

2012 WL 3041179

Only the Westlaw citation is currently available.

NOTICE: THIS DECISION DOES NOT
CREATE LEGAL PRECEDENT AND MAY
NOT BE CITED EXCEPT AS AUTHORIZED
BY APPLICABLE RULES. See Ariz. R. Supreme
Court 111(c); ARCAP 28(c); Ariz. R.Crim. P. 31.24.
Court of Appeals of Arizona,
Division 1, Department T.

SOUTHWEST AIRLINES CO., a Texas
corporation, Plaintiff/Appellant,

v.

ARIZONA DEPARTMENT OF REVENUE,
an agency of the State of Arizona; State
of Arizona, Defendants/Appellees.

No. 1 CA–TX 11–0007.

July 26, 2012.

Appeal from the Arizona Tax Court; Cause No. TX2007–
000621; The Honorable Dean M. Fink, Judge. AFFIRMED.

Attorneys and Law Firms

Mooney Wright & Moore PLLC by Paul J. Mooney, Bart S.
Wilhoit, Mesa, Attorneys for Plaintiff/Appellant.

Thomas C. Horne, Attorney General by Kenneth J.
Love, Assistant Attorney General, Phoenix, Attorneys for
Defendants/Appellees.

MEMORANDUM DECISION

JOHNSEN, Judge.

*1 ¶ 1 This appeal arises out of the valuation for property tax purposes of the aircraft fleet owned by Southwest Airlines Co. Southwest contends the Arizona Department of Revenue erroneously failed to allow for obsolescence in determining the full cash value of the aircraft for tax years 2008, 2009 and 2010. After a six-day bench trial, the Arizona Tax Court issued findings of fact and conclusions of law upholding the Department's valuations. For the reasons that follow, we affirm.

FACTS AND PROCEDURAL BACKGROUND

¶ 2 Southwest's annual property-tax reporting forms identify each of its airplanes and its original cost, along with its manufacturing and acquisition dates. Applying the property tax valuation formula in Arizona Revised Statutes ("A.R.S.") section 42–14254 (West 2012) to that information, the Department determined the full cash values of the company's aircraft to be \$211,343,700 in tax year 2008, \$212,727,000 in 2009 and \$211,002,000 in 2010.¹

¶ 3 Southwest timely asked the Department to consider obsolescence for the 2008 tax year. After consulting the Airliner Price Guide ("APG"), Department representative Kirk McElhane determined that the Department's full cash values exceeded the APG's wholesale values for fewer than five of Southwest's airplanes. Accordingly, the Department refused to reduce the valuation based upon obsolescence. Southwest and the Department repeated the process with respect to the 2009 and 2010 tax years.

¶ 4 Southwest appealed the assessments for all three tax years pursuant to A.R.S. §§ 42–14005 and 42–16204 (West 2012). After trial, the tax court found that the Department's valuation of the aircraft was correct for purposes of A.R.S. § 42–16213(B)(2) (West 2012). This timely appeal followed. We have jurisdiction pursuant to A.R.S. § 12–2101(A)(1) (West 2012).

DISCUSSION

A. Legal Principles.

¶ 5 We defer to the tax court's factual findings so long as they are not clearly erroneous. *Kocher v. Dep't of Revenue*, 206 Ariz. 480, 482, ¶ 9, 80 P.3d 287, 289 (App.2003). We review mixed questions of law and fact *de novo*. *Eurofresh, Inc. v. Graham County*, 218 Ariz. 382, 385, ¶ 14, 187 P.3d 530, 533 (App.2007).

¶ 6 Arizona taxes property based upon its full cash value as provided in A.R.S. § 42–11001(6) (West 2012):

“Full cash value” for property tax purposes means the value determined as prescribed by statute. If no statutory

method is prescribed, full cash value is synonymous with market value which means the estimate of value that is derived annually by using standard appraisal methods and techniques. Full cash value is the basis for assessing, fixing, determining and levying secondary property taxes. Full cash value shall not be greater than market value regardless of the method prescribed to determine value for property tax purposes.

¶ 7 The method for valuing “flight property” such as Southwest’s aircraft is prescribed by A.R.S. § 42–14254(B) (2), which directs the Department to “determine the valuation of each fleet type by the original cost less depreciation,” then “[a]llow additional obsolescence if supported by market evidence.”

B. Trial Proceedings.

*2 ¶ 8 Both sides called expert witnesses who had determined the full cash value of the aircraft as a percentage of the total company (unitary value) with an allocation for the state of Arizona.² Each of the two experts considered three standard appraisal methods—income, cost and market (sales).³

¶ 9 Southwest’s expert, Thomas K. Tegarden, employed the cost and income approaches to support his opinion that the full cash values of the aircraft were lower than those set by the Department. Tegarden used the yield capitalization method to employ the income approach and rejected the Department’s expert’s use of the sales-comparison approach.

¶ 10 The Department’s expert, D. Brent Eyre, declined to employ the cost approach. Instead, he used the income approach (using a direct capitalization method) and sales-comparison approach (using the stock and debt method). According to Eyre, the Department’s valuations fell below fair market values.

¶ 11 The tax court found Southwest had rebutted the statutory presumption that the Department’s valuations of the aircraft were correct. The court found both expert witnesses to be qualified, based on their education and experience. The court stated, however, “Having had the special opportunity

of listening to each witness as he gave live testimony and was subjected to rigorous cross-examination, the Court was especially impressed by Mr. Eyre and found his testimony and opinions to be more credible, more reliable, more persuasive, and entitled to greater weight than the testimony and opinion of Mr. Tegarden.”

¶ 12 The tax court concluded:

The Court has weighed the evidence and testimony of the expert witnesses, both of whom it has found competent, and finds that the weight of the evidence, in particular the opinion of Mr. Eyre, in the light of all the evidence, preponderates in support of the value urged by the Department as against either the value urged by [Southwest] or any intermediate figure.

* * *

In accordance with all of the foregoing, the Court finds that the full cash value of [Southwest’s] flight property for tax years 2008, 2009, and 2010 shall remain at \$211,343,700, \$212,727,000, and \$211,002,00, as noticed by the Department.

C. A.R.S. § 42–16212(B) and the Burden of Proof.

¶ 13 Southwest first argues the tax court erred by failing to adopt Tegarden’s analysis after the court concluded Southwest had rebutted the presumption of correctness afforded to the Department’s analysis. We disagree: The court was not obligated to overturn the Department’s valuation simply because it concluded Tegarden’s opinions were sufficient to rebut the presumption accorded the Department’s valuation.

¶ 14 “The valuation ... as approved by the appropriate state or county authority is presumed to be correct and lawful.” A .R.S. § 42–16212(B) (West 2012). Once the presumption is rebutted, the tax court “is bound to follow the usual rules of evidence in reaching the ultimate conclusion of fact.” *Dept of Revenue v. Transamerica Title Ins. Co.*, 117 Ariz. 26, 28, 570 P.2d 797, 799 (App.1977). Even when the party attacking the taxing authority’s valuation submits sufficient evidence to rebut the statutory presumption, that party retains the burden to show that the authority’s valuation is incorrect. *Graham County v. Graham County Elec. Coop., Inc.*, 109 Ariz. 468, 470, 512 P.2d 11, 13 (1973); *Honeywell Info. Sys., Inc. v. Maricopa County*, 118 Ariz. 171, 174, 575 P.2d 801, 804 (App.1977); see *Inspiration Consol. Copper Co. v. Ariz. Dept of Revenue*, 147 Ariz. 216, 231, 709 P.2d 573, 588

(App.1985), superseded by statute on other grounds, 1990 Ariz. Sess. Laws, ch. 360, § 1 (2d Reg.Sess.).⁴

*3 ¶ 15 Southwest further argues, however, that the tax court was obligated to accept Tegarden's opinions because Eyre's opinions were not competent evidence of the values of the aircraft. At oral argument, Southwest acknowledged that a properly calculated fair market value necessarily will reflect obsolescence of the sort the tax statutes reference. It argues that Eyre's opinions of the fair market values of the aircraft were not competent because they were not derived from "standard appraisal methods and techniques" pursuant to A.R.S. § 42-11001(6).⁵

¶ 16 More specifically, Southwest contends that the methodology by which Eyre applied the income approach to valuation "has been expressly rejected." In performing his income approach, Eyre used a variation of the direct capitalization method that uses price/earnings ratios rather than comparable sales to derive a capitalization rate. Although the capitalization rate normally is determined from sales of comparable properties, both experts agreed there are no comparable properties to Southwest. Southwest argues that the authorities teach that while the use of price/earnings ratios to calculate capitalization rates might be appropriate in valuing stock, it is not appropriate in valuing real or personal property. But as the Department points out, in *PacifiCorp v. State*, 253 P.3d 847, 851-52, ¶¶ 26-28 (Mont.2011), the Montana supreme court endorsed Eyre's use of price/earnings ratios to calculate capitalization rates in a case involving the value of a utility company. Southwest argues *PacifiCorp* does not support Eyre's approach in this case because in Montana, the assessing agent is required to begin the valuation process by calculating the value of all of a company's assets, including intangible assets that are not at issue here. This argument lacks merit, however, given that the starting point in this case for both sides' consideration of the existence of obsolescence was to estimate a unitary value of the company.

¶ 17 Southwest also attacks Eyre's use of the "stock and debt" approach as a surrogate for the sales approach. See

Delta Air Lines, Inc. v. Dep't of Revenue, 984 P.2d 836, 842-43 (Or.1999). Southwest argues this method is inappropriate as a means of appraising tangible assets because it uses the value of a company's debt and equity securities, which by nature are fungible and more liquid than its tangible assets. Further, Southwest argues that because Eyre could not identify any other airlines comparable to Southwest, he used Southwest's own reported stock price and the value of its publicly traded debt securities. Southwest argues, "That may tell someone what the value of the company is as a whole, but it does nothing to determine the value of Southwest's 'flight property' (i.e., its airplanes), which is the only property that is subject to taxation under A.R.S. § 42-14254." (emphasis in original).

¶ 18 Eyre, however, testified that the stock and debt approach was appropriate to evaluate the going concern value of a publicly traded company with 85 percent of its capital in operating property. After using the stock and debt approach to derive an estimate of the value of the company, Eyre deducted a portion attributable to intangible property using a balance sheet analysis, and then made further refinements to determine the value allocable to Southwest's aircraft. And at trial, Tegarden conceded that he had used the same approach in valuing Southwest in 2003 in a tax proceeding in another state.

*4 ¶ 19 In sum, we do not agree with Southwest that Eyre's opinions must be rejected as incompetent. The tax court found Eyre's opinions were "more reliable, more persuasive," and for that reason, "entitled to greater weight" than Tegarden's opinions, and we are unwilling to upset those findings of fact.

D. Southwest Failed to Demonstrate that the Department's Valuations Were Excessive.

1. Obsolescence in general.

¶ 20 At trial, McElhaney, Eyre and Tegarden offered the following estimates of the full cash value of Southwest's aircraft:

Tax Year	Department	Eyre	Tegarden
2008	\$211,343,700	\$413,500,000	\$184,776,000
2009	\$212,727,000	\$351,000,000	\$178,118,750
2010	\$211,002,000	\$269,000,000	\$164,082,000

¶ 21 In applying the cost method, Tegarden determined that additional deductions from the statutory formula were needed to account for obsolescence. Tegarden derived obsolescence percentages ranging from 50.21 to 51.11 for the three relevant tax years.

¶ 22 “Obsolescence, which is a form of depreciation, is defined as a loss of value and is classified as either functional or economic.” *Ariz. Dep’t of Revenue v. Questar S. Trails Pipeline Co.*, 215 Ariz. 577, 580, ¶ 12, 161 P.3d 620, 623 (App.2007) (quotations omitted). Economic obsolescence, the type at issue in this case, is “a loss in value caused by forces external to the property and outside the control of the property owner.” *Magna Inv. & Dev. Corp. v. Pima County*, 128 Ariz. 291, 293, 625 P.2d 354, 356 (App.1981).

¶ 23 Eyre argued Tegarden failed to test his obsolescence opinion against market evidence. Eyre recommended comparing weighted market values to book values; if the resulting ratio exceeds one, the investment community is valuing the taxpayer's assets in excess of their book value. Eyre calculated the overall market-to-book ratio for 2008 as 1.64. For the 2009 and 2010 tax years, Eyre's values were 1.26 and 1.22, respectively. From this, Eyre argued the market-based evidence fails to support any adjustment for obsolescence.

2. Tegarden's calculation of obsolescence.

¶ 24 In its specific criticisms of Tegarden's opinions, the Department argues his reliance upon the income-shortfall approach to perform a cost valuation was erroneous. It argues Tegarden's analysis was flawed because, *inter alia*, rather than compare Southwest's income to the income of other airlines, Tegarden “created a comparison market by hypothesizing an entirely subjective figure for what he thought that [Southwest's] earnings should be and compared the hypothetical earnings to its actual earnings.” The tax court accepted Eyre's criticism of this method as circular.⁶

¶ 25 Moreover, the Department argues that the income-shortfall approach that Tegarden used has been rejected by the Western States Association of Tax Administrators. See *PacifiCorp*, 253 P.3d at 854–55 (rejecting use of income-shortfall approach); *Transcon. Gas Pipe Line Corp. v. Bernards Twp.*, 545 A.2d 746, 754 (N.J.1988) (noting “circularity” of the approach).

*5 ¶ 26 At trial, Eyre also criticized Tegarden's yield-capitalization income approach to valuation. This approach forecasts future net cash flows, and uses a discount figure to calculate value from those anticipated cash flows. Eyre argued Tegarden used dissimilar companies to select the average cost of capital, improperly chose and inflated the risk premium for the capital asset pricing model, used incorrect long-term growth rates, and used non-airline companies to compute cost of equity.

¶ 27 The record confirms these deficiencies. Rather than using other domestic airlines as comparables, Tegarden compared Southwest to profitable companies such as FedEx and UPS. Indeed, Eyre found that Tegarden's cost of capital calculations exceeded Southwest's during similar periods.

¶ 28 In addition, Eyre strongly criticized Tegarden's assumption of no growth, which would mean that depreciation would tend to approximate capital expenditures in perpetuity. As noted, this conclusion flies in the face of the investment community's valuation of Southwest's assets, which reflects an expectation of growth.

¶ 29 Another problem with Tegarden's calculation was his admitted failure to specifically account for the value of leased property. According to Arizona Administrative Code R15–4–302(1), flight property includes “both owned and leased aircraft.” When Tegarden calculated Southwest's net operating income, he did not include the income stream generated through use of leased airplanes, which resulted in a lower rate of return.

¶ 30 Based on the record presented, we cannot conclude the tax court erred by accepting these criticisms of Tegarden's analysis.

E. The Tax Court Was Not Required to Find the Market Value of the Aircraft.

¶ 31 Finally, Southwest argues without citation to legal authority that the tax court erred by failing to determine the aircraft's market values during the relevant years. We disagree. Under A.R.S. § 42–14254, the Department must value the aircraft using original cost less depreciation, then must “[a]llow additional obsolescence if supported by market evidence.” Southwest urged the tax court to reject the values the Department established because, according to Southwest, they exceeded the aircraft's market values. In evaluating that argument, the tax court was not required to make express

findings of the aircraft's market values during the tax years in question. It only had to find that the Department's full-cash values did not exceed market values. When the tax court concluded that the Department's full-cash values were "correct," it impliedly concluded that the fair market values of the aircraft exceeded the Department's valuations. The extent to which the fair market values of the aircraft exceeded the Department's valuations, however, is irrelevant.

the tax court found Eyre's testimony to be more reliable and persuasive. "The weight to be accorded expert testimony is within the sole province of the trial court, and since competent evidence supports its conclusion, we decline to intervene." *Magna*, 128 Ariz. at 294, 625 P.2d at 357. We affirm the tax court's judgment with respect to all three tax years, and award the Department its costs on appeal, subject to its compliance with Rule 21(a) of the Arizona Rules of Civil Appellate Procedure.

CONCLUSION

¶ 32 Substantial evidence supports the tax court's decision to reject Southwest's appeal of the Department's valuations. The tax court was in the best position to judge the testimony of the two sides' expert witnesses. Both Eyre and Tegarden bear impressive credentials and produced detailed reports, but

CONCURRING: MAURICE PORTLEY, Presiding Judge and PHILIP HALL, Judge.

All Citations

Not Reported in P.3d, 2012 WL 3041179

Footnotes

- 1 Absent material revision after the date of the events at issue, we cite a statute's current version.
- 2 The parties agree on the percentage of value allocated to Arizona.
- 3 See *Maricopa County v. Sperry Rand Corp.*, 112 Ariz. 579, 581, 544 P.2d 1094, 1096 (1976).
- 4 Southwest cites *Department of Property Valuation v. Salt River Project Agricultural Improvement & Power District*, 27 Ariz.App. 110, 551 P.2d 559 (App.1976), *rev'd*, 113 Ariz. 472, 556 P.2d 1134 (1976), but that case does not teach a different rule. The court there found that the Department's affidavits overcame the presumption of correctness of valuations earlier set by the State Board of Property Tax Appeals. *Id.* at 114, 551 P.2d at 563. The court explained that "this statutory presumption merely gives rise to a burden of proof requirement and as pointed out in [*Dep't of Prop. Valuation v. Trico Elect. Coop., Inc.*, 113 Ariz. 68, 546 P.2d 804 (1976)] 'that the Department must bear the burden of proving that the assessment is insufficient *when it appeals* from the decision of the Board.' " *Id.* (emphasis added).
- 5 Southwest argues that by referring to the APG to determine the obsolescence of the aircraft, the Department failed to use standard appraisal techniques. The tax court, however, did not endorse the Department's use of the APG to set the full cash value of the aircraft. In affirming the decision of the tax court, we do not need to consider whether the Department correctly used the APG.
- 6 See, e.g., *Delta Air Lines*, 984 P.2d at 849 (characterizing the "income-deficiency" approach as "illogical" at best and stating that at worst the method "strips the cost approach of its use as an independent determiner of value, because it always will track the result under the income approach").