)

constituted economic rent and did not include the value of any nontaxable intangible assets.

DFS then filed this appeal. DFS contends the Assessor (and presumably the Board) erred because the MAG rent purportedly included value for the "exclusive right to operate the duty-free concession,"[2] a nontaxable intangible asset whose value the Assessor was required to determine and deduct from the assessment.[3] (Appellant DFS Group L.P.'s Opening Brief ("AOB") at 8.) DFS also contends the "Assessor had an affirmative, active duty" to assess that exclusive right and remove its value from the assessment, and that it "had the burden of proof to demonstrate" it satisfied that duty. (AOB at 27.)

II. DFS Has the Burden of Proof.

At the heart of DFS's appeal is its erroneous claim that "[t]he Assessor and Board had an affirmative, active duty to segregate the MAG to identify the portion that was solely rent for real property and determine the assessed value of the taxable interest using market or economic rent." (AOB at 9.) Most important for purposes of this brief, DFS argues the

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[2] Notwithstanding the document's title ("Lease Agreement for Post-Security Master Retail/Duty Free Concession"), DFS does not refer to this agreement as a "lease." Instead, DFS calls it a "Concession Agreement." (AOB at 8.) Additionally, DFS refers to the rent it pays under the lease as a "concession fee . . . for the right to occupy space at SFO *and* for the exclusive right to operate the duty-free concession." (*Ibid.*)

[3] DFS's appraiser concluded the MAG rent was not economic rent because the rate was higher than for other retail spaces, such as at Union Square in San Francisco. He testified it was either "a really phenomenal location or . . . they are paying for something else besides just the real estate there." (AOB at 13, fn. 11.) Dismissing the likelihood of a "really phenomenal location," DFS concluded a portion of the MAG rent was attributable to the exclusive right to sell duty-free merchandise, an intangible right whose value was the difference between the MAG rent and "normal" rent for duty-paid retail space. (AOB at 14.)

Assessor "also had the burden of proving that such duty was satisfied." (*Ibid.*) DFS seeks to alter longstanding legal authority imposing on the taxpayer the burden of proving entitlement to a reduction in an assessment where there is a claim of tax exemption.

Since 1933, the California legislature has exempted "certain forms of intangible property" from the broad mandate to assess all non-exempt real property at its "fair market value." (*Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593, 606-07, citing Cal. Const. art. XIII, §§ 1 & 2; *see also* Cal. Rev. & Tax. Code § 128.) The exemption for intangible assets is one of many exemptions from property taxation codified in the Revenue and Taxation Code. (*See* Rev. & Tax. Code § 201 *et seq*.; *see, e.g., id.,* § 212, subd. (c) (exemption for intangible assets).)

DFS has the burden of proving its entitlement to an exemption to property tax. (*See, e.g., Fellowship of Humanity v. County of Alameda* (1957) 153 Cal.App.2d 673, 680-81.) Taxpayers "are not entitled to an exemption merely because they say they are; they must offer some *credible evidence of exemption entitlement*." (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443 (italics added).) "Doubts concerning the applicability of the tax exemption are to be resolved against that exemption." (*Amdahl Corp. v. County of Santa Clara* (2004) 116 Cal.App.4th 604, 614, citing *Alpha Therapeutic Corp. v. County of Los Angeles* (1986) 179 Cal.App.3d 265, 270; *see also Fellowship of Friends v. County of Yuba* (1991) 235 Cal.App.3d 1190, 1196-97 [taxpayer failed to prove building used in part as a museum qualified for exemption from property taxes].) Therefore, where there is a claim that an intangible asset is included in an assessment and exempt from tax, the taxpayer bears the burden of proving its entitlement to that exemption.

Requiring the taxpayer to prove its entitlement to an exemption is consistent with the burden of proof the taxpayer bears when challenging an

assessment before the assessment appeals board. (*See* 18 Cal. Code Regs. § 321, subd. (a) ("Rule 321").) It is likewise consistent with the well-established rule that when seeking a tax refund, "the burden of proof is on the taxpayer." (*926 North Ardmore Ave., LLC v. County of Los Angeles* (2017) 3 Cal.5th 319, 328; *see also Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744, citing *Flying Tiger Line v. State Bd. of Equalization* (1958) 157 Cal.App.2d 85, 99.)

The burden of proof is placed on the taxpayer because the taxpayer "creates the transaction" and thus "has the power to determine the nature of the transaction, to create and retain detailed records or other evidence needed to prove its nature (and proper tax treatment). . . . [and] to destroy or conceal the records or other evidence which would establish the taxable nature of such transaction." (*Honeywell, Inc.*, *supra*, 128 Cal.App.3d at pp. 744-745, citing *Morris v. Williams* (1967) 67 Cal.2d 733, 760.)

III. DFS Failed to Carry Its Burden of Proof.

A. DFS Misconstrues the Legal Authority Regarding the Burden of Proof.

DFS seeks to upend the burden that has long been placed on the taxpayer to prove its entitlement to a reduction in an assessment due to a tax exemption for nontaxable intangible assets. Its argument that "[t]he Assessor and Board had an affirmative, active duty to segregate the MAG to identify the portion that was solely rent for real property and determine the assessed value of the taxable interest using market or economic rent" (AOB at 9) relies on its misreading of legal authority.

DFS mistakenly contends it "need only '***proffer*** evidence that the Board included the fair market value of an intangible asset in the unit whole . . .' to require the Board to make the required deduction." (AOB at 31, quoting *Elk Hills Power*, *supra*, 57 Cal.4th at p. 617, fn. 11 (original

italics and bold).) On the contrary, as the California Supreme Court explained, if the taxpayer proffers evidences that "the value of intangible assets contributed in some way to the unit valuation of its taxable property", that proffer merely requires the board or court to "determine if those intangible assets were necessary to the beneficial or productive use of the property." (*Elk Hills Power*, *supra*, 57 Cal.4th at p. 615.) If the board or court determines the intangible assets were necessary for the property to be put to productive use, the court or board must then "determine whether the [taxpayer] has put forth *credible evidence* that the fair market value of those assets has been improperly subsumed in the valuation." (*Ibid.* (italics added).) Only if that evidence convinces the board the value of intangible assets is improperly subsumed in the assessment must the board remove that value the assessment. (*Ibid.*) Conversely, if the taxpayer's evidence is not "credible" and thus does not convince the board of the improper inclusion of intangible assets, the inquiry ends and the assessment stands. In other words, if the taxpayer does not carry its burden of proof, the board or court must affirm the assessment.

DFS's argument would require the board to accept a taxpayer's claim that the value of nontaxable intangible assets was included in the assessment regardless of how weak or unconvincing the taxpayer's evidence. It would prevent the Board from exercising its function of assessing and weighing the evidence. (*See* Rule 321, subd. (b), *supra* ["If the applicant has presented evidence, and the assessor has also presented evidence, then the board must weigh all of the evidence . . . ."].)

Instead of uncritically accepting DFS's claim that the assessment improperly included the value of nontaxable intangible assets, the Board evaluated all the evidence and concluded DFS failed to convince them that the MAG rent included payment for the exclusive right to operate the duty-free concession. (AA0464-467.) Thus, the Board did not find the

assessment violated Revenue and Taxation Code section 110(d)(3)'s rule that "[t]he exclusive nature of a concession . . . shall not enhance the value of taxable property." (Cal. Rev. & Tax. Code § 110, subd. (d)(3).)

DFS's claim that a "taxpayer sustains his burden by introducing 'some evidence of the assessment inequality'" is inaccurate. (AOB at 33, quoting *Griffth v. County of Los Angeles* (1968) 267 Cal.App.2d 837, 842.) DFS relies on bare dicta in *Griffith* that is contradicted by the facts and outcome of that case, which held the taxpayer failed to sustain its burden of proof, even though it presented some evidence, because the "record as a whole" supported the board's assessment. The Court explained: "'Whether a party has discharged the burden of proof is a question for the trier of fact to decide. If the party with the burden of proof fails to establish in the mind of the trier of fact the requisite degree of belief concerning the fact in issue, the trier of fact is required to rule against him regarding that fact.'" (*Griffith*, *supra*, 267 Cal.App.2d at 848, quoting California Evidence Code Manual (Cont.Ed.Bar 1966), § 2.37, p. 435.) As in *Griffith*, DFS failed to "establish . . . the requisite degree of belief" that the MAG rent included payment for the exclusive right to operate the duty-free concession.

Moreover, the lease on which DFS relies to justify its claim of exemption does not "express[] in direct terms" the inclusion of the exclusive concession right in the MAG rent; nor is the inclusion of the exclusive right in the MAG rent "fairly inferable from the language of the [lease].'" (7AR1982-2083; *Amdahl Corp.*, *supra*, 116 Cal.App.4th at 614 (citation omitted).) DFS failed to carry its burden of proof because it failed to prove the MAG rent included consideration for the exclusive right. Accordingly, as explained by *Elk Hills Power*, the Board was not required to value that right and remove that value from the assessment. (*Elk Hills Power*, *supra*, 57 Cal.4th at p. 615.)

Contrary to DFS's unsupported claim, the burden did not shift to the Assessor or Board to "demonstrate that DFS's exclusive concession rights had no value." (AOB at 32.) California law does not impose on the Assessor or Board the obligation to prove its assessment does not include the value of nontaxable intangible assets. DFS "'cannot assert error and thus shift to the state the burden to justify the tax.'" (*Dicon Fiberoptics, Inc. v. Franchise Tax Bd.* (2012) 53 Cal.4th 1227, 1236, quoting *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal. App. 3d 739, 744, and citing *Apple, Inc. v. Franchise Tax Bd.* (2011) 199 Cal.App.4th 1, 22.)

B. DFS Relies on Inapposite Authorities That Concern the Unit Valuation of a Business Rather Than Economic Rent.

DFS's argument that the Assessor and Board erred by not actively seeking out and valuing nontaxable intangible assets relies on inapplicable statutory and case authority governing assessments of multiple properties within an ongoing business enterprise, *i.e.*, using the unit valuation method. In this context, Revenue and Taxation Code section 110(d) provides: "If the principle of unit valuation is used to value properties that are operated as a unit and the unit includes intangible assets and rights, then the fair market value of the taxable property contained within the unit shall be determined by removing from the value of the unit the fair market value of the intangible assets and rights contained within the unit." (*Id.*, § 110, subd. (d)(2).) That provision does not apply here because the assessment of DFS's possessory interest did not employ the principle of unit valuation. (*See* Cal. Assessor's Handbook, Section 502, Advanced Appraisal (Dec. 1998, rep. Jan. 2015), p. 4-5 [describing principle of unit valuation].)

An assessor has discretion to employ one of multiple valid methods to assess the value of a possessory interest in real property. (*De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 563-64; *Bret Harte Inn,*

Inc. v. City and County of San Francisco (1976) 16 Cal.3d 14, 23-24); Cal. Assessor's Handbook, Section 510, Assessment of Taxable Possessory Interests (Dec. 2002, rep. Jan. 2015) ["Assessor's Handbook 510"], p. 18, 23.) The present value of the rent paid by a lessee under a lease—such as the MAG rent DFS paid for the concession space—is one proper measure of the fair market value of a possessory interest. (Assessor's Handbook 510, p. 18, 23.)

Assessing the fair market value of DFS's lease using economic rent was preferable to using DFS's operating income because economic rent did not include nontaxable intangible assets. (*See* Assessor's Handbook 510, p. 31.) It is an "established rule that, faced with several valid methods of valuation, the Board's selection of a method, including the choice to apply a particular combination of methods, rests in its discretion." (*Trailer Train Co. v. State Bd. of Equalization* (1986) 180 Cal.App.3d 565, 583, citing *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 564; *ITT World Communications, Inc. v. County of Santa Clara* (1980) 101 Cal.App.3d 246, 252.) Although DFS claims the Assessor used an improper method, it cannot show the Assessor or Board acted arbitrarily, abused its discretion or violated the law in choosing the MAG rent (economic rent) to value DFS's possessory interest in the lease. (*Cat P'ship v. County of Santa Cruz* (1998) 63 Cal.App.4th 1071, 1079 (citations omitted) [taxpayer's challenge to valuation method used is "a question of law" that "must be sustained unless it is arbitrary, in excess of discretion, or in violation of law"].)

DFS's case authorities requiring the Board and Assessor to value nontaxable intangible assets and remove that value from its assessment are factually distinct because those cases concern the valuation of multiple properties as a unit within an ongoing business enterprise rather than the valuation of a possessory interest based on economic rent. For example, the

assessment in *Service America Corp.* was based on the taxpayer's income. The court found "some 'large part' of the income earned by Service America was based on its 'enterprise value' as distinguished from the value of its use of property." (*Service America Corp. v. County of San Diego* (1993) 15 Cal.App.4th 1232, 1240.) Likewise, the taxpayer's income was used to value a hotel in *SHC Half Moon Bay, LLC*. But that approach "failed to attribute a portion of [the hotel's] income stream to the enterprise activity that was directly attributable to the value of intangible assets and deduct that value prior to assessment." (*SHC Half Moon Bay, LLC v. County of San Mateo* (2014) 226 Cal.App.4th 471, 490-491; *see also GTE Sprint Communications Corp. v. County of Alameda* (1994) 26 Cal.App.4th 992, 1004 ("the Board and its appraisers erred in assuming that unit valuation, especially when calculated by the [income] method, necessarily taxes only the intangible values as they enhance the tangible property").) Such cases are inapposite because the Assessor and Board here used MAG rent (economic rent) rather than DFS's income to determine the value of the lease. Substantial evidence supports the Board's assessment, and therefore the Court must affirm the trial court's decision affirming that assessment. (*Elk Hills Power, supra*, 57 Cal.4th at p. 606 (citation omitted).)

IV. Conclusion

Amicus curiae CSAC urges the court to affirm the trial court's decision affirming the Board's decision affirming the assessment of DFS's possessory interest through its lease of concession space at San Francisco International Airport. That assessment appropriately valued the possessory interest using the amount of rent DFS pays under the lease. Neither the Board nor the Assessor was required to value DFS's exclusive right to operate duty-free concessions and remove that value from the assessment because they properly concluded, after reviewing and weighing all the

evidence, that DFS did not meet its burden of proof and the MAG rent did not include payment for that exclusive right. Substantial evidence supports the Board's and Assessor's findings, requiring affirmance of the assessment. The Court should deny DFS's attempt to impose a new burden on the Board and Assessor and confirm longstanding authority placing on DFS as the taxpayer the burden of proof showing entitlement to a reduction in an assessment due to an exemption.

Dated: December 21, 2017

Respectfully submitted,

/s/

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CERTIFICATION OF COMPLIANCE WITH CALIFORNIA RULES OF COURT, RULE 8.204(c)(1)

I hereby certify that this brief has been prepared using proportionately double-spaced 13 point Times New Roman typeface. According to the word count feature in my Microsoft Word software, this brief contains 3,025 words.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 21st day of December, 2017 in Sacramento, California.

Dated: December 21, 2017

Respectfully submitted,

/s/

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