

WILLIAMS TELECOMMUNICATIONS §
GROUP
Post Office Box 2400 §
Tulsa, Oklahoma 74102, §
LDDS COMMUNICATIONS, INC. §
515 East Amite Street §
Jackson, Mississippi 39201, §
Taxpayers, §
v. §
STATE OF ALABAMA §
DEPARTMENT OF REVENUE. §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION
DOCKET NOS. ADV. 95-331
ADV. 95-332

FINAL ORDER

The Revenue Department entered final assessments of value of utility property against LDDS Communications, Inc. ("LDDS") and Williams Telecommunications Group ("WilTel") for 1995. WilTel is a wholly-owned subsidiary of LDDS.

WilTel and LDDS (together "Taxpayers") appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. The appeals were consolidated, and a hearing was conducted on April 18, 1996. Martin Charlton, Robert Walthall, and Joe DiBenedetto represented the Taxpayers. Assistant Counsel Claude Patton represented the Department.

The Revenue Department is required to assess the value of utility property in Alabama pursuant to Code of Ala. 1975, §40-21-1 et seq. The Department notifies the counties of a utility's assessed value, and the counties assess and collect the appropriate tax due.

The issue in this case is whether the Department fairly assesses the intangible property of all utilities in Alabama. Intangibles include a company's goodwill, patents and trademarks,

a trained workforce, etc.

The Taxpayers concede that the Department accurately assessed their tangible and intangible property for the year in issue. They argue, however, that under the cost method of appraisal used by the Department, a utility that has grown through acquisition, such as LDDS, is assessed a greater intangible value than a company with the same intangible value that has grown internally. According to the Taxpayers, the unequal treatment occurs because intangibles acquired through acquisition are required to be listed on a company's financial statements, and thus are assessed under the cost method, while intangibles resulting from internal growth are not.

LDDS is the fourth largest long distance telecommunications company in the United States. LDDS grew rapidly from 1991 to 1995 by acquiring other long distance companies. LDDS's revenue grew from approximately \$948 million in 1992 to approximately \$2.2 billion in 1995, mainly through acquisitions.

For accounting purposes, LDDS booked the tangible assets of the acquired companies on its balance sheet. The difference between the value of the tangible assets and the acquisition price was booked as an intangible - "excess of cost over net tangible assets acquired." For example, LDDS acquired WilTel for approximately \$2.5 billion. Seven hundred million dollars was booked as physical assets, while the balance of \$1.8 billion was booked as an intangible.

The Taxpayers filed the required utility property tax

information (financial statements, FCC filings, etc.) with the Department for the 1995 tax year. Based on that information, the Department used the cost method to value LDDS's tangible and intangible property. The cost method relies on a company's financial statements to determine value. Consequently, the Department included the intangibles booked on LDDS's financial statements in its assessed value. The Department used the cost method because LDDS had grown rapidly in recent years, and thus did not have a sufficiently stable earnings history for use of the income or any other accepted appraisal method. (R. 22, 43).

Concerning WilTel, the Department used a combination of valuation methods, including both the cost and income method, because WilTel had a more stable earnings history than LDDS. (R. 38).

The Alabama Constitution, at §§211 and 217, and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution both require that all property in Alabama must be taxed equally. See generally, Hamilton v. Adkins, 35 So.2d 183 (1948); State v. Murphy, 235 So.2d 888 (1970); Weissinger v. Boswell, 330 F.Supp. 615 (M.D. Ala. 1971); and Howell v. Malone, 388 So.2d 908 (1980).

However, property appraisal is an inexact science, and occasional errors in judgment will occur. Consequently, the Department's appraisal procedures will not be rejected unless it is

established that the Department systematically and intentionally discriminates against certain utilities.

It seems clear that the constitutional principle of uniformity of taxation may be infringed by the method of administration of a property tax statute, even though the statute is fair on its face. Discrimination in the assessment or valuation by administrative officers may result in violation of the equality clause of the Fourteenth Amendment to the Federal Constitution. *Cumberland Coal Co. v. Board of Revision*, 284 U.S. 23, 52 S.Ct. 48, 76 L.Ed. 146; *Southern R. Co. v. Watts*, 260 U.S. 519, 43 S.Ct. 192, 67 L.Ed. 375. Before this result can be reached, however, it is necessary that the action of the administrative officials be more than mere error in judgment or result in more than inequality in valuation. It must be shown that the officials are chargeable with a purpose or design to discriminate by a systematic method. (Cites omitted).

Hamilton v. Adkins, supra, at page 184.

The Supreme Court pointed out that mere inequality in valuation does not contravene constitutional provisions, to-wit, Sections 217 and 211 of the Constitution of Alabama, nor the Equality Clause of the Fourteenth Amendment of the Federal Constitution. It is only when there is a plan or intent to systematically or intentionally discriminate against an area, or class of taxpayers or class of property within a taxing area, and such plan smacks of fraud, bad faith, or evil design on the part of the taxing authority, that constitutional privileges are infringed.

Exact equality of assessment is not expected nor required, for from a practical and common sense consideration, equality of taxation is impossible to achieve. However, reasonable effort and diligence, using the best information and procedure available, must be made with as little human error involved as possible.

State v. Murphy, supra, at pages 894 - 895.

The Taxpayers are correct that if the Department used only the

cost method, a utility that has grown through acquisition, such as LDDS, will be assessed a higher intangible value than a similar utility that has grown internally. But the Taxpayers' argument fails because the Department uses a variety of different appraisal methods to assess value, not just the cost method. A utility's intangible value may be assessed using those other appraisal methods, even if the intangible is not recorded on the utility's books.

James Moores has appraised utility property for the Department since 1978. Moores testified that the Department uses various appraisal methods, depending on the quality and quantity of the information provided by the utility. Code of Ala. 1975, §40-21-6 authorizes the Department to use "as a factor," (1) the income approach, (2) the stock and debt or market approach, or (3) the cost approach. Other guidelines are also set out at Code of Ala. 1975, §40-21-20. The method most used, if the utility has an earnings history, is an income approach tempered with the cost approach. A limited market approach may also be used. The Department weighs the values indicated by the above methods, and an estimated value is determined based on the judgment of the appraiser. (R. 70 - 71).

The Department used a combination of the above methods to value WilTel, but used a pure cost approach with LDDS because LDDS did not have a sufficient earnings history to use an income

approach.

Concerning intangibles, Moores testified that a variety of appraisal methods are used:

Q. Under the Department's rules, how do you value an intangible?

A. How do I value an intangible property?

Q. Yes.

A. Its cost; if it's been in existence for a period of time, its earnings; the present worth of all its future benefits or, you know, any income if that evidence is available. If similar intangibles are being sold on the market and have established a market price, we would use those and do a market study and develop a market price. If the stock is publicly traded and the debt of the company that owns the intangibles, we may do a surrogated market approach and add up all the stock and all the debt and relate that back to the assets and distribute it back to that intangible asset based on its -- you know, the investment of the company, its pro rata share of the value.

(R. 58 - 59).

Moores conceded that mistakes are possible. But clearly, the Department attempts to assess all utilities fairly, using "reasonable effort and diligence, using the best information and procedures available," State v. Murphy, at page 895. The fact that intangibles are not uniformly assessed under the cost method is not fatal to the Department's overall appraisal system because intangibles may be assessed using other methods. Inequality in valuation may occur on a case-by-case basis, depending on the information available, but the Taxpayers have

failed to establish actual systematic discrimination by the Department.

The Taxpayers cite Edward Valves, Inc. v. Wake County (NC), 451 S.E.2d 64 (1995) in support of their case. However, that case can be distinguished because Wake County used a single, inflexible taxing method. If the intangible was capitalized on the business's financial statements, it was taxed. If not capitalized, the intangible was not taxed. There was no alternative method available.

The Department, however, uses a variety of different methods to assess utility property. Unlike the Wake County system, a utility's intangible value may be assessed and taxed in Alabama, even if the intangible is not booked on the utility's financial statements.

The Taxpayers do not contest the final assessments of value in issue. Those final assessments are accordingly affirmed.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered November 1, 1996.

BILL THOMPSON
Chief Administrative Law Judge