ADOPTED REGULATION OF THE

NEVADA TAX COMMISSION

LCB File No. R085-98

Effective November 23, 1998

EXPLANATION – Matter in *italics* is new; matter in brackets **[ ]** is material to be omitted.

AUTHORITY: §§ 1-6, NRS 360.090 and 361.320.

Section 1. Chapter 361 of NAC is hereby amended by adding thereto a new section to read as follows:

The taxpayer may present and the department shall consider, in addition to the information required by NAC 361.421, one or more of the following alternative cost indicators of value:

1. A calculation of the reproduction cost new less depreciation for all taxable operating property of the collective unit being assessed. The calculation must have been performed in accordance with generally accepted appraisal methodology.

2. A calculation of the replacement cost new less depreciation for all taxable operating property of the collective unit being assessed. The calculation must have been performed in accordance with generally accepted appraisal methodology.

3. Any other relevant and verifiable information, such as rate base for regulatory purposes.

Sec. 2. NAC 361.408 is hereby amended to read as follows:

361.408 1. The cost approach consists of that cost of all operating assets subject to the ad valorem property tax pursuant to NRS 361.315 and 361.320 that most closely reflects the taxable value of these operating assets.

2. For the income approach, the adjusted net operating income either after or before an allowance for depreciation and federal income tax will be capitalized (converted to value) through the use of an appropriate capitalization rate for the industry **[**.**]** *group.* The income of the property to be capitalized will be determined as follows:

(a) With regard to those **[**industries**]** *industry groups* in which annual earnings are reasonably stable, the most recent year's earnings may be capitalized.

(b) For those **[**industries**]** *industry groups* in which annual earnings vacillate frequently over a period of years, an average of past earnings may be used.

3. The market approach or stock and debt method of valuation is a technique that is applicable to valuing railroads and utilities and it results initially in an enterprise value which encompasses the entire unit. The stock and debt indicator will be determined by multiplying either the average monthly, quarterly or annual high and low market price quotations of all the securities which are actively traded in the market place including common stock, preferred stock and long-term debt, by the number of shares outstanding at the end of the year. With regard to those securities which are not actively traded, computations of the present worth of the income flows may be made for the determination of their value. To this amount will be added short-term debt *,* together with other applicable adjustments. From this amount will be deducted the nonoperating and nonassessable assets for the indication of the value of those assets encompassed within NRS 361.315 and 361.320.

4. A review will be made of the one or more available indicators of value. These indicators of value will then be reconciled to derive the final estimate of value.

Sec. 3. NAC 361.421 is hereby amended to read as follows:

361.421 The cost approach consists of:

1. Determining the gross book cost *for financial reporting purposes* of all *taxable* operating property *,* including, but not limited to, all property relating to rail transportation, utility plant in service, plant held for future use, contributed plant, nuclear fuel, construction work in progress, experimental plant, acquisition adjustments, materials and supplies, plant and other property leased from others and common plant.

2. Deducting from the gross book cost the accrued book depreciation **[**as permitted by regulatory agency requirements which includes**]** *recorded for financial reporting purposes, which may include* physical, functional and economic obsolescence.

Additional obsolescence **[**may be calculated and**]** *must be* deducted when **[**considered applicable.**]** *adequately quantified.*

Sec. 4. NAC 361.423 is hereby amended to read as follows:

361.423 1. The capitalized income approach consists of deducting from the *normalized and annualized* gross operating income any direct and indirect *normalized and annualized* operating expenses specifically related to the *normalized and annualized gross* operating income including any **[**annual**]** *annualized* book depreciation. Deferred **[**federal**]** income taxes will be treated as an operating expense. **[**Reported**]** *Normalized and annualized* rental expense on operating property leased from others, less imputed depreciation, *income taxes and other applicable expenses,* will be disallowed as an operating expense.

2. The resulting adjusted net operating income will be capitalized (converted to value) using an appropriate capitalization rate for the industry [.] *group.* The capitalization rate for the typical company will be used for the firms being appraised in each industry [. The statistical median] *group. The market* capitalization rate will be derived from calculations made for selected companies in each industry [.] *group.*

3. The operating income to be capitalized into taxable value will be *normalized and annualized based on* the most recent year's adjusted net operating income. When the most recent year's net operating income is not a reasonable representation of a company's net operating income, such as [,] where a company's net operating income tends to be cyclical, a 3- or 5-year average of adjusted net operating incomes *will be normalized and annualized and* may be used.

4. Construction work in progress is not a factor in applying the income approach to value.

5. Any normalization or annualization adjustments to a company's net operating income must be based on known, measurable and experienced changes in a company's operation or taxable property as of the current year's reporting date.

Sec. 5. NAC 361.425 is hereby amended to read as follows:

361.425 The capitalization rate will be established from a selected number of firms to derive the rate for the typical company in each industry *group* when the information is available:

1. The band-of-investment method will be used in the compilation of the capitalization rate.

2. The band-of-investment method represents the cost of the money needed by the typical company in each industry *group* to acquire its operating plant and carry on its operations. It is composed of two factors:

(a) The capitalization ratios of the typical company; and

(b) The cost of the items which comprise the total capital structure of the typical company.

3. A "typical company" means a theoretical company which is representative of **[**a group of**]** *the* firms within an industry **[**.**]** *group.* The selected firms in the industry *group* will be **[**similar**]** *comparable* in amount of revenues, bond ratings, nature of operations and regulatory environment. Certain nonutility conglomerates which have utility operations in Nevada will be studied in the light of other similar conglomerates. Conglomerates will not be grouped with nonconglomerates where possible. The development of the typical company will reflect input by the companies *within the industry group* which are centrally assessed.

4. The items which comprise the total capital structure of the typical company are those **[**reported book amounts reflected under the credit side of the balance sheet indicating**]** *amounts as recorded for financial reporting purposes that represent* the sources of the money or capital funds made available to acquire the **[**properties reflected under the debit or asset side of the balance sheet.**]** *taxable operating property of the industry group.* For the purposes of this subsection, "capital funds" means money obtained from:

(a) Creditors through notes or bonds;

(b) Stockholders through stocks, paid-in capital and undistributed retained earnings; and

(c) Similar financial capital accounts, except **[**,**]** not from the Federal Government through deferred **[**federal**]** income taxes.

[Each item will be given consideration.] The *total* capital structure of the typical company will be derived through the use of a statistical median from the selected sample of firm calculations.

5. *In addition to the total capital structure of the typical company derived pursuant to subsection 4, the taxpayer may present and the department shall consider the total capital structure of the typical company based upon common equity, preferred equity and the long-term debt percentages as developed from market information for comparable companies in the industry group. The total capital structure of the typical company must be derived from the use of market information from the selected sample of firm calculations.*

6. The annual *average of* high-low [average yield] *monthly yields to maturity* compiled by Moody's Investors Service (Public Utility and Transportation) *,* or another accepted service [,] approved by the executive director of the department, will be used for the assignment of a cost to the long-term bonded indebtedness component of the *total* capital structure.

[6.] *7.* The assignment of cost to preferred stock will be determined in a manner consistent with subsection [5.

7.] *6.*

8. The assignment of cost to that portion of the *total* capital structure which represents equity for the typical company in each industry *group* will be determined in the following manner:

(a) [For each selected firm, the common stock value is the average of the annual high and low market price quotation during the year multiplied by the yearly average number of shares outstanding.

(b) For each selected firm, the income before extraordinary items (available to common equity shareholders) is divided by the calculated market value of the common stock.

(c) The equity rate of the typical company is the statistical median of the equity rates for the entire group of the firms selected as the sample of the industry.

(d)**]** *The department shall develop an equity rate for each industry group based on one or more of the following models:*

(1) Discounted cash-flow method.

(2) Capital asset-pricing.

(3) Risk premium analysis.

(b) The department shall also consider the results of cost of equity studies provided by members of the industry group based on the models set forth in paragraph (a).

(c) When considered applicable, the cost of equity capital established for the industry *group* may be determined by using additional models *, such as direct capitalization,* accepted in the appraisal and financial communities and approved by the executive director of the department.

[8.**]** *9.* The capitalization rate of the typical company for the industry *group* will be calculated by using a weighted method (band-of-investment) which is the *total* capital structure percentage times the component rate percentage. The weighted values are then totaled and rounded to four decimal places to get the capitalization rate.

EXAMPLE:

MEDIAN

TYPICAL COMPANY	CAPITAL STRUCTURE X	RATE =	WEIGHTED RETURN
Common Equity	42.50%	11.20%	4.76000%
Preferred Equity	9.25%	9.35%	.86488%
Long-Term Debt	48.25%	9.45%	4.55963%
Capitalization Rate for Industry *Group*			10.1845%

[9.**]** *10.* The determination of the income value indicator requires the capitalization of the adjusted net operating income at the current capitalization rate. Financial data for selected companies in each industry **[**,**]** *group,* as presented in the latest annual reports by Moody's Investors Service (Public Utility and Transportation) *,* or another accepted service **[**,**]** approved by the executive director of the department, will be used in the compilation of the capitalization rate of the typical company.

[10.**]** *11.* An alternative to the capitalization rate method in subsections 1 to **[**8,**]** *9,* inclusive, may be the use of a rate for the industry *group* as published by the Western States Association of Tax Administrators *,* or another recognized tax-related organization **[**,**]** approved by the executive director of the department.

Sec. 6. NAC 361.427 is hereby amended to read as follows:

361.427 1. The [market or] stock and debt approach proposes a value for the entire firm [.] , *but is generally recognized as a less applicable methodology for determining the value of taxable property.*

2. The stock and debt indicator is determined by multiplying either the average monthly, quarterly or annual high and low market price quotations *,* when available, for all [of] the securities which are actively traded in the market place, including common stock, preferred stock and long-term debt, by the number of shares outstanding at the end of the year. Computations of the present worth of income flows may be made to determine values for securities which are not actively traded.

3. The value of the stock of a holding company is apportioned among its operating companies according to the ratio of:

(a) Each operating company's property to the aggregate property of all of the operating companies, valued at historical cost and weighted at one-third; and

(b) Each operating company's net income before income taxes to the aggregate net income of all of the operating companies, weighted at two-thirds.

For the industry *group* of rail transportation *,* the direct deduction method to eliminate nonoperating assets will be used when the information is available and considered applicable.

4. To this amount will be added items such as customer advances for construction which are nontaxable for federal income tax purposes, current liabilities less dividends declared, the present worth of leased property over the period of the lease together with any other items conforming to the theory that if a person were to purchase all the stock and assume all the

outstanding liabilities of a company, he would have acquired all the assets which appear on the asset side of the balance sheet and, therefore, own the company.

5. From this amount will be deducted the market value of all **[**nonassessable assets**]** *exempt or nonoperating property,* including, but not limited to, cash, accounts receivable, notes receivable, miscellaneous investments, temporary investments, nonoperating properties and other current and accrued assets and properties not subject to the ad valorem property tax imposed by NRS 361.315 and 361.320.