Unit Valuation: Oklahoma's Illegal Tax on Intangible Property

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UNIT VALUATION: OKLAHOMA’S ILLEGAL TAX ON INTANGIBLE PROPERTY

I. INTRODUCTION

A hypothetical public utility, railroad, or similar company, is purchased by an unrelated third party for $5 billion. The price is perplexing because all normal valuation techniques value the company to be worth only $4 billion. In fact, State X has valued the property at $4 billion for ad valorem tax purposes. So would the sale of the company for $1 billion over its calculated worth permit the State to increase its taxable value?

The problem with such a potential increase in the assessed value, from the perspective of many public utility companies and railroads, is that the value in excess of assessed value does not represent worth attributable to either real or tangible personal property which is subject to ad valorem taxes. Instead, the $1 billion represents value attributable to the company’s intangible property such as customer lists, assembled workforce, long-term contracts, computer software, and goodwill, all of which are normally exempt from property taxes. In fact, the $4 million assessed value determined by State X may already include value from these intangible assets since it was computed using the unit valuation method.

This hypothetical is not far from reality in the State of Oklahoma. Public service companies and various transportation companies in the State, which are subject to centralized assessment based on unit valuation, are effectively assessed property taxes on their intangible assets. The tax that results is not only beyond the scope of the state’s taxing authority but is also in violation of the Oklahoma Constitution.

The proposition of this comment is that the unit valuation method used by the State of Oklahoma to assess property taxes on railroads and public service corporations implicitly taxes intangible property in violation of the State’s constitution. To lay a foundation for this argument, the reader is first introduced to the theory and mechanics of the unit valuation method, followed by a discussion of what constitutes intangible assets and how they are effectively taxed by this valuation method. The comment then reviews how other
states have resolved similar policy issues, and the controlling constitutional and statutory provisions which should prevent Oklahoma from taxing the intangible values. In conclusion, a recommendation is provided of how the State should arrive at the proper valuation of the public utilities.

II. Theory of Unit Valuation

Property taxes, also referred to as ad valorem taxes, are a very common means to raise revenues for state and local governments. When compared to other state and local taxes, property taxes usually generate the highest amount of revenues; in 1989 that amount was in excess of $142.5 billion. The tax is usually assessed on a local level, either by counties or cities, and is the major component for public school financing.

The property tax system utilized in Oklahoma is paradigmatic of the methods in most jurisdictions. The tax is based on the value of property as of a specific date and is assessed on an annual basis. The value of the property, referred to as the fair cash value, is basically the price at which a willing buyer and a willing seller would agree to sell the property, each having knowledge of any particulars associated with the property which may affect its value. The locality, through an official referred to as an assessor, will estimate this value by making a market appraisal. To calculate the tax, the assessor multiplies the assessed value, or a portion thereof, by the applicable tax rate.

The normal procedure utilized by assessors is to value each property location based upon its individual worth. Some commercial taxpayers may have operations at more than one location in the taxing

1. Defined as a tax imposed on the value of property. BLACK'S LAW DICTIONARY 51 (6th ed. 1990). Throughout this article the terms “ad valorem tax” and “property tax” will be used interchangeably.
5. In Oklahoma, with the exception of railroads and public utilities, property taxes are assessed by the counties. OKLA. CONST. art. X, §§ 9, 20, 21.
6. E.g., Amdur, supra note 4, at 221.
7. Id. The tax rate is often referred to as the millage rate or mill. OKLA. CONST. art. X, § 9.
district. The method utilized to assess property taxes on these properties is referred to as the summation approach.\(^8\) Under this approach, the assessor takes each individual property and determines its separate value, usually based on the sales of comparable properties in the same vicinity of the property being assessed.\(^9\) The commercial taxpayer is then assessed a property tax on the total of the values assigned to each separate property.\(^10\)

The summation approach is not used by Oklahoma to value the property of railroads and public utilities,\(^11\) the property of which may extend through several localities or several states. These properties are assessed on a centralized basis by a state agency\(^12\) rather than locally and are valued by using the unit valuation method\(^13\) which is typical of most jurisdictions.\(^14\) Instead of valuing property of a public utility on an asset by asset basis and totaling those values, the State values the property of an entire system as a going concern.\(^15\)


\(^9\) Although other methods may be used (e.g. income capitalization), the comparable sales approach is generally considered to be the best indicator of what the property would sell for between a willing buyer and a willing seller. James A. Amdur, *Property Taxation of Regulated Industries*, 40 TAX LAW. 339, 347-48 (1987).

\(^10\) Rabe & Reilly, supra note 8 at 13.

\(^11\) Although this comment will focus primarily on public service companies, railroads and other taxpayers subject to unit valuation are similarly affected. Public service companies are businesses that supply the public with “some commodity or service which is of public consequence and need” including energy (e.g. electricity and gas), transportation (e.g. railroads and pipelines), or telecommunications. Michael E. Green & Terrence J. Benshoof, *Exclusion of Intangibles From the Unit Value*, 1 ST. TAX NOTES 547, 548 (1991); see also Amdur, supra note 9, at 339. In Oklahoma, a public service company is defined as:

all transportation companies, transmission companies, all gas, electric, light, heat and power companies and all waterworks and water power companies, and all persons authorized to exercise the right of eminent domain or to use or occupy any right-of-way, street, alley, or public highway, along, over or under the same in a manner not permitted to the general public.

**OKLA. STAT. tit. 68, § 2808(A) (1991).**

\(^12\) Amdur, supra note 9, at 342.

\(^13\) Amdur, supra note 4, at 222.

\(^14\) Thirty-six other states assess railroad and public utility property using similar methods. The states include Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Georgia, Idaho, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Virginia, Washington, West Virginia, and Wyoming. *Id.* at 221 n.6 (citing 1 Advisory Comm’n on Intergovernmental Relations, M-176, Significant Features of Fiscal Federalism 163 (1991)).

\(^15\) Amdur, supra note 4, at 222.
Unit valuation, which has passed constitutional scrutiny,\(^{16}\) is basically the valuation of the entire unit comprised of all the operating assets which are utilized in the production or a service of product by a public utility;\(^{17}\) it is the valuation of a business as compared to its individual assets. The property of public utilities is assessed as a unit because the value of the property is thought to be more accurately represented when the entire system is valued together as an integrated system rather than as a group of separate properties.\(^{18}\) This method views property of public utilities as "an organic system... [which] may be assessed in terms of the economic contribution which each component makes to the entire system."\(^ {19}\)

Unit valuation may be analogous to selling a pair of shoes. Under the summation method, the value of the pair of shoes would be determined by valuing the right shoe and the left shoe separately and then combining those values.\(^{20}\) A more accurate indicator of the worth of the shoes is achieved if the pair of shoes is valued as a "unit," rather than separately.\(^ {21}\) A pair of shoes as a unit is worth more then two separate shoes.\(^{22}\) The lower value achieved through the summation approach is distortive of the worth that the shoes has to a potential buyer. Unit valuation corrects this distortion.

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16. Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, reh'g denied, 166 U.S. 185 (1897) (providing additional explanations of original opinion). The Court in Adams Express Co. stated:

As to railroad, telegraph, and sleeping car companies, engaged in interstate commerce, it has often been held by this Court [sic] that their property, in the several States through which their lines and business extended, might be valued as a unit for purposes of taxation, taking into consideration the uses to which it was put and all the elements making up aggregate value, and that a proportion of the whole fairly and properly ascertained might be taxed by the particular State, without violating any Federal restriction. The valuation was, thus, not confined to the wires, poles, and instruments of the telegraph company; or the roadbed, ties, rails and spikes of the railroad company... but included the proportionate part of the value resulting from the combination of the means by which the business was carried on, a value existing to an appreciable extent throughout the entire domain of operation... The States through which the companies operate ought not to be compelled to content themselves with a valuation of separate pieces of property disconnected from the plant as an entirety, to the proportionate part of which they extend protection, and to the dividends of whose owners their citizens contribute.

Id. at 220, 227. (emphasis added) (citations omitted).


21. Id.

22. Id.
The companies which are usually subject to unit valuation include both regulated and unregulated public utilities and transportation companies. They are usually "interstate, capital-intensive businesses that employ systems of interdependent interrelated assets in multiple jurisdictions." Although the businesses were historically almost always publicly regulated utilities, this is no longer necessarily true due to extensive deregulation.

Unit valuation is used to value public utilities for several reasons. Historically, the method was adopted because of the lack of uniformity and inherent bias involved by allowing local assessors to value the fractional parts of a public utility located within their taxing district. The primary reason that the method is used is to capture and tax the value attributable to the operations as a unit; value which the local assessors could not effectively measure. The value of the particular telephone pole, pipe, railroad track, or generator located in a county has very little intrinsic worth. But when viewed as a part of the entire operation of a telephone company, railroad, or electric company, the particular assets increase in value due to the synergistic worth they contribute to the enterprise.

III. Mechanics of Unit Valuation

A. Generally

The State Board of Equalization, the agency in Oklahoma with the vested authority to assess property taxes on public service companies, may use various appraisal techniques to value the state assessed

24. Id.
25. Amdur, supra note 9, at 342-43. (citing 2. J. BONBRIGHT, THE VALUATION OF PROPERTY 637-57 (1937)).
26. Id. at 343-44.
27. See ITT World Communications, Inc. v. City & County of San Francisco, 693 P.2d 811, 815 (Cal. 1985) stating:
   One of the primary objectives of the system of unit taxation of public utility property is to ascertain and reach with the taxing power the entire real value of such property . . . . It has long been recognized that "public utility property cannot be regarded as merely land, buildings, and other assets. Rather, its value depends on the interrelation and operation of the entire utility as a unit. Many of the separate assets would be practically valueless without the rest of the system."
   Id. (citations omitted).
property.\textsuperscript{29} Although not mandated by either the State's constitution or statute, the Board has chosen to use the unit valuation method to value the property of the public utilities.\textsuperscript{30}

A state assessed property tax using the unit valuation method has five basic steps: (1) compute several market value indicators, (2) correlate the market value indicators to derive a fair market value for the property, (3) allocate the value attributable to the property located in the state, (4) equalize the allocated fair market value with all other properties in the same class, and (5) distribute the value to the various localities within the state where the property is located.\textsuperscript{31}

B. \textit{Computing Market Value Indicators}

Unit valuation is typically measured by the use of several appraisal techniques; the most common ones used by states are the market approach, the income approach, and the cost approach.\textsuperscript{32} The assessor will usually compute an estimated value for the property under each of the appraisal techniques, rather than using just one particular method.\textsuperscript{33} The value of the property as determined by each approach is generally referred to as the "value indicator."\textsuperscript{34} The market indicators are then correlated by the appraiser to determine the fair market value of the property.

The market approach estimates the value of a property based on the price that a willing buyer would purchase the property from a willing seller.\textsuperscript{35} Traditionally, this has been established by market data on recent sales of comparable property within the vicinity of the property being assessed.\textsuperscript{36} But since public utilities are not sold on a regular

\textsuperscript{29} E.g., Sinclair Prairie Oil Co. v. State, 50 P.2d 150 (Okla. 1935).

No particular method of valuation is prescribed by the Constitution or the statutes for the guidance of the [State] Board of Equalization in determining the value of property, and the method used is immaterial so long as it does not appear that the value so determined and fixed by the board exceeds the fair cash value of the property.

\textit{Id.} at 151.

\textsuperscript{30} Of the thirty-six states which use the unit method, only seventeen do so under legislative or constitutional mandates. Administrative agencies in the other nineteen states, including Oklahoma, voluntarily use unit valuation to value centrally assessed property. Thomas M. Kaine & Thomas W. McCandlish, \textit{Unit Valuation of Railroad Property and Public Utilities: Does the Unit Method Measure Asset Value?}, J. Prop. Tax Mgmt., Summer 1991, at 51, 53.

\textsuperscript{31} See Amdur, \textit{supra} note 4, at 223-224; Kane & McCandlish, \textit{supra} note 30, at 52.

\textsuperscript{32} Amdur, \textit{supra} note 9, at 343.


\textsuperscript{34} Amdur, \textit{supra} note 9, at 365-64.

\textsuperscript{35} Amdur, \textit{supra} note 4, at 231.

\textsuperscript{36} \textit{Id.}
basis, data on comparable sales is generally not available. As a result, the market approach for unit valuation is usually based on the aggregate market value of the utilities' stocks and bonds. Value is determined under this approach, referred to as the stock and debt approach, by the market price of the taxpayer's securities. Market price is calculated either as of a particular day during the year or by taking the average value of the securities throughout the assessment year.

The income approach, also referred to as the capitalized earnings method, states value in terms of the present value of the anticipated future income which could be generated from the property. The underlying theory of this approach is that any potential buyer of the property would only pay as much as the income which the property could generate. Value under this approach is calculated by first determining the future income stream from the property, based on either past income for a period or projected future income based upon prospects. This income stream is then discounted at a rate of return that a prospective purchaser would expect to earn on a similar investment.

The cost approach determines value based on the original, reproduction, or replacement cost of the property less an allowance for depreciation. This method is considered an accurate indicator of value because a potential buyer would "pay no more for a particular property than the cost of acquiring or constructing a substitute property having the same utility." The value is basically either the original cost of the property, the cost of constructing an exact duplicate of the property at current market prices (reproduction cost), or the cost of a functionally equivalent property which incorporates the latest technological improvements (replacement cost).

37. Amdur, supra note 9, at 348.
38. Id.
39. Id. at 350.
40. Id.
42. Amdur, supra note 9, at 350, 353.
43. Id. at 357.
44. Id. at 357-58.
45. Id. at 358-59.
C. Correlation

The unit valuation of a public utility is generally accomplished by the use of one or a combination of the above appraisal techniques. The value indicators will generally not be the same and can possibly vary quite significantly. The assessor must determine how to correlate the value indicators to arrive at a value that is a fair estimate of the value of the property. The process of correlation may determine that the value indicator of only one of the appraisal techniques should be used, or it may determine that a combination of several of the indicators most fairly represents the value of the property. When several of the indicators are used, the assessor must determine the relative weight each value indicator will be assigned in the final valuation. The final valuation, the estimated fair market value, then becomes the ultimate value used to determine the public utility's property tax liability.

D. Allocation

Because many public utilities and other corporations assessed on a unit valuation are located in more than one state, and since the Due Process and Commerce Clause of the Federal Constitution prohibit a state from taxing value outside its borders, the value determined after correlation must be properly allocated to the taxing state. Allocation may be achieved by using either a formula based on quantity of physical property or the relative productivity of the property. The allocated amount then becomes the assessed value of the property.

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46. Amdur, supra note 4, at 223 (noting use of market, income, and cost techniques for valuation of public utilities).
47. Id. at 258-59.
48. Bertane, supra note 33, at 432.
49. Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n, 390 U.S. 317, 324-26 (1968) (ruling that the method of allocation used by Missouri resulted in an amount which was grossly disproportionate to the actual value of the property of the railroad in the State and was therefore in violation of both the Due Process Clause and the Commerce Clause).
50. Amdur, supra note 9, at 365.
51. An example would be an allocation based on miles of track, with the numerator representing total miles of track located in the state and the denominator representing total miles of track in the entire system. See Id. at 364-65.
52. An allocation based on kilowatt hours is an example, with the numerator representing the kilowatt hours utilized in the state and the denominator representing the total kilowatt hours generated. See Id. at 365.
E. Equalization

Equalization is the process "by which the assessed value of a taxpayer's property is adjusted so that it bears the same relationship of assessed value to market value as other properties within the same taxing jurisdiction." Many states, including Oklahoma, assess property at some percentage of fair market value under constitutional and legislative mandates or due to prevailing practice. The percentage of the fair market value to assessed value is referred to as the "assessment ratio." Not all property is treated equally for this purpose, as some states have created classification systems of property which enable them to apply different equalization rates to the property according to its use characteristics. The process of equalization assures that property within the same classification is equally taxed by adjusting the assessed values to a uniform percentage of full value.

Public service companies are treated as a separate class of property in Oklahoma. This allows the state to apply a higher assessment ratio to these properties as compared to others. The maximum assessment ratio that can be applied to all property is 35 percent. The prevailing current practice is to apply a 22.85 percent assessment ratio to the property of public service companies and a 12.08 percent assessment ratio to the property of railroads. Therefore, only 22.85 or 12.08 percent of the allocated fair cash value becomes the assessed value subject to ad valorem taxation.

53. INSTITUTE OF PROPERTY TAXATION, supra note 23, at 608.
54. Id. at 608-09.
55. Amdur, supra note 9, at 369.
56. See Id. at 368-69. The Equal Protection Clause of the United States Constitution permits the classification of individuals and entities for taxing purposes. The Clause only requires that the taxpayers who are in the same class be treated equally. Charleston Fed. Sav. & Loan Ass'n v. Alderson, 324 U.S. 182, 190 (1945). The Oklahoma Constitution also does not prohibit the classification of taxpayers. OKLA. CONST. art. X, § 22.
57. Amdur, supra note 9, at 369.
60. Brian Ford, Firms Protest Tax Ratios, TULSA WORLD, Aug. 9, 1994, at A1, A3. At least 75 companies, primarily pipelines and public utilities, filed lawsuits challenging the application of the assessment ratio as a violation of the Oklahoma Uniformity Clause since railroads are only assessed at a 12.08 percent. Brian Ford, More Companies Join Protest of Tax Ratios, TULSA WORLD, Aug. 10, 1994, at N1. The issue has been temporarily decided in favor of the State by the Oklahoma Supreme Court. Williams Natural Gas Co. v. State Bd. of Equalization, 891 P.2d 1219 (Okla. 1994).
F. Distribution

Distribution of the assessed value to various localities in the state is then necessary since the property is usually located in more than one city or county. Distribution is accomplished by the use of various formulas, some of which may mirror the formula used to allocate the property value to the state.

IV. Taxation of Intangibles

A. Policy Decisions Concerning Intangibles

Although a property tax on real and personal property is fairly universal in the United States, a trend in several states has been to provide special treatment for intangible property. While some states tax intangible property under an entirely different system, the majority of the states exclude the property from ad valorem taxation. The exemption from an ad valorem tax on intangibles is accomplished by either a constitutional prohibition against such tax, statutory exemptions, or excluding the property from the definition of taxable property.

There are two reasons for this trend, the first being that it is difficult to define exactly what is included in the definition of an intangible asset. This has led to inconsistent treatment of intangibles as applied to domestic and foreign corporations, resulting in successful court challenges under the Commerce Clause of the U.S. Constitution. Instead of attempting to correct the discriminatory tax, several states have decided simply to repeal any tax on intangible property.

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61. E.g., Kaine & McCandlish, supra note 30, at 52.
62. Id.
64. BLACK'S LAW DICTIONARY defines the term as a right rather than a physical object, including goodwill, trademarks, and copyrights, or the like. BLACK'S LAW DICTIONARY 809 (6th ed. 1990). Intangible property may be more exactly defined as:
   property which has no intrinsic and marketable value, but is merely the representative or evidence of value . . . . Intangible property is quite different in nature from corporeal property, and there is an obvious distinction between tangible and intangible property. Intangible property is held secretly; that is, it cannot be readily located, and there is no method by which its existence or ownership can be ascertained. . . .
66. Hellerstein, supra note 18, at 302.
67. See OKLA. CONST. art. X, § 6A.
68. E.g., IOWA CODE § 441.21(2) (1990); CAL. REV. & TAX. CODE § 212 (West 1992).
69. Id.
70. Id.
second concern has been the difficulties associated with the valuation and identification of the intangible property.\textsuperscript{71}

B. \textit{Types of Intangibles}

Historically, any time the worth of a business exceeded the value attributable to the tangible real and personal property, the entire value was assumed to come from the \textit{goodwill} of the business.\textsuperscript{72} The concept of goodwill was used to refer to the existence of all intangible assets possessed by the business.\textsuperscript{73} But gradually, due to increases in business complexity and a related increase in analytical tools used to value businesses, individual intangible assets have been identified and separated from the catch-all concept of goodwill.\textsuperscript{74}

The individual intangible assets\textsuperscript{75} may be classified into five categories: evidence of ownership, rights, relationships, intellectual property, and undefined intangibles.\textsuperscript{76} An intangible which is evidence of ownership is property which has no intrinsic value, but its value is attributable to legal benefits inuring to its owner.\textsuperscript{77} Examples are stocks, bonds, and accounts receivables.\textsuperscript{78} The category of rights refers to the asset which is representative of the "right of an enterprise to provide or receive goods and/or services that yield an economic benefit."\textsuperscript{79} This category inclusively includes supply contracts, financing arrangements, licenses, and franchises.\textsuperscript{80} The category of relationships includes assembled work force, customer relationships, and other assets arising out of the business's relationships with outside parties which equate to some level of economic benefit.\textsuperscript{81} Patents, trademarks, and computer software comprise the intellectual property category.\textsuperscript{82}

\textsuperscript{71} Id. at 439-40.
\textsuperscript{73} Id.
\textsuperscript{74} Id.; Dennis McNiere & Brad A. Purifoy, \textit{Valuation Under the Unit Method; Should Intangibles Be Subtracted?}, J. PROP. TAX MGMT., Spring 1992, at 9, 11.
\textsuperscript{75} For definition of intangible assets, see supra note 64.
\textsuperscript{76} Smith, supra note 72, at 33. Other experts have classified intangible assets into eight categories including technology related, customer related, contract related, data processing related, human capital related, marketing related, location related, and goodwill related. Rabe & Reilly, supra note 8, at 16. Classifications are as diverse as imaginations allow.
\textsuperscript{77} Smith, supra note 72, at 33.
\textsuperscript{78} Id.
\textsuperscript{79} Id.
\textsuperscript{80} Id.
\textsuperscript{81} Id. at 34.
\textsuperscript{82} Id.
The final category, undefined intangibles, basically includes all other intangible assets which cannot be separately identified from the business.\textsuperscript{83} This category consists of goodwill and going concern value.\textsuperscript{84} The concept of goodwill, although historically\textsuperscript{85} thought to encompass all intangible values of a business, is generally the asset which arises from "the reputation of a business and its relations with customers;"\textsuperscript{86} the "proclivity of customers to return to a business and to recommend it to others."\textsuperscript{87} Goodwill explains why, when all things are considered equal, a customer will prefer to patronize a particular business instead of a competitor's. The concept can be represented by consumer loyalty, brand name recognition, or firm reputation.\textsuperscript{88}

Going-concern value is generally the worth of a business attributable to the fact that it has all its tangible assets in place and operating, has an adopted business strategy, and has established operating practices and procedures.\textsuperscript{89} This value can basically be explained as the difference between an operating pipeline company, which has the capacity to immediately generate revenue, and one which has all the same assets and employees, but with no possible means to immediately generate income because it has no pipe in the ground and none of its employees are trained.

Intangible assets are not unique to profitable Fortune 500 businesses. They are possessed by all business enterprises, "from a pushcart vendor of hot dogs on the street to the largest multi-national corporation,"\textsuperscript{90} even though the enterprise may not be profitable. The types of intangibles possessed by an enterprise will depend upon several factors, including the type of industry, ownership structure, and

\begin{thebibliography}{99}
\bibitem{83} Id.
\bibitem{84} Id.
\bibitem{85} The concept of good will has appeared as early as 1571 in English legal documents, making it the oldest recognized intangible asset. Green \& Benshoof, \textit{supra} note 11, at 549.
\bibitem{86} \textit{THE RANDOM HOUSE COLLEGE DICTIONARY} 568 (1st rev. ed. 1980).
\bibitem{87} Smith, \textit{supra} note 72, at 34.
\bibitem{88} Bell \& Zhu, \textit{supra} note 2, at 5.
\bibitem{89} See Smith, \textit{supra} note 72, at 34-35. The term may be more technically defined as "the additional element of value which attaches to property by reason of its existence as part of a going concern." \textit{Gordon V. Smith \& Russell L. Parr, VALUATION OF INTELLECTUAL PROPERTY AND INTANGIBLE ASSETS} 37 (1989). Going concern has also been defined by the U.S. Supreme Court as:
\begin{quote}
\textit{an element of value in an assembled and established plant, doing business and earning money over one not thus advanced, and that this element of value is a property right which should be considered in determining the value of the property upon which the owner has a right to make a fair return.}
\end{quote}

\bibitem{90} Smith \& Parr, \textit{supra} note 89, at 145. For a more in-depth analysis, see Smith, \textit{supra} note 72, at 35.
\end{thebibliography}
competitive environment. No matter what types of intangibles are possessed, they can often significantly increase the value of an enterprise, although sometimes they may have the effect of reducing the net value of a business (e.g. negative goodwill). Consider, for example, the trademarks of the Coca-Cola Corporation, which have an estimated worth of approximately $35 million, and the substantial premium over book value that the stock of Merck & Co., Inc. trades for, attributable to its drug patents and research programs. Intangible assets may also significantly increase the net worth of public service companies and railroads, such as Burlington Northern Railroad, the largest railroad in the United States:

Burlington Northern's 25,000 mile transportation system is guided by sophisticated software systems created and managed by hundreds of highly trained professionals. Its skilled workforce of over 30,000 employees is critical to the success of the company. Its customer contracts, which secure over 90 percent of the company's most valuable revenue source... are also substantial...

Therefore, in addition to being present in every business enterprise, although they might appear in different forms depending upon the nature of the business, intangible assets usually add significantly to the entire net worth of an enterprise.

C. Unit Valuation Implicitly Taxes Intangibles

Although a majority of states have made a public policy decision to exclude intangible property from property taxation, their taxing system may be effectively taxing the property through the application of unit valuation techniques in assessing public service companies. The issue of whether unit valuation results in taxing intangibles is basically a question of fact, as opposed to law, and can only be resolved by an analysis of the different methodologies used in unit valuation.

While it is axiomatic that unit valuation includes values attributable to intangible assets, there is always an issue as to the extent of such inclusion. The general theory of unit valuation, which is to assess a value on the entire business operations as a going concern, does

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91. Smith, supra note 72, at 33.
92. See Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, reh'g denied, 166 U.S. 185, 222 (1897) (finding that of the $16.8 million fair market value of the railroad, $12 million represented value attributable to intangible property like franchises and privileges).
93. McKnire & Purifoy, supra note 74, at 11.
94. E.g., Hellerstein, supra note 18, at 302; Green & Benshoof, supra note 11, at 547.
95. Green & Benshoof, supra note 11, at 547, 550; E.g., Amdur, supra note 9, at 344.
96. See discussion supra part II.
not prohibit including worth attributable to the intangibles in the assessment. In fact, the theory is to value the entire business concern and not just the individual assets of the business. Since every business has some form of intangible assets, the conclusion can therefore be made that value attributable to intangibles are included in the fair cash value as determined by unit valuation.

The stock and debt approach, which values a company based on the market price of its securities, includes the value of all the assets (real, personal, and intangible) of such business. When an investor buys the stock of Exxon, the price he pays is not merely the market value of the tangible assets, but the price represents the total worth of all the assets of the company. Likewise, the value derived from the use of the income approach, which bases the value of an enterprise on its income stream, represents the total value of a business. The stream of income used in the income approach reflects benefits derived from all assets of the enterprise, including the intangibles. The only method employed under the unit valuation method which does not appear to value the intangible assets is the cost approach.

D. Litigation Over Impermissible Taxation

Although it can be easily established that unit valuation results in the taxation of intangible assets, two questions remain: (1) whether such a result is impermissible, and (2) to what extent such value is actually taxed. Both of these questions have been the subject of much litigation in various state courts.

97. See supra notes 90-93 and accompanying text.
98. Green & Benshoof, supra note 11, at 550.
   In addition to the physical assets of the unit, a unit valuation implicitly includes necessary working capital to carry on the operations of the unit plus all franchises, permits, licenses, consents, grants, and any other intangible which by necessity or law "attaches" itself to the unit and without which the unit could not operate.
   Id. (emphasis added).
99. See discussion supra part III.B.
100. Hal B. Heaton, Key Problems in Using the Stock and Debt Approach, J. PROP. TAX MGMT., Winter 1994, at 4. This may be demonstrated by the disparity between the $24 billion value of Microsoft Inc., as calculated under the stock and debt approach, and the $800 million value which would be derived from valuing only the operating assets of the company. Id. at 4-5.
101. See Adams Express Co. v. Ohio State Auditor, 166 U.S. 185, 221, petition for reh'g of 165 U.S. 194 (1897) "The capital stock of a corporation . . . represent[s] not only the tangible property, but also the intangible, including therein all corporate franchises and all contracts, privileges and good will of the concern." Id.
102. See discussion supra part III.B.
103. Rabe & Reilly, supra note 8, at 16.
104. Bell & Zhu, supra note 2, at 3.
Since the theory of unit valuation does not prohibit including value attributable to intangibles, nor does it violate the Constitution of the United States the implicit tax on the property can only be impermissible if it is in violation of a state law. This particular analysis will depend upon the form of prohibition, and whether the application of unit valuation violates the public policy decision as enacted by the state legislature. Some states have determined that unit valuation, without any reduction for intangible value, is in violation of their laws. Others have creatively justified an implicit tax on intangible assets, despite a constitutional or statutory prohibition, by finding that such values are properly considered to the extent they enhance the value of the tangible property.

1. California

California has the greatest body of law on this issue. The State has determined that intangible value may be included in unitary valuation of public utilities despite a statutory provision exempting all forms of intangible personal property from property taxation. The State's courts have ruled that, although intangibles are exempt from taxation and cannot be separately taxed, they may be considered in the valuation of taxable property, and their value may be included in such valuation to the extent they enhance the value of the taxable property.

105. See discussion supra Part IV.C.
106. Adams Express Co. v. Ohio State Auditor, 166 U.S. 185, 218, petition for reh'g of 165 U.S. 194 (1897). The Supreme Court stated that:

[A] large portion of the wealth of a community consists in 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 at its real value such intangible property. . . . To ignore this intangible property, or to hold that it is not subject to taxation at its accepted value, is to eliminate from the reach of the taxing power a large portion of the wealth of the country. Now, 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 infrequently developed a property, intangible though it may be, which in value exceeds the aggregate of the value of the separate pieces of tangible property. Upon what theory of substantial right can it be adjudged that the value of this intangible property must be excluded from the tax lists, and the only property placed thereon be the separate pieces of tangible property?

Id. (emphasis added).

108. See discussion infra part IV.D.1.
110. FTN World Communications, Inc. v. City and County of San Francisco, 693 P.2d 811, 816 (Cal. 1985); Roehm v. Orange County, 196 P.2d 550 (Cal. 1948) (establishing the rule of law which has been followed by California courts for over 45 years); Los Angeles SMSA v. State Bd.
The California Supreme Court has determined that unit valuation results not in the "taxation of real property or personal property or even a combination of both, but rather as the taxation of property as a going concern."\textsuperscript{111} In Los Angeles SMSA \textit{v.} State Board of Equalization,\textsuperscript{112} the taxpayer argued that value attributable to its principle intangible asset, which was a license to operate, should be deducted from its unitary valuation since the California law prohibited a property tax on intangibles. But the court found that the State may consider intangible value in the valuation of taxable property without violating the statutory provision.\textsuperscript{113} The California Supreme Court has stated that "[u]nit taxation [(i.e. unit valuation)] prevents real but intangible value from escaping assessment and taxation by treating public utility property as a whole, undifferentiated into separate assets . . . , or even separate kinds of assets (reality or personalty)."\textsuperscript{114} Therefore, the public utilities in California are not assessed a property tax per se, but instead they are subject to a tax on their "going concern." This theory has allowed the state to tax the intangible values.

But subsequent case law in California has seriously limited the application of the "going concern" argument.\textsuperscript{115} The concept was recently narrowed in \textit{GTE Sprint Communications Corp. \textit{v.} County of Alameda.}\textsuperscript{116} Although the court did not refute that intangible assets may permissively enhance the value of the tangible property, it decided that it was incorrect to allow the entire value of the intangibles to be included in such value.\textsuperscript{117} Typical of most cases, GTE Sprint argued that the appraiser for the state unlawfully included the value of its nontaxable intangible assets in the unit valuation of its property.\textsuperscript{118} The taxpayer argued that because its fair market value contained

\footnotesize{
\textit{ITW World Communications, Inc.}, 693 P.2d at 815.
\textit{ITT World Communications, Inc.}, 693 P.2d at 816.
Id. at 524-26.
Id. at 524-26.
32 Cal. Rptr.2d 882 (Cal. Ct. App. 1st Dist.), 
Id. at 888-91.
GTE Sprint claims to have intangible assets in the form of trade names, 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 going concern. Id. at 885.
}
value attributable to intangible assets, allowances must be made for the value. The response of the State was also typical, stating that it was not directly taxing the intangible assets, but instead it was taxing the value of the tangible property as enhanced by the intangible values.\textsuperscript{119}

However, the court found that the State's valuation went beyond just capturing the enhancement value of the intangibles.\textsuperscript{120} The State relied primarily on the market approach\textsuperscript{121} and income capitalization to determine the assessed value of the property. Although GTE Sprint offered proof of both the existence and value of its intangible assets, the State refused to make any adjustments to the assessed value. The State's position was that the valuation methods only included intangible values as they enhanced the tangible property and were therefore valid. In determining that the State's position was incorrect, the court found that the appraiser should have deducted from the appraised value the value of any intangible property that Sprint could have substantiated.\textsuperscript{122}

Therefore, the current law in California appears to be that intangible property cannot be separately taxed ad valorem, but may be subject to tax to the extent that the property enhances the value of tangible, taxable property which is subject to unit valuation. To the extent that the taxpayer can establish the existence and value of the intangible property, allowances must be made to the unit value for the property. Consequently, if an intangible does not have an ascertainable value or if the taxpayer cannot adequately prove its existence, its value will be included in the unit valuation and will be subject to property tax. Although the current law appears to put the burden of proof on the taxpayer, proposed legislation would put the State in the position of disproving the existence of presumed intangibles.\textsuperscript{123}

\begin{footnotesize}
\begin{enumerate}
\item Id. at 886.
\item Id. at 889-91.
\item In the prior year, all capital stock of Sprint was purchased by GTE for $1.03 billion. This data was weighted heavily in the correlation of the market indicators. Id. at 884.
\item Id. at 891. The case was remanded to the appropriate administrative body to determine the proper reductions in the assessed value, allowing both Sprint and the State's appraisers to present evidence as to the value of the intangibles. Id.
\item Current legislative reform could clarify the taxing system in California. The California Taxpayers Association has proposed that the state agency in charge of administering the system adopt Property Tax Rule 11. This rule would:
1. Establish that intangible assets and enterprise values are exempt from property tax assessment without qualification.
2. Establish a presumption that the purchase price or FMV [fair market value] of a business includes enterprise values, which the assessor has the burden of disproving.
\end{enumerate}
\end{footnotesize}
2. Iowa

The courts in Iowa seem to be indecisive on whether unit valuation as applied in that state results in an impermissible tax on intangibles. In 1985, the Iowa Supreme Court determined that the unit valuation of a pipeline company does not impermissibly impose a property tax on intangibles.\(^\text{124}\) The public utility alleged that the stock and debt approach which the State used to assess its property resulted in taxing its intangible assets.\(^\text{125}\) The court determined that the property value may include a portion of the company's intangibles, because they enhanced the value of the tangible property.\(^\text{126}\) Although the intangibles were considered in the assessment, the resulting valuation "was of the tangible assets only," and it could not be said that a property tax was assessed on the intangibles.\(^\text{127}\)

But a federal court decision which evaluated Iowa's unit valuation contradicts the Iowa Supreme Court ruling. In *Burlington Northern Railroad Co. v. Bair*,\(^\text{128}\) the railroad argued that under unit valuation it was being taxed on intangible value attributable to computer software, assembled workforce, and long-term contracts.\(^\text{129}\) The court found, after a very thorough analysis of the various possible methods used to determine unit value, that "when a railroad is valued as a unit on a business enterprise or going concern basis, that valuation necessarily includes intangible assets."\(^\text{130}\) When an intangible asset has an ascertainable value, the court determined that such value

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3. Prohibit an assessor from using any appraisal method that would impute or attribute to real or other taxable property any part of the business's purchase price that exceeds the FMV [fair market value] of the real and tangible personal property owned by the business.

4. Indicate that taxpayers would have no legal burden of proving either the existence, composition, or value of intangible assets, including the enterprise value.

Ancel, *supra* note 110, at 172.


125. *Id. at 192*. See also discussion *supra* part IV.C.


127. *Id. This is the same finding of law arrived at by the California Supreme Court. See supra* notes 112-14 and accompanying text.

128. 815 F. Supp. 1223 (S.D. Iowa, 1993). This is the only federal court decision to address the issue at point. This is due to the fact that the Tax Injunction Act, codified in 28 U.S.C. § 1341 (1948), precludes federal courts from having jurisdiction over cases concerning state taxation. This particular case was allowed jurisdiction due to a federal statute which specifically permits federal jurisdiction. 49 U.S.C. § 11503(g) (1988).


130. *Id. See infra* part V.C. for the discussion concerning the collateral argument that by including intangible values in the unit valuation, Oklahoma is in violation of a federal statute which protects railroad properties from discriminatory taxing measures.
must be deducted from the unit valuation. On remand, Burlington was only allowed to deduct the value attributable to assembled workforce and computer software, since these were the only intangibles for which it could establish a value. No adjustment was allowed for their long-term contracts because they failed to establish their worth “by a preponderance of evidence.”

3. Michigan

The Michigan Supreme Court decided in Michigan Bell Telephone Co. v. Department of Treasury that unit valuation did not violate Michigan law by implicitly taxing intangible values. Michigan Bell challenged the assessed value of its property, determined by unit valuation using income capitalization method, as impermissibly including value attributable to its intangible property. The taxpayer argued, inter alia, that the State did not have the authority under Michigan law to tax intangible property since the statute did not explicitly permit the tax. The court did not agree, finding that the State had authority to tax all property, including intangibles.

V. UNIT VALUATION VIOLATES OKLAHOMA POLICY DECISIONS

A. Constitutional Prohibition

Oklahoma, like many other states, has made a policy decision not to permit an ad valorem tax on intangible assets. Article 10, Section

131. Id. at 1238-40.
133. Id.
134. 518 N.W.2d 808 (Mich. 1994).
135. Id. at 809.
136. Id. at 810.
137. MICH. COMP. LAWS § 207.5 (1986). The pertinent part of the statute reads as follows:

The term property . . . shall be deemed to include all property, real or personal, belonging to . . . companies . . . subject to taxation under this act, including . . . telephone poles, wires, conduits, switchboards, and all other property used in carrying on their business and owned by them respectively, and all other real and personal property, and all franchises, said franchises not to be directly assessed, but to be taken into consideration in determining the value of the other property.

Id. (emphasis added). Michigan has no general prohibition against or exemption from ad valorem tax on intangible property.

138. Molter v. Department of Treasury, 505 N.W.2d 244 (Mich. 1993) (holding that the authority to impose a tax must be expressly authorized by law; it cannot be inferred).
139. Michigan Bell Tel. Co., 518 N.W.2d at 814. The decision turned on the definition of property, the court determining that the term should be given its usual and customary meaning. Id. at 812.
6A of the Oklahoma Constitution prohibits an ad valorem tax on intangible personal property.\textsuperscript{140} The provision defines "intangible personal property" very specifically and generally only includes cash, accounts receivables, promissory notes, and annuity contracts.\textsuperscript{141} Although the definition of intangibles in the provision is very narrow, and only includes one class of intangible property, a review of the history of how the constitutional prohibition was adopted indicates that the intent of the provision is to exempt all types of intangibles from an ad valorem tax.\textsuperscript{142}

Section 6A was adopted as an amendment to the Oklahoma Constitution in 1969 when the provision was approved by referendum.\textsuperscript{143} The actual effect of the amendment was to repeal the 1939 law which enacted an ad valorem tax on intangibles.\textsuperscript{144} The 1939 law defined "intangible personal property" in the exact same terms as currently used by Section 6A; in fact, the definition found in Section 6A was taken in toto from the 1939 law.\textsuperscript{145}

Because the amendment repealed the tax on intangible personal property, it may be argued that the intent of Section 6A was only to serve that purpose. To the extent that a particular form of intangible was not subject to taxation under the repealed law, Section 6A would not prohibit its taxation based upon its value.

The amendment may also be interpreted to cover all intangibles due to the specific language used on the voting ballot, which may be indicative of a much broader public policy decision made by the Oklahoma voters. In interpreting constitutional amendments by referendum, courts will seek to ascertain and give effect to the intentions

\textsuperscript{140} Okla. Const. art. X, § 6A [hereinafter Section 6A]. The section reads in part:

Intangible personal property as below defined shall not be subject to ad valorem tax or to any other tax in lieu of ad valorem tax within this State:

(a) Money and cash on hand . . . .
(b) Money on deposit in any bank . . . .
(c) Accounts and bills receivable . . . .
(d) Bonds, promissory notes, debentures, and all other evidences of debt . . . .
(e) Shares of stock or other written evidence or proportional shares of beneficial interests in corporations . . . .
(f) All interests in property held in trust or on deposit . . . .
(g) Final judgments for the payment of money.
(h) All annuities and annuity contracts.

Id.

\textsuperscript{141} Id.

\textsuperscript{142} H.J.R. Res. 505, 31st Leg., 2d Sess. (1968).

\textsuperscript{143} 1968 Okla. Sess. Laws 802. The actual amendment was designated as State Question No. 460.


of the voters passing the measure; seeking to "determine what the people believed the amendment to mean when they accepted it as their fundamental law."\textsuperscript{146} In many jurisdictions, the language of the ballot title is considered to be indicia of the voter's intent.\textsuperscript{147} The proposed amendment asked the Oklahoma voters whether a provision should be added to the State's constitution which would prohibit "the taxation of intangible personal property."\textsuperscript{148} In this particular referendum, the ballot title did not define intangible personal property. Nor did it make any reference to the statutory definition found in the 1939 law or the fact that the amendment's intended purpose was to simply repeal that law. Since the ballot failed to define intangible personal property, it would be reasonable to argue that the voters who approved the amendment understood the term to be used in its ordinary usage.\textsuperscript{149} The voters would have considered intangible property to include any property which could not be perceived by their senses, i.e. not real or personal property. Therefore, all forms of intangible assets\textsuperscript{150} should be protected by the prohibition, and not just those specifically enumerated.

The State could argue that the maxim of \textit{ejusdem generis} requires a narrow interpretation of the definition of intangibles found in Section 6A. The maxim states that where specific words follow general ones, the application of the general terms is restricted to things that are similar to those enumerated.\textsuperscript{151} Under the application of this rule, only intangible assets which are analogous to cash, receivables, stocks,

\textsuperscript{146} Urbish v. Lamm, 761 P.2d 756, 769 (Colo. 1988); \textit{See also} Voters for Responsible Retirement v. Board of Supervisors, 884 P.2d 645, 649 (Cal. 1994); Zaner v. City of Brighton, 899 P.2d 263, 268 (Colo. App. 1994).

\textsuperscript{147} Oklahoma courts have neither accepted nor rejected this rule of construction. The following jurisdictions do recognize the language of the ballot title as extrinsic evidence in interpreting a constitutional amendment or statute by referendum or initiative: Arkansas (McDonald v. Bowen, 468 S.W.2d 765, 769 (Ark. 1971)); California (\textit{Voters,} 884 P.2d at 649; Davis v. City of Berkeley, 765 P.2d 46, 49, 55-57 (Cal. 1988)); Colorado (\textit{Zaner,} 899 P.2d at 268, 269); Oregon (Ecumenical Ministries of Oregon v. Oregon State Lottery Comm'n, 871 P.2d 106, 110-11 (Or. 1994)); Roseburg School Dist. v. City of Roseburg, 851 P.2d 595, 597 (Or. 1993)); and Washington (Washington Fed'n of State Employees v. State, 901 P.2d 1028 (Wash. 1995)).


\textsuperscript{149} \textit{See Davis,} 765 P.2d at 50. "The words used in a constitution must be taken in the ordinary and common acceptance, because they are presumed to have been so understood by the framers and by the people who adopted it." \textit{Id.} (citing Kaiser v. Hopkins, 58 P.2d 1278 (Cal. 1936)). \textit{See supra} note 64 for some common definitions of intangible property.

\textsuperscript{150} \textit{See discussion supra} part IV.B.

\textsuperscript{151} Sutherland Stat. Const. § 47.17 (5th ed. 1992).
bonds, etc., would be covered under Section 6A. This narrow interpretation would only cover one class of intangibles; those that are represented by some form of tangible evidence of their existence.\textsuperscript{152}

However, the use of the maxim of \textit{ejusdem generis} is not appropriate if it hinders the intent of the statute.\textsuperscript{153} In fact, in construing a statute or constitutional provision, strong preference is often given to the intent of the statute or constitutional provision when it was passed.\textsuperscript{154} Because the intent of the voters in adopting Section 6A was to repeal property taxes on all forms of intangible property, the use of the maxim then would be inappropriate as it would reach a directly contrary result.

Additional support for a broad application of Section 6A is found in the principle that when a constitutional provision is stated in general terms, it may be interpreted to apply to situations which may not have existed when it was passed.\textsuperscript{155} General constitutional provisions should have a "degree of elasticity as to make them applicable to new conditions not in existence at the time of their adoption, and hence not thought of by those who framed and adopted them."\textsuperscript{156} Arguably, when the Oklahoma voters approved Section 6A, they only intended to exempt those class of intangibles which were taxable under the intangible personal property tax. Assuming that this proposition is accurate, the only reason that the other classes of intangibles were not considered was because they were not subject to taxation under the 1939 law. It is likely that the repealed law only applied to the particular property defined because the property could easily be valued, unlike the other forms of intangibles. But since 1939, intangibles such as franchise rights, assembled work force, long-term contracts, computer software, and going concern have been recognized to exist and subject to valuation.\textsuperscript{157} Therefore, Section 6A should be construed broadly to encompass all forms of intangibles because the general idea, that of relieving the Oklahoma taxpayers of the burden of paying a property tax on an entire class of property, should not be limited just to those intangibles which were subject to taxation in 1939.

\textsuperscript{152} See discussion supra part IV.B.
\textsuperscript{153} E.g., Lyman v. Town of Bow Mar, 533 P.2d 1129, 1133 (Colo. 1975).
\textsuperscript{154} E.g., Atlantic Refining Co. v. Oklahoma Tax Comm'n, 360 P.2d 826, 830-31 (Okla. 1959).
\textsuperscript{155} Wimberly v. Deacon, 144 P.2d 447, 450 (Okla. 1944); See Davis, 765 P.2d at 50.
\textsuperscript{156} \textit{Wimberly}, 144 P.2d at 450-51.
\textsuperscript{157} See Smith, supra note 72, at 33-35.
B. No Authority to Assess Ad Valorem Tax on Intangibles

Even if Section 6A only applies to the specific intangibles enumerated in the provision, the State is nevertheless without any authority to assess an ad valorem tax on any form of intangible property. In assessing a property tax on railroads and public service corporations, the taxable values must be established in accordance with Article 10, Section 8 of the Oklahoma Constitution.\textsuperscript{158} Section 8 provides that:

\begin{quote}
All property which may be taxed ad valorem shall be assessed for taxation at its fair cash value . . . except real property and tangible personal property shall not be assessed for taxation at more than thirty-five percent (35\%) of its fair cash value, estimated at the price it would bring at a fair voluntary sale.\textsuperscript{159}
\end{quote}

The section does not address the valuation of intangibles anywhere within its provisions. By inference it appears that the property was considered due to the distinction made by the language following “except.” However, in an opinion issued in 1978, the Oklahoma Attorney General determined that the language preceding “except” in Section 8 does not have any practical present-day meaning since “intangible personal property is no longer taxed by reason of the adoption of [Section 6A].”\textsuperscript{160} As a result, intangible property is not addressed in Section 8 - the only grant of authority which permits an ad valorem tax on property. Therefore, because intangible property is not provided for in Section 8, there is no authority in the Oklahoma Constitution or statutes which would permit a property tax on the property.

C. Collateral 4-R Argument

In addition to being in violation of the state constitution, the Oklahoma method of unit valuation also violates federal law. Section 306 of the Railroad Revitalization and Regulatory Act of 1976,\textsuperscript{161} basically prohibits any discriminatory measures imposed upon railroads by various states and any other localities.\textsuperscript{162} The provision has been construed to require that railroad property be treated as favorably as local commercial and industrial property.\textsuperscript{163}

\textsuperscript{158} OKLA. STAT. tit. 68, § 2847(B) (1991); OKLA. CONST. art. X, § 8 [hereinafter Section 8].
\textsuperscript{159} OKLA. CONST. art. X, § 8 (emphasis added).
\textsuperscript{162} 49 U.S.C. § 11503(b) (1988).
\textsuperscript{163} Trailer Train Co. v. Leuenberger, 885 F.2d 415, 418 (8th Cir. 1988); Kansas City S. Ry. Co. v. McNamara, 817 F.2d 368, 375 (5th Cir. 1987).
The 4-R Act was the basis upon which the unit valuation in Iowa was challenged in Burlington Northern Railroad Co. That same prohibition does not apply to the railroad companies, or other public utilities, subject to unit valuation. Upon finding that unit valuation "necessarily includes intangible assets," the federal court found that there was a disparity in the treatment between the commercial and industrial property and the railroad property. Because such a disparity is in direct violation of the 4-R Act, the court mandated that value attributable to the intangibles be deducted from the unit valuation of Burlington.

The unit valuation of railroads in Oklahoma could be subject to the same challenge. Similar to the Iowa statute, Oklahoma also prohibits an ad valorem tax on intangibles. A broad application of the prohibition, which would exempt all types of intangibles from property taxation, would result in a violation of the 4-R Act. Additionally, the actual practice of assessing local commercial property on an asset summation basis, rather than on its going concern value under unit value theory, implicitly excludes most intangible values. As a result, railroad companies subject to ad valorem tax in Oklahoma could challenge their assessed values for including intangible property in direct violation of the 4-R act.

A successful challenge under the 4-R Act by the railroad companies could have implications to other transportation companies and public utilities. The Oklahoma constitution requires that "taxes shall be uniform upon the same class of subjects." Railroads and public service companies are treated as the same class of taxpayers for

167. Id. at 1238.
169. Burlington N. R.R. Co., 815 F. Supp at 1237-40, 1243. The adjustment allowed was not made on a dollar for dollar basis. The court instead allowed a deduction based upon the proportion of book value attributable to the intangible assets. Id. at 1240.
170. OKLA. CONST. art. X, § 6A.
171. See discussion supra part V.A.
173. OKLA. CONST. art. X, § 5. [hereinafter the Uniformity Clause].
174. See supra note 11 for definition.
property tax purposes, and therefore should be treated equally under the Uniformity Clause. If the State cannot include intangible values in the assessment of railroad companies under the 4-R Act, neither would it be allowed to include such values in the fair market value of the public service companies.

The 4-R argument appears not to be a viable position after the Oklahoma Supreme Court's decision in Williams Natural Gas Co. v. State Board of Equalization. Upon perfunctory analysis, the court determined that the legislature created a sub-classification of taxpayers including only railroads and airlines. The court came to this conclusion by an obscure reading of the statutes which clearly include railroads and airlines in the same class as public service corporations. The court determined that the legislature created a permissive sub-class when it passed the statute which brought Oklahoma law in compliance with the 4-R restrictions. But a strong and very thorough dissent opinion by Justice Opala, in which two other Justices joined, leaves open the possibility that the court could change its opinion. While admitting that the legislature created a sub-class, the dissent found that railroads and all companies included in the public service corporation definition must be treated equally for property tax purposes.

VI. Recommendation to Correct Illegal Effects

If unit valuation is going to be utilized to assess public utilities in Oklahoma, any value attributable to intangible assets, to the extent included in the value, must be deducted so that the method does not violate the policy decisions as found in Article 6A. Although the

176. Northern Natural Gas Co. v. Nebraska State Bd. of Equalization, 443 N.W.2d 249, 256 (Neb. 1989), cert. denied, 493 U.S. 1078 (1990) (holding that the State denied the pipeline company equal protection by not taxing its property in the same manner as railroad property, which the State completely exempted from property taxes). Some states have argued that the federal 4-R Act preempts the uniformity clause, and are therefore not required to treat all companies in the same classification equally. See In re Appeal of ANR Pipeline Co., 866 P.2d 1060 (Kan. 1994), cert. denied, ANR Pipeline Co. v. Kansas Dep't of Revenue, 115 S. Ct. 296 (1994).
177. 891 P.2d 1219 (Okla. 1994).
178. Id. at 1222.
179. Id. at 1222-23.
180. Id. at 1225.
181. Id. at 1230.
182. See, Green & Benshoof, supra note 11, at 550.
necessity of this adjustment has been recognized by the tax profession since 1954,\textsuperscript{183} it has largely been ignored.

This approach would require that the appraiser to determine to what extent intangible assets are included in the valuation, estimate the value of such assets, and then subtract the value from the estimated fair value.\textsuperscript{184} The inclusion of the intangible assets depends to a significant degree on the method of evaluation. The stock and debt approach and the income approach will more than likely include all intangible assets of an enterprise.\textsuperscript{185} Therefore, the value of the intangibles must be subtracted from the market indicators from the two approaches prior to correlation. The market indicator determined by the application of the cost method will not need to be adjusted, since the method does not include value attributable to intangibles.\textsuperscript{186}

Adjustments for intangible assets should not be permitted unless the taxpayer can adequately substantiate their value. In Burlington Northern, the railroad was not allowed to reduce its unit valuation for value attributable to long-term contracts since it failed to adequately establish its value.\textsuperscript{187} The principle established by the federal court in Burlington Northern is appropriate; if the value of the intangibles cannot be substantiated by the taxpayer, then no deduction should be allowed.\textsuperscript{188} This would make it more difficult for taxpayers to erroneously assert that certain intangible assets exist or claim that certain intangible assets have significant value when the actual value may be negligible.

\textsuperscript{183.} \textit{Appraisal of Railroad and Other Public Utility Property for Ad Valorem Tax Purposes; Report of the Committee on Unit Valuation of the National Association of Tax Administrators} 2, 17 (1954). When intangible property is exempt from ad valorem tax, the report states that "if intangibles are employed in the public service, their value is merged into and is inseparable from the unit. Unless some deduction is made from the allocated segment of the unit in such a state, the ... exemption will have been nullified." \textit{Id.} (emphasis added).

\textsuperscript{184.} Bell \& Zhu, \textit{supra} note 2, at 10.

\textsuperscript{185.} \textit{See} discussion \textit{supra} part IV.C.

\textsuperscript{186.} \textit{See} discussion \textit{supra} part IV.C.


\textsuperscript{188.} Although this recommendation is similar to proposed Rule 11 in California, \textit{supra} note 123, there is one distinct difference: The burden of proof would be on the taxpayer rather than placing the burden on the State to disprove. This would significantly reduce the burden on the State, decreasing the amount of resources needed to administer the property tax system for state-assessed properties.
VII. Conclusion

Unit valuation theory is a sound approach for valuing public service corporations which are multistate in nature and have a system of assets which are interdependent on each other. To value the individual assets of such enterprises would result in distortive low values. Valuing the property as a unit, as a system of individual assets, allows for a more accurate determination of the actual worth of the property.

Although the theory itself is well founded, it conflicts with the public policy decision made by the Oklahoma voters to prohibit any form of property tax on intangibles. The fact that unit valuation includes value attributable to intangible assets cannot be disputed. Whether the particular intangibles are included in the prohibition is a question of law which will need to be decided in the Oklahoma courts. There is sufficient support to argue that the prohibition applies to all types of intangibles, rather than being limited to those specifically mentioned in the provision.

Finally, to the extent that intangible values are included in the unit valuation, such value must be subtracted from the fair cash value. The public service corporations should not be allowed to frivolously claim the existence or value of an intangible asset. Therefore, the burden of proof should be on the taxpayer to prove the existence of the intangible and to sufficiently substantiate its value.

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