IN THE SUPREME COURT OF CALIFORNIA

Case No. S280000

OLYMPIC & GEORGIA PARTNERS, LLC,

Plaintiff and Appellant,

v.

COUNTY OF LOS ANGELES,

Defendant and Appellant.

After a Decision by the Court of Appeal,
Second Appellate District, Division Eight
Case No. B312862

Los Angeles County Superior Court
Case No. BC707591
The Honorable Malcolm Mackey

[PROPOSED] AMICUS CURIAE BRIEF BY CALIFORNIA STATE ASSOCIATION OF COUNTIES IN SUPPORT OF DEFENDANT AND APPELLANT COUNTY OF LOS ANGELES

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I. INTRODUCTION

In essence, the Court of Appeal's decision in *Olympic and Georgia Partners, LLC v. County of Los Angeles* (2023) 90 Cal.App.5th 100 ("*OGP*") asks only whether an intangible asset or right ("intangible") is capable of valuation. If so, *OGP* requires that amount to be excluded from assessment. *OGP* must be reversed for three main reasons.

First, *OGP* overlooks the presence of intangibles at a taxable property can enhance the unitary value of taxable property and also the value of a business using taxable property. *OGP* also fails to distinguish between the permissible assessment of taxable property by assuming the presence of intangibles necessary to put that property to beneficial or productive use and otherwise non-taxable intangibles that relate to the going concern value of a business enterprise. Further, *OGP* neglects to apportion unitary value between the highest and best use of the taxable property itself and the business enterprise activity.

As required by this Court's decision in *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593, a taxpayer claiming the value of an intangible was improperly subsumed in the assessment and must be removed needs to establish: the presence of that intangible contributes in some way to the unitary valuation of its taxable property; that the intangible is not necessary for the beneficial or productive use of the property; and, when an income capitalization valuation approach ("income approach") is used for valuation, that a quantifiable separate income stream attributable to that intangible directly contributes value to the business enterprise.

Second, when assessing real property used as a hotel under an income approach, Rule 8 only requires that sufficient income be excluded to provide a "return on" nontaxable intangibles.[1] When an assessment deducts the capitalized expense of an intangible from the resulting net income stream used to value the taxable property, a taxpayer challenging the assessment must show not enough income was removed and that an additional amount of anticipated income should be deducted.

Third, when challenging an assessment as incorrect, the taxpayer has the burden of producing credible evidence of the quantified values of identified intangible assets that were impermissibly subsumed in the assessment value. Whether the taxpayer has proffered enough credible evidence involves questions of fact.

OGP's failure to conduct its analysis with these factors in mind requires its reversal. *OGP* will impact other counties since the total exclusion of quantifiable income related to the unitary operation of taxable property where an exempt intangible is present artificially devalues otherwise taxable property. Further, *OGP* encourages the use of terminology and principles other than those used for

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[1] Title 18 of the California Code of Regulations are also referred to as Property Tax Rules. All references to a "Rule" refer to the corresponding section number of Title 18.

property tax purposes. Finally, by framing evidentiary issues of fact as legal issues, *OGP* augments burdens that are becoming increasingly difficult to meet.

II. ARGUMENT

A. THE ANALYSIS OF A CLAIMED INTANGIBLE'S CONTRIBUTION TO VALUE OF OTHERWISE TAXABLE PROPERTY INVOLVES A THREE-PART TEST.

OGP oversimplifies *Elk Hills* by declaring if a taxpayer using an income approach can articulate *any* basis for *fairly* ascribing *any* income to an intangible's presence, then *all* income from operation of the property where that intangible is present *must* be deducted from the assessment.[2] (*OGP, supra,* 90 Cal.App.5th at pp. 102, 109-110, 111-112.) *OGP* overlooks that in order to warrant a deduction for intangibles when using an income approach, the taxpayer must establish the intangible is not taxable, i.e., that the intangible is not necessary to the beneficial or productive use of the property, and that the portion of the unitary value that the intangible directly contributes to the business's value can be quantified. (*Elk Hills, supra,* 57 Cal.4th at p. 615.)

1. The taxpayer must establish the presence of an intangible.

In cases involving unitary value where property has both taxable property and exempt intangibles operated together as a unit, the first inquiry is whether the taxpayer has presented evidence to establish the presence of the claimed intangible asset or right that contributes value to the unitary valuation. (See *Elk Hills, supra,*

[2] *OGP* sometimes asks a third question: whether the intangible is directly necessary to the productive use of property. (*OGP*, *supra,* 90 Cal.App.5th at pp. 102, 109-110.) This is discussed further below.

57 Cal.4th at p. 615.) *OGP* frames this inquiry as whether income was generated because an intangible was present at the property. (*OGP*, *supra*, 90 Cal.App.5th at pp. 108-110.)

While the income a business can generate at a property might contribute to the value of that business or its intangibles, that is not the end of the inquiry. As discussed further below, focusing solely on whether there is income from operating a taxable property where an intangible is present as a reason to exclude all this income disregards the requirement to apportion unitary value. This impermissibly overlooks whether any of that income is attributable to the taxable property itself or the use thereof and would result in that property not being taxed at all. (Rev. & Tax Code, § 110, subd. (d)(2);[3] *Elk Hills, supra,* 57 Cal.4th at pp. 614, 615-616.)

2. The taxpayer must show the intangible is not taxable.

The next step requires going beyond inquiring whether an intangible asset or right is present. For each identified intangible, the taxpayer must establish it is not taxable by showing it is not necessary to put the property to beneficial or productive use. (§§ 110, subd. (e); 212, subd. (c); see also *Elk Hills*, *supra*, 57 Cal.4th at pp. 614-615, 619.)

An intangible that puts taxable property to beneficial or productive use allows for the production of income from operation of the property. (See *OGP*,

[3] All sections references are to the Revenue and Taxation Code unless otherwise specified.

supra, 90 Cal.App.5th at pp. 114-115; *Elk Hills, supra,* 57 Cal.4th at p. 618, discussing *American Sheds, Inc. v. County of Los Angeles* (1998) 66 Cal.App.4th 384, 388, 395.) Some intangibles also allow for the highest and best use of taxable property, such that if the intangible was not present, the property would not be put to its highest and best use. (*Elk Hills, supra,* 57 Cal.4th at p. 616-617, fn. 10; see also *American Sheds, supra,* 66 Cal.App.4th at p. 395.) Taxable property put to its highest and best use yields more income, which thereby increases its assessable value. (*American Sheds, supra,* 66 Cal.App.4th at p. 395; see also Rule 8, subd. (c), (e).) The law explicitly provides for the taxation of this increased value. (§§ 110, subd. (e); 212, subd. (c).)

If the intangible was "directly necessary to the productive use of the property," *OGP* nonetheless concludes income ascribable to that intangible must be deducted from the property's income stream used to value that property.[4] (*OGP*, 90 Cal.App.5th at pp. 102, 109-110.) This appears to be based on a misinterpretation of several statements in *Elk Hills*.

The first of these statements is: even if an intangible is "'necessary to put the taxable property to beneficial or productive use," that asset still may not be "*directly* taxed." (*Elk Hills*, *supra,* 57 Cal.4th at p. 614 (emphasis added); see also p. 617 [intangible exempt from "direct taxation" whether or not it is "necessary"].) While *the value* of an intangible itself cannot be taxed directly, that principle does

[4] Olympic and Georgia Partners, LLC ("Olympic") contends this is not even required as part of this analysis. (Answer Brief at pp. 32-33, 66.)

not prevent assuming the presence of an intangible when valuing *taxable property*. (*Elk Hills, supra*, 57 Cal.4th at pp. 614-615.) And though a taxable property's value may be enhanced by assuming *the presence* of an intangible, the value of taxable property is not enhanced by *the value* of that intangible; rather, the taxable property's value is enhanced by *the presence* of that intangible. (*Ibid*.)

The second of these statements is: a court must determine if an intangible was "necessary to the beneficial or productive use of property," because if not, it could not have been reflected in the valuation. (*Elk Hills, supra*, 57 Cal.4th at p. 615.) However, the converse (if an intangible was necessary for the property's use, its value must have been subsumed in the valuation of the taxable property) is not necessarily also true. Under an income approach to value, the fact there is income attributable to the taxable property itself or the use thereof – not the means or form by which it is provided – is what matters. (Rule 8, subd. (c), (e).)

a. The form of consideration is irrelevant.

Whether the transient occupancy taxes (TOT) remitted to Olympic and Georgia Partners, LLC ("Olympic") is called a rebate, cost reimbursement, incentive, or subsidy, it is income earned solely from a guest's use of a room, regardless of whose efforts puts people in those rooms. The money Ritz-Carlton and Marriott (the "Managers") paid Olympic for the Managers' rights to use Olympic's property for the Managers' business operations, whether it is called key money, prepaid rent, or a discount is also income. Even if key money and TOT are not "rents" or "royalties," they are "money or money's worth." (Rule 8, subd. (c).)

b. It is unnecessary that the payor receive an interest in real estate for purposes of real property law.

The absence of an instrument granting an interest in real estate for purposes of real property law does not matter since payments for use or from operation of taxable property is income for purposes of property tax law.[5] (See *Elk Hills*, *supra*, 57 Cal.4th p. 609, fn. 8 (property interests defined and created by independent sources of state law; not defined by inherent property-like characteristics of "alleged property"), quoting *Board of Regents v. Roth* (1972) 408 U.S. 564, 577.) A guest acquires no real property interest in a room during a stay, yet income earned in consideration of the right to use a room is indisputably included in calculating the property's taxable value. (*OGP*, *supra*, 90 Cal.App.5th at p. 119.)

3. The taxpayer must show the intangible is capable of a quantified valuation.

The final inquiry is whether the taxpayer has produced independent substantial evidence of the value of the intangible relating to the value of the business using taxable property that the taxpayer seeks to exclude from the assessed value. (§§ 110, subd. (d)(1); 212, subd. (c).)

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[5] *SHR St. Francis LLC v. City and County of San Francisco* (2023) 94 Cal.App.5th 622, suggests the rights to possess or use property are intangible attributes of real property. (*Id.* at p. 640, citing § 110, subd. (f).) Even if not "attributes," and although rights are themselves intangible, they are "real property," which means the income derived from these rights is taxable since it is derived from real property itself. (§ 104, subd. (a) ("real property" includes "possession of, claim to, ownership of, or right to the possession of land").)

a. The unitary value of property operated as a unit must be apportioned between value attributable to the business enterprise and value of the taxable property itself.

In cases involving unitary value where property has both taxable property and an exempt intangible operated together as a unit, the assessment must apportion that value by removing the value of the intangible. (*Elk Hills*, *supra,* 57 Cal.4th at pp. 614, 618-619; see also § 110, subd. (d)(2).) For example, as a result of its enterprise activities, a manager might be able to charge incrementally higher rates for rooms based on the manager's use of its intangibles at the property. But the rooms still have inherent value even if not made available for rent by that manager.[6]

Under an income approach, the key is determining the source of income: the taxable property itself or the use thereof versus the exempt business enterprise activity.[7] (Rule 8, subd. (c), (e).) This requires the taxpayer to identify the separate stream of income attributable to the business enterprise' use of an intangible at the

[6] *OGP* potentially affects the taxation of property used as a restaurant or bar in other cases. (See *St. Francis*, *supra*, 94 Cal.App.5th 622.) All revenue from food and beverage operations should not be summarily classified as income solely attributable to an exempt intangible. Like the assessment of other property using an income approach to value, income attributable to use as a restaurant and bar might be the highest and best use of that property. That there might be some intangibles (prominent chef, superior management, franchise, etc.) present does not mean all income resulting from this use necessarily results solely from just those intangibles and must be indiscriminately excluded from valuation of the taxable property. (*OGP*, *supra*, 90 Cal.App.5th at p. 112; see also *St. Francis*, *supra*, 94 Cal.App.5th at p. 641, fn. 10.)

[7] Although ownership of an intangible does not affect its taxability, it is important to clarify whether income is attributable to the property, which is owned by Olympic, or the business, which is owned by the Managers.

property that “directly contributes” value to the business apart from the income attributable to use of the taxable property. (See *Elk Hills*, *supra,* 57 Cal.4th at pp. 618-619.)

In essence, *OGP* asks only whether the intangible is capable of valuation, i.e., whether the income ascribable to it can be quantified. (*OGP*, *supra,* 90 Cal.App.5th at pp. 109-110.) This appears to be based on a mischaracterization of *Elk Hills*’ explanation that only the (second) category of intangible assets that make a “direct contribution” to a business’s going concern value have a quantifiable fair market value that must be deducted. (*Elk Hills*, *supra,* 57 Cal.4th at pp. 618-619.)

Whether income from operating a property is attributable to the presence of an intangible is an incomplete inquiry. Income may be generated by an intangible together with the use of taxable property, such that the income is not solely attributable to that intangible independent of the taxable property. (*SHR St. Francis, LLC v. City and County of San Francisco* (2023) 94 Cal.App.5th 622, 634, citing *Elk Hills*, *supra,* 57 Cal.4th at p. 614 [no reason why intangible cannot enhance both taxable property and going concern value of business using taxable property].) Rather, the proper question is what income is derived from the use of the taxable property itself because that portion of income must be included in – not deducted from – the capitalized income stream.

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b. The value of an intangible to a business is not the same as the value of the business.

The assessment does not have to remove the going concern value of the entire business enterprise or the value of an intangible to the business not related to use of that intangible at the property. (*Elk Hills*, *supra*, 57 Cal.4th at p. 608 [discussing going concern value].) This is because intangibles can be used to generate income, and thus have value, apart from the particular property where they are used. Further, a reduction in costs to the manager does not necessarily result in reduced costs (and thereby increased income) for the property owner. Where a manager still charges the owner, and the owner still pays the manager, the same flat percentage fee based on room rental rates, a business has every incentive to minimize its own costs to increase its profits. While this may increase the business's value, it should not in turn reduce the property's assessable value. For example:

- A manager might have propriety processes or systems it uses to increase the efficiency of its operations thereby reducing its costs.
- A favorable operating contract likely has greater value to the party to that contract than to a third-party beneficiary since the manager does not necessarily pass on these favorable terms to the property owner.
- A customer base likely has greater value to the business overall in comparison to the limited number of those customers that might use a particular property.

Under an income approach, it is thus only the portion of income attributable to the specific use of the intangible at the property that directly contributes to the business's value that must be excluded, *if* it can be quantified.

B. APPLYING THE INCOME APPROACH BY REMOVING INTANGIBLE EXPENSES FROM AN INCOME STREAM PRIOR TO CAPITALIZATION MAY ACCOUNT FOR A RETURN "ON" AND "OF" AN INTANGIBLE INVESTMENT.

When income from operating a property is used to determine its value, Rule 8, subdivision (e), requires only that "sufficient" income be excluded to provide a "return on" nontaxable operating assets. But there is no case, statute, or Rule that requires that some additional amount of anticipated income must always be removed in every case.

In *OGP*, the methodology utilized to remove the value of identified enterprise intangibles was to deduct the expense of the intangible before capitalizing the resulting net income stream.[8] The issue is whether this

[8] This methodology is sometimes referenced as the "Rushmore Method," which has the potential to be misleading as to what it does and does not remove, capture, or account for. (See *OGP*, *supra*, 90 Cal.App.5th at p. 112 [whether deduction of franchise fee accounted for value of franchise affiliation and associated workforce]; *St. Francis*, *supra*, 94 Cal.App.5th at p. 636, fn. 7 [whether deduction of management fees captured full value of management agreement itself, not any and all other nontaxable intangibles]; *SHC Half Moon Bay, LLC v. County of San Mateo* (2014) 226 Cal.App.4th 471, 478, fn. 5 [whether deduction of management and franchise fees excluded value of all intangible assets, including goodwill].)

methodology removes the intangible's full value by accounting for both a "return of" the expense of an asset and a "return on" that investment.[9]

1. Whether application of a capitalization rate provides for a sufficient return on an investment is a question of fact, not an invalid method as a matter of law.

Deducting the expense of an asset from the income stream to be capitalized might not remove that asset's full value in all cases, but in some cases, a capitalization rate may provide for an anticipated return on an investment. (Cal. State Bd of Equalization, Assessors' Handbook ("AH") Section 501 Basic Appraisal (Jan. 2002) at pp. 99, 100, 102; AH 502 at pp. 62, 64, 66.) Capitalizing an expense and then deducting it before capitalizing the resulting net income may be sufficient since this both adjusts the income to capitalize, and it may remove the asset's full value from the capitalized income value.[10] (See AH 502, at p. 165.)

No case has held use of a capitalization rate always fails to (or can never) sufficiently account for the "return on" an investment as a matter of law. *SHC Half Moon Bay, LLC v. County of San Mateo* (2014) 226 Cal.App.4th 471, did not address whether deduction of a capitalized expense for an intangible accounted for

[9] *OGP* and the parties do not appear to dispute removing the expense of an asset from the income stream accounts for a "return of" that capital.

[10] Mathematically, in determining the value of taxable property using an income approach, there is no difference whether an expense is separately capitalized and removed, or the resulting net income stream is capitalized after the removal of that expense.

its full value.[11] (*St. Francis, supra,* 94 Cal.App.5th at pp. 637-638.) While *St. Francis* found the otherwise "formulaic" deduction of fees from an income stream was "legally erroneous," it did not hold using a capitalization rate to provide a return on an intangible is an invalid methodology as a matter of law. (*Id.* at p. 636.) Rather, there was a lack of evidence to show why the applied capitalization rate accounted for the claimed return on the intangible as opposed to the other taxable property. (*Id.* at pp. 638-639.) To wit, AH 501's guidance that a capitalization rate must be derived from comparable sales involves factual questions since whether a property is comparable to the subject is a question of degree, or how much they are similar. (AH 501 at p. 103.) Whether the selected capitalization rate excluded "enough" income was an observation of the lack of substantial evidence to answer that question of fact.[12]

2. Rule 8 does not support an automatic blanket approach for a return on each and every expense.

OGP assumes no reasonable property owner would enter into a management agreement unless the agreement would generate more income to the

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[11] At the very least, deducting management fees as an expense from gross income and capitalizing the net income removes the full value of goodwill, an intangible. (*SHC Half Moon* Bay, *supra,* 226 Cal.App.4th at pp. 492-493.)

[12] To calculate an appropriate "return on," the plaintiffs in *St. Francis* suggested it was proper to deduct an additional percentage ***<u>based on</u>*** the management fees. (*St. Francis, supra*, 94 Cal.App.5th at pp. 639, fn. 8.) But using a percentage deduction is no different than applying a capitalization rate. Both are based on an underlying expense, e.g., the fees for the management agreement – applying a percent reduction is a function of multiplication, whereas applying a capitalization rate is a function of division.

owner than the fees payable to the manager. (*OGP*, *supra*, 90 Cal.App.5th at p. 112; see also *St. Francis*, *supra*, 94 Cal.App.5th at pp. 636, 638.) This is based on the faulty premise that a property owner anticipates income from every expense. Such a position does not consider the costs of doing business. Rule 8 differentiates between expenses required to maintain income and income that provides a return on expenditures. (Rule 8, subd. (c), (e).)

Considering owners are not in the business of managing hotels themselves, an owner might incur the cost of a management agreement if the owner desires to break even or avoid a loss through its own under-performing or inferior management. Likewise, an owner might hire a manager if the fees the owner must pay the manager are less than what it would cost the owner to manage the property itself.

C. *OGP* IMPERMISSIBLY USURPS ASSESSMENT APPEALS BOARDS' FACT-FINDING AUTHORITY TO DETERMINE EVIDENTIARY MATTERS.

The sufficiency and credibility of evidence are evidentiary issues involving questions of fact. Factual findings and determinations must be sustained if supported by substantial evidence. (*Elk Hills*, *supra*, 57 Cal.4th at p. 606; *SHC Half Moon Bay*, *supra*, 226 Cal.App.4th at p. 493.)

1. Sufficiency of the evidence is a factual question.

Rule 8, subdivision (e), requires "sufficient" income be excluded to account for a return on an intangible asset. Since sufficiency is a question of degree, whether the applied methodology removed "enough" value of an exempt intangible is a factual question. (*EHP Glendale, LLC v. County of Los Angeles* (2011) 193 Cal.App.4th 262, 275-276.)

In *St. Francis*, although the assessor did not, it could have presented evidence that the return on the management agreement or its quantified value did not exceed the fees that were removed, such that deduction of those fees themselves may have been sufficient to remove the full value and not “otherwise formulaic.” (*St. Francis, supra,* 94 Cal.App.5th at pp. 636-637, 638-639.) In *GTE Sprint Communications Corp. v. County of Alameda* (1994) 26 Cal.App.4th 992, 1003-1004, the assessor’s “absolutist approach” made no effort to remove the value of identified intangibles and instead claimed they were all taxable enhancement value. In *SHC Half Moon Bay*, by refusing to identify and value certain intangible assets the assessor admitted were not removed through deduction of management and franchise fees, the assessor paid only “lip service” to the exemption of those intangibles from taxation. (*SHC Half Moon Bay*, *supra*, 226 Cal.App.4th at p. 492.)

All this points to a factual question of whether there was substantial evidence to support the value that was removed, not that deducting the capitalized expense of an intangible is incapable of accounting for its full value of as a matter of law. Whether the parties have put forth enough evidence (or there is none) to show (or not show) a sufficient value of a nontaxable intangible asset was removed are all factual questions. (*EHP Glendale*, *supra*, 193 Cal.App.4th at pp. 275-276.)

2. The credibility of evidence is a factual question.

Whether a taxpayer produces credible evidence of a quantified value of an exempt intangible that was allegedly subsumed in the assessed value of taxable property is a question of fact. As the finder of fact, assessment appeals boards determine the credibility of evidence, not reviewing courts. (*EHP Glendale*, *supra,* 193 Cal.App.4th at pp. 275-276.) In *OGP*, the assessment appeals board found the evidence relating to the enterprise assets not persuasive, not compelling, and not reliable, i.e., not credible. (*OGP*, *supra*, 90 Cal.App.5th at pp. 106, 111.) These are all issues of fact.

The findings indicating disagreement with the evidence were not a "peremptory" dismissal of that evidence, which would mean it was not even considered at all. (See *OGP*, *supra,* 90 Cal.App.5th at pp. 108, 111-112.) Adequately addressing, diligently grappling with, or responding to evidence does not mean assessors and assessment appeals boards must accept all proffered evidence, adopt conclusions of value based on inadmissible evidence, and remove mathematically quantified values from the assessment. (*Id.* at pp. 111-112.)

If there is a question about whether the treatment of evidence is peremptory, the Court should look to the record of the proceedings below. If there is not enough evidence to support a finding of fact, then the proper remedy is for the Court to remand that determination to the assessment appeals board. This does not mean, however, the Court should instead reweigh evidence and substitute its own judgment by finding quantified valuations of intangibles to be "apparently credible," unless there is no issue of fact as a matter of law. (See *OGP*, *supra*, 90 Cal.App.5th at pp. 111-112.)

III. CONCLUSION

For all these reasons, Amicus Curiae respectfully requests this Court reverse the Court of Appeal and find in favor of County of Los Angeles.

Dated: December 29, 2023

Respectfully submitted,

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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 4309 words.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 29th day of December, 2023 in Sacramento, California.

Respectfully submitted,

/s/ *Jennifer B. Henning*
By: ________________________
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