NOTICES OF FINAL RULEMAKING

The Administrative Procedure Act requires the publication of the final rules of the state's agencies. Final rules are those which have appeared in the *Register* 1st as proposed rules and have been through the formal rulemaking process including approval by the Governor's Regulatory Review Council. The Secretary of State shall publish the notice along with the Preamble and the full text in the next available issue of the *Arizona Administrative Register* after the final rules have been submitted for filing and publication.

NOTICE OF FINAL RULEMAKING

TITLE 4. PROFESSIONS AND OCCUPATIONS

CHAPTER 46. BOARD OF APPRAISAL

PREAMBLE

1. **Sections Affected** — **Rulemaking Action**

Sections Affected	Rulemaking Action
R4-46-401	Amend

2. **The specific authority for the rulemaking, including the authorizing statute (general) and the statutes the rules are implementing (specific):**

   Authorizing statute: A.R.S. § 32-3605(A).

   Implementing statute: A.R.S. § 32-3605(B)(1).

3. **The effective date of the rules:**

   July 21, 1999

4. **A list of all previous notices appearing in the Register addressing the final rules:**

   Notice of Rulemaking Docket Opening: 5 A.A.R. 765, March 12, 1999.
   Notice of Proposed Rulemaking: 5 A.A.R. 1095, April 16, 1999.
   Notice of Public Information Hearing: 5 A.A.R. 1096, April 16, 1999.

5. **The name and address of agency personnel with whom persons may communicate regarding the rules:**

   Name: Linda L. Schutzenhofer

   Address: Board of Appraisal
   1400 W. Washington, Suite 360
   Phoenix, Arizona 85007

   Telephone: (602) 542-1539

   Fax: (602) 542-1598

6. **An explanation of the rule, including the agency's reasons for initiating the rule:**

   All rules are written to comply with the provisions of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, and state statutes applicable to real estate appraisers. The change in the existing rule is to comply with Title XI and the A.R.S. § 32-3605(A).

7. **A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:**

   Not applicable.

8. **The summary of the economic, small business, and consumer impact:**

   The primary groups that would be affected would be the Board of Appraisal, the licensed or certified appraisers and the public. There should be no appreciable change in the economic impact. The key features of the 1999 USPAP are in the Table of Contents, Terminology, Ethics Rule, Departure Rule, Definitions, Standard I, Standard II, Standard III, and Statement 7.

9. **A description of the changes between the proposed rules, including supplemental notices, and final rules:**

   None.

10. <u>A summary of the principal comments and the agency response to them:</u>
The only response that we received was a positive response in support of the proposed change and submitted by the Phoenix Chapter of the Appraisal Institute.

11. <u>Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:</u>
Not applicable.

12. <u>Incorporations by reference and their location in the rules:</u>
Uniform Standards of Professional Appraisal Practice, 1999 Edition published by the Appraisal Foundation, 1029 Vermont Avenue, NW, Suite 900, Washington, DC 20005-3517, (202)347-7722. The location in the rules is R4-46-401.

13. <u>Was this rule previously adopted as an emergency rule?</u>
No.

14. <u>The full text of the rules follows:</u>

TITLE 4. PROFESSIONS AND OCCUPATIONS

CHAPTER 46. BOARD OF APPRAISAL

ARTICLE 4. STANDARDS OF PRACTICE

Sections
R4-46-401. Standards of Appraisal Practice

ARTICLE 4. STANDARDS OF PRACTICE

R4-46-401. Standards of Appraisal Practice
Every state-licensed or certified Appraiser, in performing the acts and services of a state-licensed or certified Appraiser, shall comply with the Uniform Standards of Professional Appraisal Practice (USPAP), ~~1998~~ <u>1999</u> edition, published by the Appraisal Foundation, which are incorporated by reference and on file with the Board and the Office of the Secretary of State. This incorporation by reference contains no future additions or amendments. A copy of the USPAP may be obtained from the Appraisal Foundation, 1029 Vermont Avenue, NW, Suite 900, Washington, DC 20005-3517, (202) 347-7722.

NOTICE OF FINAL RULEMAKING

TITLE 15. REVENUE

CHAPTER 4. DEPARTMENT OF REVENUE
PROPERTY AND SPECIAL TAX SECTION

<u>PREAMBLE</u>

1.

<u>Sections Affected</u>	<u>Rulemaking Action</u>
Article 5	Amend
R15-4-501	Repeal
R15-4-502	Amend
R15-4-503	Repeal
R15-4-504	Repeal
R15-4-505	Repeal
R15-4-507	Repeal
R15-4-508	Repeal

2. <u>The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):</u>
Authorizing statutes: A.R.S. §§ 42-1005, 42-11053 and 42-11054.

Implementing statutes: A.R.S. §§ 42-12002, 42-14002 through 42-14005, 42-14201, 42-14203, 42-14204, and 42-14401 through 42-14403.

3. **The effective date of the rules:**
July 21, 1999

4. **A list of all previous notices appearing in the Register addressing the final rule:**
Notice of Rulemaking Docket Opening: 4 A.A.R. 1414, June 19, 1998.
Notice of Rulemaking Docket Opening: 4 A.A.R. 2130, July 31, 1998.
Notice of Proposed Rulemaking: 5 A.A.R. 557, February 26, 1999.

5. **The name and address of agency personnel with whom persons may communicate regarding the rulemaking:**

Name:	Ernest Powell, Tax Analyst
Address:	Tax Research & Analysis Section Arizona Department of Revenue 1600 W. Monroe Phoenix, AZ 85007
Telephone:	(602) 542-4672
Fax:	(602) 542-4680

6. **An explanation of the rule, including the agency's reasons for initiating the rule:**
These rules deal with the valuation of pipeline and telecommunication properties for property tax purposes. As a result of legislative changes and the 5-year review of Title 15, Chapter 4, the Department is amending or repealing these rules because they are repetitive of or contrary to current statute.

7. **Reference to any study that the agency proposes to rely on and its evaluation of or justification for final rule and where the public may obtain or review the study, all data underlying each study, any analysis of the study and other supporting material:**
Not applicable.

8. **A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:**
Not applicable.

9. **The summary of the economic, small business, and consumer impact:**
It is expected that the benefits of the rules will be greater than the costs. The repeal of R15-4-501, R15-4-503 through R15-4-505, R15-4-507 and R15-4-508 will benefit the public by eliminating obsolete rules that no longer serve their intended purpose. The amendment of R15-4-502 will benefit the public by removing definitions that are no longer needed. The department will incur the costs associated with the rulemaking process. Taxpayers are not expected to incur any expense in the repeal or amendment of these rules.

10. **A description of the changes between the proposed rules, including supplemental notices, and final rules (if applicable):**
Upon a final review, the department discovered that the new section R15-4-501, Determination of Value of Telecommunications Companies, contained inaccurate information. Therefore, this rule has been removed from the package and will be resubmitted at a later date. In addition, the title of Article 5 has been changed to remove the reference to telecommunication companies.

Also, the department decided to leave the name of Chapter 4 unchanged. Therefore, the underlined language and the strikeouts have been removed from the Chapter title.

In addition, nonsubstantive grammatical and formatting changes were made on the suggestion of the Governor's Regulatory Review Council staff.

11. **A summary of the principal comments and the agency response to them:**
The department did not receive any written or verbal comments on the rule action after the publication of the rulemaking in the Notice of Proposed Rulemaking.

12. **Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:**
None.

13. **Incorporations by reference and their location in the rules:**
None.

14. **Was the rule previously adopted as an emergency rule?**
No.

15. <u>The full text of the rules follows:</u>

TITLE 15. REVENUE

CHAPTER 4. DEPARTMENT OF REVENUE PROPERTY AND SPECIAL TAX SECTION

ARTICLE 5. VALUATION OF PIPELINE ~~AND TELECOMMUNICATION~~ COMPANIES

Sections

ARTICLE 5. VALUATION OF PIPELINE ~~AND TELECOMMUNICATION~~ COMPANIES

R15-4-501. ~~Pipeline and telecommunication valuation~~ <u>Repealed</u>

~~**A.** For the purpose of annually determining the full cash value of pipeline and telecommunication properties under A.R.S. §§ 42-144 and 42-793, the Department shall use the appraisal methods and techniques provided in Title 15, Chapter 4, Article 5 of its rules. The three approaches to value, as defined in R15-4-503, R15-4-504, and R15-4-505, are:~~
  ~~1. The Income Approach,~~
  ~~2. The Market Approach,~~
  ~~3. The Cost Approach.~~

~~**B.** The Department shall annually prepare an appraisal manual for pipeline and telecommunication properties. The manual shall include the guidelines necessary for appraising the properties subject to these rules. The Department shall hold an annual meeting with affected taxpayers prior to February 1 for the purpose of discussing proposed changes to the manual for the current tax year. Upon request, the Department shall make available information used to develop the guidelines in the manual, except information which is confidential in nature. The manual shall be available to the taxpayers by March 15 of the tax year.~~

~~**C.** The Department shall annually prepare capitalization rate guidelines, which shall describe the methods and techniques used by the Department to develop industry capitalization rates for use in converting income to value. The industry capitalization rates shall be based on the market value of debt and equity securities and the income attributable to those securities.~~

~~**D.** The Department shall prepare annual appraisals of the operating properties of pipeline and telecommunication companies. The appraisals shall include:~~
  ~~1. Calculations used in the methods and techniques employed,~~
  ~~2. A reconciliation of the estimates of value from the three approaches, and~~
  ~~3. A final unit value.~~

~~The Arizona allocation factor shall be applied to the final unit value in order to determine the full cash value of the property in Arizona.~~

~~**E.** Upon written request of the taxpayer, the Department shall hold an informal conference with the taxpayer after preliminary worksheets are issued and before the final value is established. At the informal conference, the Department shall review with the taxpayer the procedures and calculations employed in the Department's valuation of the property. If the taxpayer requests a change in the preliminary value, the taxpayer shall provide copies of studies and any other written information supporting the requested change.~~

~~**F.** At the request of the taxpayer, preliminary appraisal worksheets shall be made available to the taxpayer at least seven calendar days before the informal conference. The seven day requirement may be waived by mutual agreement of the Department and the taxpayer. The Department shall release final worksheets and the determination of value by the first Monday in June.~~

R15-4-502. <u>Pipeline Companies</u> ~~Definitions~~

<u>For purposes of determining class 2 property under A.R.S. § 42-12002, "pipeline companies" are individuals, partnerships, or corporations that are</u> ~~In this Article unless context otherwise requires:~~
  ~~1. "Allocation" means the process of assigning a portion of a unit value.~~
  ~~2. "Arizona allocation factor" means the factor used by the Department to assign a portion of a unit value to the state of Arizona.~~

~~3. "Common stock" means a share of ownership (equity) in a corporation which usually, but not always, possesses voting power.~~
~~4. "Construction work in progress" means property contained in the construction work in progress account reflected on the company's balance sheet as of the assessment date.~~
~~5. "Current asset" means an asset that will normally be converted into cash in the normal operation of business within one year.~~
~~6. "Current liabilities" means liabilities that will normally be paid within one year.~~
~~7. "Deferred income tax" means the amount of income tax for which a taxpayer is not currently liable as a result of the use of accelerated depreciation.~~
~~8. "Department" means the Arizona Department of Revenue.~~
~~9. "Depreciation" means the loss in value due to all causes, including physical deterioration, functional obsolescence, and economic obsolescence.~~
~~10. "Direct capitalization" means a method used to convert a single year's income expectancy into an estimate of value. This conversion is accomplished by dividing the income by the appropriate capitalization rate.~~
~~11. "Direct capitalization rate" means a rate derived from the market which is a ratio or relationship between income and value. It is a conversion rate used to convert a single year's estimate of income into a market value indication.~~
~~12. "Discernible trend" means the annual rate of change in the net operating income over the three-year period preceding the assessment date has always been positive or has always been negative.~~
~~13. "Earnings before interest and taxes (EBIT)" means operating revenues less the following expenses:~~
    ~~a. Operating and maintenance,~~
    ~~b. Depreciation and amortization, and~~
    ~~c. Taxes other than income taxes.~~
~~14. "Economic obsolescence" means the impairment of desirability or useful life arising from factors external to the property, such as economic forces or environmental changes which affect supply-demand relationships in the market. Loss in value due to economic obsolescence is distinguished from loss in value due to physical deterioration or functional obsolescence. Economic obsolescence is also referred to as locational or environmental obsolescence.~~
~~15. "Functional obsolescence" means the impairment of functional capacity or efficiency. Functional obsolescence reflects the loss in value due to over capacity, inadequacy, and changes in technology, that affect the property itself or affect its relation with other properties which constitute a larger economic unit.~~
~~16. "Going-concern value" means the value of an enterprise considered as an operating business, and therefore based on its earning power and prospects, rather than its value in the event of liquidation. A synonym for going-concern value is value in use.~~
~~17. "Long-term debt" means a financial obligation generally extending for one or more years.~~
~~18. "Market-to-book" means the ratio of industry market value divided by industry book value. Industry market value is derived from a representative sample of companies in the respective industry selected annually by the Department. Book values are from the same industry sample and reflect the book values of debt, preferred, and common capital.~~
~~19. "Materials and supplies" means all materials and supplies owned or leased and used in the operation of the company, the costs of which may be partially or totally carried in an account or accounts of this type of property, as prescribed by the regulatory agency or by generally accepted accounting principles.~~
~~20. "Net book value" means the cost of a property as carried in the accounting records less the accumulated depreciation for that property.~~
~~21. "Net operating income" means operating revenues less the following expenses: operating and maintenance, depreciation and amortization, other taxes, and income taxes (current and deferred).~~
~~22. "Non-capitalized lease" means an agreement which transfers use of property to the lessee during the term of the lease and is not capitalized on the reporting company's balance sheet. Non-capitalized leased property used in the operation of a pipeline company or telecommunications company shall include only that property for which the lease agreement provides that the lessee is responsible for reporting the property for property tax purposes.~~
~~23. "Non-traded stock" means common or preferred stock that is closely held and not publicly traded.~~
~~24. "Overall capitalization rate" means a ratio of one year's net operating income to the value of the company. It is an "overall" capitalization rate in that the income and corresponding rate represent amounts necessary, on the average, to service the debt and provide dividend returns to both common and preferred equities.~~
~~25. "Pipeline company" means any person, partnership, or corporation~~ engaged in the business of producing, storing, selling, or transporting within, through, into, or from the state through a pipeline system~~,~~ the following: oil, natural gas, processed gas, manufactured gas, petroleum products, coal, or other products~~, within, through, into, or from the state~~.
~~26. "Preferred stock" means stock which takes priority over common stock as regards dividends or in liquidation. The dividend rate on preferred stock is usually fixed at the time of issue.~~
~~27. "Traded stock" means common or preferred stock that is bought and sold publicly, either on the New York Stock Exchange, American Stock Exchange, or some other stock exchange, including the over-the-counter market.~~

28. ~~"Unit value or unit market valuation" is a method of valuation which treats the entire property of a company as an integrated enterprise, without reference to the separate value of the component parts.~~
29. ~~"Yield-to-maturity" means the total return on a bond during the holding period, expressed as a percent.~~

R15-4-503. ~~Income approach procedures~~ Repealed

~~A.~~ ~~The income approach used to estimate the value of the operating properties of pipeline and telecommunication companies shall be based on direct capitalization of net operating income.~~

~~B.~~ ~~If there is a discernible trend in net operating income, the income to be capitalized shall be the net operating income for the year preceding the current tax year, unless the income is negative, extremely low, atypical, or not representative of the earning capacity of the operating unit.~~

~~C.~~ ~~If the income is negative, extremely low, atypical, or not representative of the earning capacity of the operating unit, or if there is no discernible trend in net operating income, an income which is representative of the earning capacity of the property shall be determined based upon typical industry standards and performance ratios.~~

~~D.~~ ~~The capitalization rate shall be based on the industry capitalization rate determined by the Department.~~

~~E.~~ ~~The industry rate of capitalization may be adjusted if it is not representative of the operating unit as of the appraisal date. Adjustments to the industry rate of capitalization shall be based upon such factors as the business risk and financial risk of the company compared to the industry. These factors shall be computed by the use of typical industry standards and performance ratios to determine whether the company conforms to the industry pattern.~~

~~F.~~ ~~The capitalization is accomplished by dividing the net operating income by the capitalization rate expressed as a decimal; the result of this calculation is the value estimate of the operating unit. This value estimate does not include any value attributable to construction work in progress or the proprietary value of leased property, which shall be added to the final value estimate after reconciliation, as provided in rule R15-4-508.~~

R15-4-504. ~~Market approach procedures~~ Repealed

~~A.~~ ~~The market approach used to estimate the value of the operating properties of pipeline and telecommunication companies shall be the stock-and-debt method.~~

~~B.~~ ~~The value of common equity shall be determined by one of the following three methods:~~

1. ~~If the common stock is traded, then its value shall be calculated by taking the average daily closing price of the stock times the number of shares outstanding. The daily stock prices shall be taken from the period of January 1 through December 31 immediately preceding the assessment date. The number of shares outstanding shall be the number reported by the company as of the date of valuation.~~
2. ~~If the common stock of the operating company is held by another company whose common stock is publicly traded, the value of the holding company's common stock shall be computed as in Subsection (B), Paragraph (1) of this rule. This value shall then be allocated to the operating company using the unweighted average of the following two ratios:~~
   a. ~~The ratio calculated by dividing the book value of the common equity of the operating company by the book value of the common equity of the holding company, and~~
   b. ~~The average ratio, for the previous three years, of the pre-tax net income available to common stock of the operating company divided by the pre-tax net income available to common stock of the holding company.~~
   c. ~~If the ratio calculated in Subsection(B), Paragraph (2), Subparagraph (b) of this rule is negative or atypical for the operating company, then the following ratio shall be substituted: the average ratio, for the previous three years, of the gross revenues of the operating company divided by the gross revenues of the holding company.~~
3. ~~If the common equity of the operating company is privately held, the value shall be calculated by capitalizing net income available to common for the year preceding the valuation date, before extraordinary items, by the appropriate rate of capitalization determined by the Department. If the income is negative, extremely low, or atypical, the income shall be determined in accordance with rule R15-4-503(C).~~

~~C.~~ ~~The value of preferred stock of the operating company shall be computed for each issue of stock as follows:~~

1. ~~If the issue has a par or stated value, the market value of the issue shall be computed by dividing the face rate of the issue by the 52-week average of utility preferred stock yields for the issue's rating, then multiplying by the number of shares outstanding times the par or stated value.~~
2. ~~If the issue does not have a par or stated value, and the annual dividend rate is expressed in dollars and cents, the value in liquidation for the issue will be substituted for par or stated value. The market value of the issue shall be computed as follows: The dollar dividend times the number of shares outstanding, divided by the value of the issue in liquidation, will produce a face rate for the issue. Then divide the face rate by the 52-week average of the utility preferred stock yield ratio for the issue's rating, and multiply by the value in liquidation.~~

~~D.~~ ~~The market value of long-term debt is calculated for each debt issue of the operating company by using the current yield, the coupon rate, and the maturity of the debt issue. This valuation technique is referred to as the yield-to-maturity method. The current yield on debt for a company may be obtained from reliable financial sources. The values for each debt issue are summed to arrive at the market value of the long-term debt.~~

~~E.~~ ~~The sum of Subsections(B) and (C) and (D) is the gross stock-and-debt value of the operating company.~~

~~**F.** The gross stock-and-debt value shall be allocated between the operating property and the nonoperating properties by use of the unweighted average of the following two ratios:~~

~~1. The sum of those accounts in the annual report representing operating property (net plant in service, plus construction work in progress, plus current assets), divided by total assets, and~~

~~2. Earnings before interest and income taxes (EBIT) of the operating property divided by the company's EBIT.~~

~~**G.** The market value estimate of the company's operating property is computed by subtracting the value of construction work in progress from the value obtained in Subsection (F). Construction work in progress shall be added to the final estimate of value after reconciliation, as provided in rule R15-4-508.~~

~~**H.** In the determination of value by the market approach, the Department shall consider sales transactions of companies in the same industry when comparable sales are available.~~

R15-4-505. ~~Cost approach procedures~~ <u>Repealed</u>

~~**A.** The cost approach used to estimate the value of the operating properties of pipeline and telecommunication companies shall be based on the net book value of the plant in service accounts plus materials and supplies. For gas transmission pipeline companies, gas stored underground (noncurrent only) shall be included in the cost approach value. Construction work in progress shall be included in the final value estimate for all companies in accordance with R15-4-508.~~

~~**B.** The sum of the preceding amounts shall be multiplied by the market-to-book ratio determined by the Department for the respective industry. This calculation will produce the preliminary value estimate of the company's operating properties by the cost approach.~~

~~**C.** The Department shall consider typical, representative operating and performance ratios for the subject property in order to determine if additional obsolescence is appropriate in the value estimated by the cost approach.~~

R15-4-507. ~~Reconciliation of the value estimates~~ <u>Repealed</u>

~~**A.** In making a final determination of value, the Department shall consider each of the approaches and methodologies described in these rules, the reconciliation of which will result in the determination of the full cash value of the company's operating property.~~

~~**B.** The Department shall reexamine the specific data, procedures, and techniques used to derive preliminary estimates. Each approach shall be reviewed separately by comparing it to the other approaches to value in terms of adequacy, accuracy, completeness of reasoning, and overall reliability. From this correlation and integration of related facts, the Department shall determine the full cash value as of the assessment date.~~

~~**C.** The Department's final determination of value shall always be within the range indicated by the three approaches to value described in these rules, except as provided in R15-4-506.~~

~~**D.** The Department shall give less weight to the income approach to value when the income to be capitalized is determined in accordance with rule R15-4-503(C).~~

~~**E.** The Department may consider comparable sales in its determination of full cash value. If the subject property has sold within three years prior to the date of valuation, then more weight will be given to its sales price as an indication of value.~~

~~**F.** The Department shall not rely upon fixed numerical weights for each approach in arriving annually at its final value determination. Each year the Department may exercise its discretion to vary the relative weights of the value estimates derived from the three approaches.~~

R15-4-508. ~~Valuation of construction work in progress, non-capitalized leases, and rents~~ <u>Repealed</u>

~~**A.** To develop the final value of the unit, the value of the operating properties from R15-4-507 must be increased by the value of construction work in progress and by the proprietary value of non-capitalized leases and rents used as an integral part of the operating unit as defined in R15-4-502(22).~~

~~**B.** The value to be added for construction work in progress shall be the total book value of the account, unless extraordinary circumstances warrant discounting all or part of the account.~~

~~**C.** The value of rented and leased property as defined in R15-4-502(22) shall be the rent and lease expenses for the year preceding the valuation date, capitalized at the industry rate for earnings before interest, income taxes, and depreciation.~~