

**BOARD ORDER: MGB 035/05**

**IN THE MATTER OF THE** "*Municipal Government Act*" being Chapter M-26.1 of the Statutes of Alberta 1994 (Act).

**AND IN THE MATTER OF A COMPLAINT** respecting certain 1997 and 1998 Linear Property assessment prepared by the Assessor designated by the Minister of Municipal Affairs.

**BETWEEN:**

Telus Communications Inc., Telus Communications (Edmonton) Inc. and Telus Mobility Inc. as represented by Telus Corporation - Complainant

- a n d -

Minister of Municipal Affairs – Respondent

**BEFORE:**

J. Schmidt, Presiding Officer  
S. Caithness, Member  
S. Cook, Member

B. Fenske, Secretariat  
A. Yaremchuk, Secretariat

Upon notice being given to the affected parties, a complaint hearing was held in the City of Edmonton, in the Province of Alberta on June 12, 13, 14, 15, 16, 26 and 27, 2000.

This is a hearing about complaints made by Telus Corporation on behalf of Telus Communications Inc., Telus Communications (Edmonton) Inc. and Telus Mobility Inc. respecting 1997 and 1998 linear property assessments prepared by the Assessor designated by the Minister and entered in the assessment roll of various municipalities identified under Appendix "A" attached hereto. For purpose of this Board Order, the Complainants will be collectively known as "Telus".

**OVERVIEW**

In July 2002 one of the members of the panel, Mr. S. Caithness, ceased to be a member of the Municipal Government Board (MGB). The remaining two members of the MGB continued as a quorum of the Board and completed this decision pursuant to the authority in section 489 and 490 of the Act.

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At a preliminary complaint hearing for the 1999 to 2002 Telus assessment years the parties agreed to the process in finalizing the outstanding 1997 and 1998 complaints. It was agreed that the two remaining panel members who heard the complaint should complete the decision of the 1997 and 1998 complaints as heard and issue a separate Board Order independent of any other complaint hearings that remained outstanding.

The complaint against the 1997 and 1998 Telus Communications Inc. and Telus Communications (Edmonton) Inc. assessment came forward on grounds certain "switching" costs are not liable to linear property assessment and the depreciation, as applied to the switching machinery and equipment, is not fair and equitable.

The complaint against the 1997 Telus Mobility Inc. assessment came forward on grounds the depreciation as applied to the switching machinery and equipment is not fair and equitable. The Complainant also submitted that the outcome of a similar 1996 hearing regarding the assessment of application software is applicable to the 1997 and 1998 complaints.

### **COMPLAINTS ON INDIAN RESERVES AND METIS SETTLEMENTS**

The complaints as filed by Telus included complaints for property located in Indian Reserves and Metis Settlements, however, the MGB does not have jurisdiction over property within Reserves or Settlements. Pursuant to section 298 of the Act, no assessment is to be prepared for property in Indian reserves and Metis settlements. Since there is no assessment prepared in these jurisdictions, there can be no assessment complaint pursuant to section 492 of the Act. As there can be no linear property assessment complaint, the MGB is without jurisdiction pursuant to section 488 to hear an assessment complaint in relation to valuations made in Indian and Metis jurisdictions. The valuations listed on the complaints filed in respect of Indian Reserves and Metis settlements for both the 1998 and 1999 complaint years are therefore removed from the lists of complaint.

### **INTERVENORS**

A notice of this hearing was sent to all affected parties, relative to this complaint matter, to allow potential Intervenors the opportunity to be heard. The Cities of Calgary and Edmonton responded and were given Intervenor status at the hearing.

The Intervenors requested that the issue of quantum be addressed. The Complainant, with some concurrence from the Respondent, argued that their position is based on whether the software is assessable and to argue a quantum amount, which the Department has in their possession, would be irrelevant at this time.

On behalf of the Intervenors, Ms. Trylinski, solicitor for the City of Calgary, submitted that no evidence has been led regarding the assessment amounts in dispute. As a result, it was argued the

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MGB cannot decide the issue of assessment quantum in the absence of a properly constituted agreement or recommendation. It was, therefore, requested the MGB direct that the Intervenors' consent is to be obtained prior to any assessed value change. In the alternative, the MGB could direct a further hearing on the issue of assessment quantum.

The MGB agreed with the Complainant's and Respondent's position on this matter, ruling that the complaint hearing is to continue based on the issues as presented by the Complainant and Respondent. However, it is agreed that the Intervenors are affected parties and if any assessed value recommendations are to subsequently be put forth, then the Intervenors would have the right to be heard on the matter.

Further, in the event of the complaint being allowed, the MGB would, at the further request of the parties, consider reopening the hearing to deal specifically with the quantum issue.

### **ORGANIZATION OF THIS ORDER**

Due to the complexities of the subject matter this order is organized into four parts.

- Part I - Relationship to the 1996 decision
- Part II - Are Application Software Costs Assessable?
- Part III - Fairness and Equity
- Part IV - Depreciation

### **PART I – RELATIONSHIP TO THE 1996 DECISION**

#### **Background**

#### **1996 Decision**

The MGB issued a decision respecting similar complaints for the 1996 assessment year. Following the release of that decision, the Designated Linear Assessor made application to the Alberta Court of Queen's Bench for judicial review of the decision. The Alberta Court of Queen's Bench issued a decision quashing the Order and returning the matter to the MGB. This decision was appealed to the Alberta Court of Appeal. The decision of the Alberta Court of Queen's Bench was overturned on appeal and the MGB decision reinstated. The Designated Linear Assessor then sought, before the Supreme Court of Canada, leave to appeal the decision of the Alberta Court of Appeal. The Supreme Court of Canada denied the application for leave to appeal and the decision of the MGB for the 1996 complaint remains in full force and effect.

At the time of the hearing of the subject complaints, the decision of the Alberta Court of Queen's Bench was issued. The parties, at that time, were given an opportunity to argue the relevance of this decision on the subject complaints. However, before the issuance of this decision, the appeal

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was filed with the Alberta Court of Appeal and the subject complaints were held in abeyance pending the final outcome of the court challenges. Following the denying of the application for leave to appeal by the Supreme Court of Canada, the parties were consulted as to their preferences for the finalization of the outstanding decision.

During the delay between the parties proceeding to the Alberta Court of Appeal and the decision of the Supreme Court, complaints were also filed for the 1999 to 2002 assessment years. After hearing from the parties regarding all the outstanding years, the MGB directed that the 1999 to 2002 complaints would proceed to a hearing and the subject complaints would remain in abeyance pending the conclusion of those hearings.

Following the close of the hearing for the subsequent complaint years, the parties would then comment, in writing, on the relevance of the Alberta Court of Appeal decision in respect to the subject complaints. The hearing into the 1999 to 2002 complaints has now concluded and written argument has been received from the parties respecting the Alberta Court of Appeal decision.

### **Issues**

1. Are the 1997 and 1998 complaints the same or different from the 1996 complaints?
2. Are the evidentiary facts the same or different?
3. Are the arguments the same or different?
4. Is the legislation the same or different?

### **Legislation**

In order to decide these issues, the MGB examined the following key parts of the legislation.

Assessment is prepared on an annual basis. In the case of linear property the designated linear assessor prepares the assessment annually.

#### ***Municipal Government Act (Act)***

*285 Each municipality must prepare annually an assessment for each property in the municipality, except linear property and property listed in section 298.*

*289(1) Assessments for all property in a municipality, other than linear property, must be prepared by the assessor appointed by the municipality.*

*292(1) Assessments for linear property must be prepared by the assessor designated by the Minister.*

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The Board has jurisdiction to hear complaints about the assessments of linear property.

*488(1) The Board has jurisdiction*

*(b) to hear complaints about assessments of linear property,*

*492(1) A complaint about an assessment of linear property may be about any of the following matters, as shown on the assessment notice.*

*(a) whether the liner property is assessable; ... .*

*499(1) On concluding a hearing, the Board may make any of the following decisions;*

*(b) make any change with respect to any matter referred to in section 492 (1), if the hearing relates to a complaint about an assessment for linear property.*

### **Summary of Complainant's Position**

The Complainant points out that the 1997 and 1998 linear complaints involve the same issues as the 1996 complaint with the exception of depreciation of the DMS switching equipment. The facts, evidence, issues and legislation for the 1997 and 1998 complaints are the same as those dealt with by the MGB in the 1996 decision. The evidence in 1996 is no different than the evidence in the 1997 and 1998 complaints.

The argument that telecommunications systems should be given a broad meaning and whether intangible or intellectual property is assessable was squarely dealt with in the 1996 decision. The 1996 decision found that the application software was not essential to the operation of the DMS switch. Whether the operation unit was the DMS switch or part of the broader system was fully canvassed. In summary, the Complainant is of the opinion that the 1996 decision is a sound basis to decide the 1997 and 1998 complainants and reach a similar remedy. Issues of equity and depreciation are squarely before the MGB in the 1997 and 1998 complaints.

### **Summary of Respondent's Position**

The Respondent maintains that the evidence in the present hearings are different in several material respects. In the previous hearing the evidence was to the effect that all of basic software was the only software necessary to complete a telephone call and that application software was in no respect necessary to operate the computer or complete the telephone call. The Respondent has introduced evidence and witnesses that was not at the previous hearing to illustrate that the relationship and function of basic and application software presented at the 1996 hearing was not accurate.

The Respondent provided further argument with respect to the meaning of necessary to operate and its application, intangible versus tangible and its relationship to the legislation, additional focused argument on the application of integral, and an additional argument on the operational unit being the telephone system and not just the DMS switch.

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### Findings

1. The 1997 and 1998 complaints, although similar on a number issues, are not the same as the 1996 complaint.
2. The evidentiary facts which came forward at the 1997 and 1998 hearing were different than those given at the 1996 hearing.
3. The arguments put forth by the parties to the complaint in the 1997 and 1998 hearing were different than those shown in the 1996 decision.
4. In relation to the issues put forth, the legislative provision was generally the same for purposes of both the 1997 and 1998 and the 1996 complaint hearings.
5. Equity issues raised at the 1996 hearing were not addressed in the decision, however, equity remains an issue to be decided for the 1997 and 1998 complaints.
6. The matter of depreciation was not at issue for the 1996 complaint, however, depreciation is an issue at the 1997 and 1998 hearing.

As stated in many other MGB decisions there is nothing in the Act to bind the MGB to a previous decision. Although an assessment is an annual event which may lead to an annual complaint, the MGB appreciates its ability to recant a decision from one year to the next. However, the MGB is keenly aware that consistent decisions based on the same legislation, evidence, fact and argument will result in the achievement of fairness and equity to all taxpayers over time. Therefore, the MGB looks carefully to any previous decisions and the context of those decisions in relation to the subject case; its specific evidence and argument.

In the subject case, the MGB notes that the evidence regarding the relationship between basic and application software placed before the MGB in 1996 is different from that before the 1997/1998 hearing. In the 1996 decision, the Respondent asserted without an expert witness that no reasonable distinction could be made between basic and feature software. The Complainant in the 1996 decision did submit that basic software was assessable, however, with expert witnesses was able to convince the MGB that a distinction could be made between basic and application software. This evidence was pivotal to the 1996 decision as is evidenced by careful reading of page 30 of Board Order MGB 099/99. In the subject 1997 and 1998 hearings, the Respondent introduced expert witness Mr. Forest to speak to the relationship of basic and application software. In the 1996 hearing the Respondent provided no witness like Mr. Forest.

In addition, the MGB observes that the argument in the subject case although similar to the 1996 decision, has become more focused on what is the operational unit in light of the evidentiary differences. In the 1996 decision, there was considerable focus on the DMS switch being an operational unit and whether or not the feature software was integral to operating the unit. In this case the focus has been to consider whether or not the feature software at issue forms an integral part of an operational unit intended for or used in a telecommunication system. This argument has been further expanded in the 1997 and 1998 case resulting in additional

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consideration of the relationship to the broader telecommunication system. Although Regulation 365/94 was squarely in place for the subject years and not in the 1996 decision, the MGB observes that the legislative context is very similar in the current cases as in the 1996 case with respect to the manner in which software is to be treated.

Within this context, the MGB examines the merit of all the evidence, argument and case law of each party using the 1996 decision as one element amongst many in reaching the current decision. Throughout the remainder of this decision, the MGB will identify where, in the opinion of the MGB, the subject complaint is the same or differs from the evidence and argument of the previous hearing as it effects the critical parts of this decision.

### **PART II - ARE APPLICATION SOFTWARE COSTS ASSESSABLE?**

#### **Background**

Telus Corporation, through its subsidiaries Telus Communications Inc., Telus Communication Edmonton Inc. and Telus Mobility Inc., referred to collectively as "Telus" provide telecommunication services to their customers. To deliver these services the Telus network system utilizes various installations such as cables, wires, switches, telephones, etc. These things are interconnected in such a way that when there is a signal (or command) to the network that a connection is requested, the station equipment such as a telephone, switching computer, etc. are ready to provide certain functions. The functions include dial tones, computer signals, dialing pulses, etc. which are signals travelling along paired wire. One end of the wire is connected to the station equipment, the other end to a protected device and eventually to a central communication processing (office) location. The central office houses telephone installations that provide functions related to telephone services such as dial tone, ringing tone, busy tone, etc. as well as interconnection to other central offices.

Telecommunication (traffic) signals or commands must be "routed" to ensure that the intended transmission reaches its intended destination. At one time, telephone operators at a switchboard performed this routing function. Those operators were eventually replaced with mechanical switches that were in widespread use until the late 1980's. Subsequently, since about 1989, Telus has utilized computer technology to provide the routing function, among other things. This computer technology is known and referred to as digital switching and are located in the central offices. Virtually all of the digital switches in the Telus network are manufactured by Nortel Networks Limited ("Nortel Networks") and are known as Digital Multiple ("DMS") switches. Generally, the DMS switches located in the various central offices are identified as DMS-100, DMS-100 remote and DMS-200 switches. As a result of this DMS technology, Telus was able to offer optional customer services, in addition to providing basic telephone service to the telecommunication customer.

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These DMS switches are not unlike a computer that requires a set of instructions to perform certain functions. The instructions (intelligence) are supplied in the form of computer software. For purposes of this complaint hearing, the software has been identified as "basic software" and "application software". A particular customer service that may be provided by means of the application software function is referred to as a "feature" services.

Nortel Networks, under a set of specifications, loads both the basic and application software on each DMS switch purchased by Telus.

Linear property is subject to a regulated assessment scheme. Depending on the type of linear property, this regulated scheme utilizes a replacement cost less depreciation method or applied regulated rates or a combination of both to determine the assessment. In the subject years under complaint, the Complainant included the costs of application software in its cost report to the Designated Linear Assessor (DLA) which was used in determining the linear property assessed value.

### **Issues**

In order to decide this case, the MGB must address the following key issues:

Are application software and associated licensing agreements included in the meaning of linear property? In order to decide this major issue, the MGB must examine the following specific sub-issues?

- (a) Can basic and application software operate independently of each other as part of a DMS switch?
- (b) Does application software, whether or not it can operate independently, form an integral part of an operational unit intended for or used in a telecommunication system?
- (c) Are licensing fees associated with application software assessable cost?

### **Legislation**

In order to decide the above issues, the MGB examined the following key sections of the Act and associated Regulations.

#### ***Municipal Government Act***

For the purpose of assessment and taxation, the Act provides definitions for the various types of property that are assessed for the purpose of taxation. With respect to the subject complaints, the Act provides a definition of linear property as it relates to telecommunication systems. The application of the facts of this case to this definition is critical to the resolution of the disputed items in this case.



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*1(1)(u) In this Act,*

*(u) "owner" means*

- (i) in respect of unpatented land, the Crown,*
- (ii) in respect of other land, the person who is registered under the Land Titles Act as the owner of the fee simple estate in the land, and*
- (iii) in respect of any property other than land, the person in lawful possession of it;*

*284(1) In this Part and Parts 10, 11 and 12,*

*(k) "linear property" means*

*(ii) telecommunications systems, including*

- (A) cables, amplifiers, antennae and drop lines, and*
- (B) structures, installations, materials, devices, fittings, apparatus, appliances and machinery and equipment, intended for or used in the communication systems of cable distribution undertakings and telecommunication carriers that are owned or operated by a company as defined in Part 3 of the Telecommunications Act or that are subject to the regulatory authority of the Canadian Radio-television and Telecommunications Commission or any successor of the Commission, but not including*
- (C) cables, structures, amplifiers, antennae or drop lines installed in and owned by the owner of a building to which telecommunications services are being supplied, or*
- (D) land or buildings,*

While machinery and equipment is referred to under section 284 of the Act, it is given meaning under Alberta Regulation 365/94 for purposes of telecommunication systems.

*(l) "machinery and equipment" has the meaning given to it in the regulations;*

Within the context of the subject appeal, the Act also provides a definition of a telecommunication system. This definition gives meaning to the term "telecommunication system" when used in the definition of linear property. Whether or not application software costs are assessable is contingent upon whether or not these features fit within the following definition and/or the definition of machinery and equipment.

*(w) "telecommunications system" means a system intended for or used in the transmission, emission or reception of cable television or telecommunications, but not including radio communications intended for direct reception by the general public;*

With respect to linear property, the assessment is based on the valuation standards set by regulation and what is assessed is based on the owner or operator of linear property reporting that property to the Designated Linear Assessor (DLA) in each assessment year. The Act also recognizes that in some instances reporting is not necessarily accomplished, therefore the Act

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does direct that an assessment be prepared based on what ever information the assessor has on hand.

*(2) Each assessment must reflect*

*(a) the valuation standard set out in the regulations for linear property, and*

*(b) the specifications and characteristics of the linear property on October 31 of the year prior to the year in which a tax is imposed under Part 10 in respect of the linear property, as contained in*

*(ii) the report requested by the assessor under subsection (3).*

*(3) If the assessor considers it necessary, the assessor may request the operator of linear property to provide a report relating to that property setting out the information requested by the assessor.*

*(4) On receiving a request under subsection (3), the operator must provide the report not later than December 31.*

*(5) If the operator does not provide the report in accordance with subsection (4), the assessor must prepare the assessment using whatever information is available about the linear property.*

### ***Standards of Assessment Regulation AR 365/94 (Regulation)***

As stated earlier, the Act referenced the definition of machinery and equipment to that described in the Regulation. In the subject case the Regulation does provide such a description and further directs that this definition is applicable to machinery and equipment intended or used in a telecommunication system.

*1 In this Regulation,*

*(g) "machinery and equipment" means materials, devices, fittings, installations, appliances, apparatus and tanks other than tanks used exclusively for storage, including supporting foundations and footings and any other thing prescribed by the Minister that forms an integral part of an operational unit intended for or used in*

*(v) a telecommunications system ....*

The valuation standard for linear property is not market value. Again, as stated earlier, the Act established that the valuation standard for linear property is to be set out in the Regulation. The Regulation further directs that assessments of linear property be calculated in accordance with the procedures set out in the Alberta Linear Property Assessment Minister's Guidelines (Guidelines).

*6(1) The valuation standard for linear property is that calculated in accordance with the procedures referred to in subsection (2).*

*(2) In preparing an assessment for linear property, the assessor must follow the procedures set out in the Alberta Linear Property Assessment Minister's Guidelines established and maintained by the Department of Municipal Affairs, as amended from time to time.*

**Alberta Linear Property Assessment Minister's Guidelines**

As set out in the Regulation, the Minister has adopted guidelines for both 1997 and 1998 and the Guidelines do establish how the subject linear property is to be valued and at what rate the property is to be depreciated. Whether or not these costs are assessable is also dependent on how these cost do or do not fit within these Guidelines.

**1997 Minister's Guidelines For Farm Land, Linear Property, and Machinery and Equipment**

The procedures in the regulations set out the use of a system based on replacement cost new less depreciation for the calculation of the assessed value of linear property.

6 Calculation of Assessment

The assessed value of linear property in a municipality, excluding wellsite land, shall be calculated by:

- (a) establishing the base cost using the formulae and rates prescribed in Schedule A for linear property which is listed in Schedule A of the Linear Property Assessment Manual;
- (b) multiplying the base cost by the appropriate Assessment Year Modifier prescribed in Schedule B of the Linear Property Assessment Manual;
- (c) multiplying the amount determined in clause (b) by the appropriate depreciation factor prescribed in Schedule C of the Linear Property Assessment Manual; and
- (d) if required, adjusting the amount determined in clause (c) for additional depreciation prescribed in Schedule D of the Linear Property Assessment Manual.

**1997 Linear Property Assessment Manual (Manual)**

The Manual establishes a general method to establish a base cost with specific cost factors for electric distribution systems, street lighting, oil and gas field services and electric transmission lines.

SCHEDULE A - BASE COST

The base cost represents the replacement cost of linear property in 1983.

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The base cost for linear property that is not described in Schedule A shall be determined in a manner that is fair and equitable with the base cost for linear property described in Schedule A.

The factors in Table 1 and the formula below shall be used to determine the base cost for linear property constructed prior to 1983 that is not described in Schedule A.

The assessment year modifier for linear property that is not described in Schedule A shall be determined in a manner that is fair and equitable with the assessment year modifiers in Schedule B. (for purposes of brevity of this order the complete table is not reproduced)

Telecommunication Systems      1997    1.16

For the 1998 year, the Guidelines have changed in a few key areas.

### **1998 Minister's Guidelines For Assessment of Farmland, Linear Property, Machinery and Equipment**

#### 1. Calculation of Assessment

The assessed value of linear property in a municipality, excluding wellsite land, shall be calculated by:

- (a) establishing the base cost as prescribed in Schedule A of the 1998 Alberta Linear Property Assessment Manual.
- (b) multiplying the base cost by the appropriate Assessment Year Modifier prescribed in Schedule B of the 1998 Alberta Linear Property Assessment Manual, to determine the replacement cost in the assessment year;
- (c) multiplying the amount determined in clause (b) by the appropriate depreciation factor prescribed in Schedule C of the 1998 Alberta Linear Property Assessment Manual; and
- (d) if applicable, adjusting the amount determined in clause (c) for additional depreciation as prescribed in Schedule D of the 1998 Alberta Linear Property Assessment Manual.

Appendix II of the Guidelines is a specific manual devoted to the assessment of linear property.

Appendix II - 1998 Alberta Linear Property Assessment Manual

#### 1. SCHEDULE A - BASE COST

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The base cost represents the replacement cost of linear property in 1994.

### 1.1 LINEAR PROPERTY NOT DESCRIBED IN SCHEDULE A

Linear property described in Schedule A.

For purposes of brevity the cost tables are not reproduced, specific cost tables also exist for electric power systems, pipelines which are not reproduced.

Schedule B outlines the assessment year modifiers that apply specifically to electric power systems, telecommunication systems and pipelines.

## 2. SCHEDULE B - ASSESSMENT YEAR MODIFIERS

### 2.2 TELECOMMUNICATION SYSTEMS

<b>Code</b>	<b>Property Type</b>	<b>Year</b>	<b>Assessment Year Modifier</b>
TM 98	Telecommunication Systems	1998	1.02
TM 99	Telecommunication Systems	1999	
CM 98	Cable Television Systems	1998	1.01
CM 99	Cable Television Systems	1999	

### Special Properties Assessment Guide (SPAG)

Even though this guide has no legislative sanction, municipal assessors, the DLA and tax agents universally use it in determining fair and equitable based assessment costs. This Guide makes specific reference to computer costs which are assessable and non-assessable costs.

As an introduction to the Guide, the following statement is quoted.

#### SECTION I

The efficiency and equity of an assessment based on a Construction Cost Return is directly relate to the quality and accuracy of information provided on the Return. It has been found that when inferior quality data is used to generate an assessment, inequities will occur.

The quality of the Construction Cost Return therefore is of prime interest to the property owner as inferior quality returns can result in an inequitable distribution of the tax burden among Companies with similar properties.

SECTION II

ASSESSABLE COSTS

(10) Computer Costs

Costs for hardware and software, either owned or leased which are used to monitor or control Machinery and Equipment that forms an integral part of an operational unit.

SECTION III

NON-ASSESSABLE COSTS

The following are categories of construction costs considered non-assessable to the extent that costs for these categories are included in the Construction Cost Return as an Investment in Plant or as a project cost.

These are expenditures that may be incurred during the course of construction and may be recognized as non-assessable for such reasons as:

- Personal property, or otherwise exempt by statute
- Unrelated to plant construction
- Pre-construction or post-construction costs
- For facilities not definable as an “improvement”, under the Municipal Government Act.

The following list of non-assessable costs is not exhaustive and should not preclude the inclusion of other costs categories identified by the assessor, the Company or Company Agent as non-assessable.

(7) Royalty and Patent Fees

The fee paid for the right to use a particular process.

(13) Personal Property

While there is no provision to not prepare an assessment for personal property under section 289, pursuant to section 284 and section 304, personal property is not included as assessable property.

(14) Computer Costs

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Computer costs incurred exclusively for accounting, business or other functions that are not part of the manufacturing or processing operation

### **COMPLAINANT'S POSITION**

#### **Reporting**

The Complainant submitted the preparation of the assessment report is typified as a system of self-reporting. The self-reporting system of the Complainant is historical and stems from the original valuing the AGT Telephone system for the purpose of providing a grant in lieu of taxation. The assessment report that was forwarded to the assessor for the 1997 and 1998 assessment years included the cost of application software and associated fees.

The Complainant confirmed that:

- both basic and application software costs are included in the assessment report.
- both basic and application software are leased from Nortel.
- both basic and application leases require a one time fee payable to Nortel.
- the lease fee payable to Nortel for basic software is accepted as assessable.
- the lease fee payable to Nortel for application software should not be assessable and that partly is the reason for this complaint hearing.
- software updates (periodic) fees payable to Nortel are not included in the assessment report.
- fees payable to Nortel in connection with a particular feature being supplied to a user is not included in the assessment report.
- the fees that may be paid by Telus, where satellite connectors are used, are not included in the assessment report.

#### **Legislative Interpretation**

Telus asserts that definitions of linear property and telecommunication systems are broad and ambiguous and, therefore, the teleological approach to statutory interpretation should be used. This is supported by several case law reference Morguard Properties Ltd. v. City Winnipeg (1983) 3 D.L.R. (4<sup>TH</sup>) 1(S.C.C.), R v. MacIntosh (1995) S.C.R. 686, R v. Multifarm Manufacturing Co. (1990) 2 S.C.R. 624, Corporation Notre-Dame de Bon-Secour v. Communaute Urbaine de Quebec 95 D.T.C 5017 (S.C.C.), Stuart v. The Queen 84 D.T.C. 6 305 (S.C.C.), etc. and various references, statutory interpretation texts and authors.

Telus indicates the intent of the legislation was never to assess application software and if the intent cannot be determined then the principles of statutory interpretation require the matter be determined based on the residual presumption in favour of Telus.

#### **Legislative Intent & History**

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In 1994, Telus, as an interested party, responded to a Minister's review of proposed new legislation. The issue of "fees" was addressed for the first time with Telus taking the position that application software fees should not be included as assessable costs. As well, wording in the proposed new legislation prompted some concern. In particular, the meaning used to identify a telecommunication system, such as Telus, was to be changed from "works and transmission lines" to "linear property". Consultation with Alberta Municipal Affairs indicated that Telus could anticipate the "fee" costs would be considered non assessable and the rewording of the meaning works and transmission lines to the meaning under linear property should not be cause for concern. New legislation took place without the anticipated change. There was an understanding, however, that the assessment report required by the assessor would continue under the Municipal Government Act in the same manner as was customary under the repealed *Electric Power and Pipeline Assessment Act*. The annual assessment report as supplied continues to be provided essentially in the same manner as previously.

With respect to the proclamation of the Act in 1995, the Complainant submitted there was a mandate to combine all the Acts relative to assessment and taxation. To do that, the *Electric Power and Pipe Line Assessment Act* and the *Municipal Taxation Act* had to be amalgamated. This amalgamation resulted in some change of wording, however, the intent was to combine these Acts in such a way that there would be no effective change in the basis of determining the various property assessed values. With this in mind, the meaning of telecommunication systems, as "works and transmission lines" was changed to "linear property.'

Telecommunication properties were always assessed on the basis of regulated rates and it was the intention of the legislators of the day to continue estimating values for assessment and taxation purposes by use of regulated rates. In addition, Telus contends that the history of property taxation and its evolution support its position that application software is not assessable. Historically, property taxation has been based on the taxation of real property, buildings and property affixed thereto. The transition from a government owned agency to a private company resulted in the evolution of taxation schemes from the old Electric Power and Pipe Line Assessment Act and the focus on the definition of "works and transmission lines". In the transition to the new Act, telecommunication's property became included in the definition of linear property, however, as was heard in the 1996 decision all parties agreed there was no intent to expand or broaden what was included as assessable property.

### **Telecommunication Systems**

For purposes of assessing a telecommunication system such as Telus, particular regard must be given to section 284(1)(k)(ii) and (w) of Act. These sections of the Act identify the meaning of "linear property" and "telecommunication systems". In addition since a telecommunication system includes structures and machinery and equipment regard must also be given the meaning of "structure" and "machinery and equipment" as found in the Act and Regulations thereto.



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Telus disagrees that telecommunication system should be given an extremely broad definition and should include every aspect of Telus' operation. Telus submits that telecommunication systems has been given a specific meaning in the Act by virtue of the references to the various inclusions and exclusions in the definition of linear property and that there is no need to reference definitions from other Acts. The Respondent is attempting to have the MGB apply a broad and expansive definition of telecommunication systems whereas the definition should be given meaning within its context and within the meaning of the inclusions and exclusions included in the definition in the Act. Business value and intangible property is not included in the definition in deference to the Respondent's suggestion of a broadened interpretation of the definition. Telus submits this approach is supported by MGB 099/99 and by reference to National Bank of Greece (Canada) v. Katisikonouries (1990) (4<sup>th</sup>) 197 (S.C.C.).

Telus argues that application software cannot fall under the meaning of "structures, installations, materials, devices, fittings, apparatus and appliances" as referenced in Section 284 (1) (k) (ii) (B) as suggested by the Respondent. All these items are tangible property and application software is not tangible.

It is submitted that the Legislature did not intend that the entirety of a telecommunication system be assessable. By using the qualifications set out under the meaning of linear property, the intention was to place limits on the aspects of a telecommunications system that ought to be subject to assessment. In general, all of the terms identified in the meaning given to linear property, machinery and equipment, structures, etc. have a common thread characteristic, that of being tangible. Based on the maxim that a grouping of words should be reviewed and a common feature found among their (*noscitur a sociis*) application software should not be included in this definition as it falls outside this class of (i.e. tangible) property.

Telus takes the position that the operational unit is the DMS switch based on the definition of "machinery and equipment" within the definition of linear property as the definition refers to "an integral part of an operational unit intended for or used in a telecommunication system". Board Order MGB 099/99 in the view of Telus supports the position that the operational unit is the DMS switch and this is further supported by the Respondent's witness, Mr. Forest, who stated the operation unit could be the DMS switch or the whole communications network depending on your view point.

### **DMS Switch – Functioning of Basic and Application Software**

The Complainant, having argued that application software is not the type of property intended to be assessed in the Act, then went on to illustrate how basic and application software are separable. The Complainant submitted that once the customer needs are identified in particular areas of the province, digital switches are designed to accommodate particular telephone

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customer requirements. The requirements may include basic telephone service and feature services depending on the demographics of a particular area.

To provide the service, the switching hardware with all the designed features requires a set of instructions to perform a required function. The set of instructions are supplied in the form of a software load. The software is generally referred to as basic and feature software. The software is supplied in the form of a computer type tape or disc. Basic software will route calls from one place to another, let you receive calls; give you a dial tone and the like. Feature software will allow the telephone company to sell feature services to customers such as call waiting, call display, three-way calling, etc.

The basic software load is a set of instructions that allows the switching hardware to provide plain old telephone service (POTS). The application software load is a set of instructions to provide certain additional feature services over and above POTS.

With respect to Mr. Forest's testimony for the Respondent, the testimony is nothing more than an argument based on semantics. What remains uncontested in the evidence is that the basic software package that Nortel supplies with the DMS switch, which includes additional software packages beyond SOSBilge, permits the provision of POTS service. Nortel also refers to this software required to operate POTS as standard software. Mr. Forest's evidence confirms that basic software provided by Nortel permits the provision of POTS. Mr. Forest agreed that with SOSBilge, a DMS switch could do virtually nothing, however, Mr. Forest agrees that TELUS requires Nortel's standard base package.

The Respondent contends that application software is required to complete an ordinary phone call. This is not correct and Mr. Forest's admission that Nortel's standard base is required refutes this argument. Nortel also explained in a letter to Mr. DeFleming, witness for the Complainant, that the basic software provides basic POTS service.

### **Intangible/Intellectual Property/Business Value**

Telus identified three basic arguments as to why application software is intangible and should not be assessed and taxed. Firstly, the costs related to the software are only costs related to the right to use and this right to use is intangible and, therefore, not assessable or taxable. Secondly, the application software is severable from the basic software since the basic software is the only software essential to the use of the hardware. Lastly, computer software should not be assessed and taxed because it can be transferred to the purchaser's premises without using the physical medium. Telus' reference support for these principles in case law originating largely in the United States; Matter of Protest of Strayer, 716 P. 2d 588 (Kan. S.C. 1986), Maccabees Mutual Life Insurance v. State of Michigan, 332 N.W. 2D 561 (Mich. C.A. 1983), Detroit Automobile Exchange v. Michigan, 361 N.W. 2D 373 (Mich. C.A. 1984), First National Bank v. Department of Revenue, 85 I11, 2d 84 (I11 S.C. 1981), Washington Times – Herald v. District of Columbia,

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213 F. 2<sup>nd</sup> (D.C. Cir. Ct. 1954), State v. Central Computer Services, Inc. 349 So. 2d 1156(Alia. Civ. App. 1977), First National Bank of Fort Worth v. Bullock, 584 S.W. 2D 548 (Tex. Civ. App. 1979), Continental Commercials Systems Corporation (Telecheque Canada) v. R. in Right of British Columbia(1982) 5 W.W.R. 340(B.C.C.A.), District of Columbia v. Universal Computer Association Inc. 465 F. 2D 615 (d.c. Cir Ct. 1972), Commerce Union Bank v. Tidwell 538 S.W. 2d 405 (Tenn. S.C.1976).

For assessing property tax, state legislatures and courts specifically distinguish between system and application software. The State of California taxes "system software" as tangible personal property, but considers "application software" intangible and, therefore exempt from property taxation. Several courts have held that basic software, which is required for the computer to function, are taxable tangible property and application software is not. Telus emphasizes that the application software is not integral to the operation of the DMS switch and encourages the MGB to use the meaning of integral to be essential to the operation of the DMS which application software is not.

With reference to Apple Computers v. Mackintosh Computers. (1990) 2 S.C.R. 209, Telus emphasizes that computer software is intellectual property and that the difference between basic and application software is significant to this decision. Basic software is fundamental to all processing functions whereas application software is aimed at the specific user and not considered essential to the computer's functioning. This was supported by reference to Northeast Datacom, Inc. v City of Walling for (190) 23 com. Rev., and various case law from the United States. Emphasis was placed on what is fundamental to the functioning of a computer and those programs which were developed solely for the solution of an individual operational problem.

The distinction between operating and application software is precisely the separation Telus is seeking. The basic software is essential to the operation of the DMS switches; however the application software is optional, customer driven software that is incidental to the fundamental operation of the system as a whole. The trend in case law is to separate the application software from the tangible property to which it relates. This is in contrast to the Respondent's position, which is to attribute the value of the application software to the tangible equipment.

Numerous authorities, as cited, support the fact that application software is an intangible commodity; it is intellectual property or know how. It is submitted that there is conclusive case law that supports the position that Telus application software is intangible and not assessable for property tax purposes. The Minister asserts that there are instances where intangible property is subject to assessment under the Act. For example, when an office building is assessed, part of the value is attributable to architectural design. Although this is true, Telus asserts that the essential element of this assessment is the physical property itself, not the intangible design.

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In this case, Telus says that the essence of the licensing arrangement with respect to feature software is to acquire the intellectual property to allow you to deliver the service. It has nothing to do with acquiring or augmenting an operational unit such as a DMS. The second argument on this point is the serviceability argument which is that once the computer software has been installed, the actual medium is thrown away. Other than formant ferrite particles there is nothing physical relating to the switching equipment itself in connection with the application software. These arguments are buttressed by the method of transmission argument. This argument focuses on the medium of transportation in relation to software acquisition. Computer software should not be taxed as personal property as it can be easily transported to the purchaser without utilizing a physical medium that would otherwise not attract tax. These arguments have been settled in the courts as cited in our submission and support the Telus contention that the software costs at issue in this case do not fall to assessment as linear property.

### **SPAG – Assessable & Non-Assessable Costs**

Telus objects to the linking of intangible property to assessable physical property and contends that the amount of physical property in its telecommunication system would remain constant if a particular feature such as call waiting was deactivated. Telus is of the view that only the physical components of its system are assessable which is consistent with MGB 099/99.

To confirm the tangibility approach, reference is made to SPAG, and the Linear Property Assessment Manual where computers are discussed. Although lacking the legislative authority, the SPAG is generally used as a guideline to determine costs that can reasonably be regarded as typical construction costs that would be subject to assessment. Section II of the Guide outlines assessable costs and section III outlines non-assessable costs. Under assessable costs, computer costs are identified as costs for hardware and software, either owned or leased which are used to monitor or control, machinery and equipment that forms an integral part of an operational unit. Firstly, the application software is neither owned nor leased, it is licensed. Secondly, the application software is not required to monitor or control machinery and equipment. It is optional, customer driven, designed for the specific use of Telus customers. Thirdly, the application software is not integral to the operational unit.

Under section III fees paid to use a particular process are excluded from assessment. The fees paid by Telus to Nortel are comparable to these excluded fees paid to use. As well, business costs such as analysis and verification of processing, fine tuning of the process and other start up costs required to verify design quantities within specific warranty provisions, etc. are considered non-assessable. The application software and associated fees, which is partly the subject of this hearing, would fall into the non-assessable category when regard is given to SPAG.

In particular, this guide identifies those costs that are considered assessable costs, non-assessable costs and abnormal costs. Under the heading assessable costs, certain computer costs are included. They include costs for hardware and software, either owned or leased which are used

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to monitor or control machinery and equipment that forms an integral part of an operational unit. Other computer costs are considered non-assessable. These non-assessable costs are identified as computer costs incurred exclusively for accounting, business or other functions that are not part of the manufacturing or processing operation.

In summary, only machinery and equipment, which forms an integral part of an operational unit, is assessable. Application software fees would not be included in these costs for the reasons cited above.

### **SUMMARY OF RESPONDENT'S POSITION**

#### **Reporting**

In preparing the assessment, the Respondent stated that, on an annual basis, a request is made of the operator of linear property to report the information necessary to prepare an assessment. Each assessment is based on the reported information. In the case of Telus, the information requested was provided for both the assessment years under complaint.

The assessments, as prepared, reflect the valuation standards as set out in the Standards of Assessment Regulation, AR 365/94. Under the Regulation, the valuations standard for linear property is calculated in accordance with procedures set out in the Alberta Linear Property Assessment Minister's Guidelines established and maintained by the Department of Municipal Affairs as amended from time to time. The Guidelines have been established for both the 1997 and 1998 assessment years. The procedures provided in the Guidelines are supplemented, where appropriate, by the SPAG.

In the case of telephone systems, there are no schedules of base cost rates established, therefore, the system costs are reported annually by the operator for each municipality in which assessable property is located. Staff review and compare details of the specifications and characteristics between the various telecommunication systems operators for consistency of reporting. All telephone providers report their DMS switching equipment. Once the costs are adjusted to assessment year costs, a depreciation factor is applied. Where a requested report is returned with all the assessment calculation supplied by the operator, such as Telus, Alberta Municipal Affairs staff members also verify the procedures used to ensure compliance.

Staff also review and compare details of the specifications and characteristics between the various telecommunication systems for consistency of reporting. As well, site inspections are regularly arranged with the telephone system operators.

#### **Legislative Interpretation**

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The principle rule of statutory interpretation is that words used in a statute must be taken in their plain ordinary meaning, it is only where there is an ambiguity or some other difficulty that other rules of interpretation apply. Since the “literal interpretation” of the statutes is the first approach, it is useful to refer to the meaning given in various dictionaries to determine the meaning for words such as structure, installation, device, apparatus etc. It is noted that the many terms used in section 284(1)(k)(ii) are broad and general not narrow and restrictive as the Complainant suggests. This broad and general meaning is intentional to include all aspects of the property that make up a telecommunications system.

### **Legislative Intent and History**

With respect to the issue of software and associated cost being assessable or not assessable, the definition of "works and transmission lines" as found under the now repealed EP&PL Act and "linear property" as found under the Act, requires consideration. The installations, materials, devices, fittings, apparatus, appliances, equipment, machinery, ways, easements and structures used in the transmission or sale of telecommunication services were given the meaning of "works and transmission lines." The AGT (Telus) telephone system fell within this meaning. This meaning was considered broad and all-inclusive to ensure "any" and "all" components of a telephone system, for example, were assessed. Linear property is defined as being in part a telecommunications system including ... structures, installations, materials, devices, fittings, apparatus, appliances, and machinery and equipment intended for or used in the communication system of ... telecommunication carriers ... that are subject to regulatory authorities of the CRTC ... but not including land or buildings.

When the consolidated new Act was proposed the intention was to continue assessing the subject type property in the same manner as under the now rescinded legislation.

Software associated with DMS switching installations were included as assessable under the old *Electric Power and Pipeline Assessment Act* legislation and, therefore, there is no reason not to continue assessing these installations under the "linear property" provision of the Act. This notion is reinforced when regard is given to the meaning of telecommunication systems found in the new Act. DMS switches, including all software, are used in the transmission emission or reception of telecommunications and, therefore, subject to linear property assessment. All software, including the feature software in question, could fall within the words devices, apparatus, installations, materials, etc. which are given in the meaning of linear property under the Act.

There are many examples where electronic equipment, computers and other similar properties including the software used to operate them, have been and still are assessed. For example, the software and other equipment used to control the electric power system of TransAlta and Atco power, cable television head end equipment used to send and receive satellite transmissions,

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remote terminal units (RTMs), electronic units used to measure, monitor, etc. pipelines and oil and gas installations. All of these installations are assessed.

### **Telecommunication System**

The intent of the new Act is to continue assessing linear property under the same rules that applied under the old EP & PL legislation. It is submitted the meaning of works and transmission lines made it clear that all parts of a telecommunications system were to be assessed. If no changes were intended in the transition to new legislation, it would be illogical to interpret the Act in a manner that cause some portion of the telecommunication systems to become non-assessable.

An additional meaning was incorporated into the new legislation when identifying linear property. The term machinery and equipment is also applicable to linear property. It can be useful to examine what is meant by machinery and equipment in terms of how it applies to linear and non-linear property. To be machinery and equipment, the installations, devices, apparatus, etc, must form an “integral part of an operational unit.” It is submitted that the DMS switches including the software are integral to the operation of the telephone system generally. In particular, if a DMS switch was considered the operational unit, clearly the software is integral to its operation. In reality, the only meaningful unit in this case is the property that, in total, allows Telus to provide a identifiable service to its customers. The “integral part of an operational unit” issue has been dealt with in numerous court cases such as the B.C. Forest Products case where the Alberta Court of Queen’s Bench concluded certain cranes were part of an operational unit, that being the entire sawmill operation. The Alberta Supreme Court in the Sogemines case came to a similar finding.

In conclusion, the subject items at issue could easily fall within the meaning of machinery and equipment which form part of an operational unit and subsequently become subject to linear property assessment. The DMS switches and the software are integral to Telus’ operation. From a competitive perspective, there is no doubt whatsoever that software, including special feature software, are essential to the Telus’ operation.

### **DMS Switch – Functioning of Basic and Application Software**

The Respondent submitted that in the 1996 complaint hearing the evidence before the MGB was that only basic software was required to complete a telephone call, however, it is now the opinion of the Respondent that both basic and feature is required to perform this function. It is the position of the Respondent that all of the software used in a telephone switching installation is used or intended to be used for the transmission, emission and reception of telecommunications.

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The Respondent submitted that software is simply a set of instructions which are typically encoded on a device such as a floppy disc, CD-ROM, etc. Software is the encoded intelligence required for an installation such as a DMS switch to do something. The intelligence that is encoded on a floppy disc is made up of a number of magnetically (north/south) charged ferrite particles. These particles are arranged in a particular sequence that provides a set of instructions. Likewise the optical CD-ROM has an arrangement of pits that reflect or not reflect light so that a set of intellectual instructions can be supplied for a particular installation to do something.

With respect to a telephone company DMS switch, the Nortel software system includes a hierarchy containing a number of stacked layers. The layers are structured so that each layer provides a set of services that are available to the software layer above it. As the service (set of instructions) demand increase through the hierarchy, the software provides advanced levels of operation. For example, at the bottom of the hierarchy is the layer known as SOSBilge. This set of instructions provides the basic tools required for all the layers above it. The top layer contains instructions to allow various feature service such as the Traffic Operator Positioning System (TOPS). This is an integrated operator call-handling system that is used in conjunction with a DMS-100 switching installation.

The structure of DMS software is complicated, however, the commonly understood notion of basic software is usually taken to mean the operating system of a computer. In this case, it is the support operating system (SOSBilge) or the bottom-most layer. Every computer type installation, such as a DMS, requires this bottom layer set of instructions required for the operating (switching) system to function properly. Instructions in addition to basic software instructions are add-on instructions and are referred to as application software. Again, in the case of DMS software, these add-on instructions are progressively layered onto the basic operating set of instructions. Based on Nortel documentation, the position taken by Telus that only basic software is required to provide plain old telephone service, is not supported. Practically speaking, basic software lets the computer (DMS) be turned on to work. In order to provide ordinary telephone service, there would be a requirement to have switching installations equipped with various layers of application software in addition to the basic software.

The Respondent submitted that in a Connecticut Law Review the writer makes the distinction between basic and application software. In short, the review states that the system software, sometimes called basic software, is required for a computer (system) installation to operate. It provides instructions allowing the installation to be turned on and off, store data, retrieve data, etc. Application software is designed to perform a particular application, function, or operation for the user of the installation. It makes the telephone system function compared to the basic software that makes the DMS switch functional.

From this description, it can be seen that in order for an ordinary telephone service to be provided, in addition to providing a set of basic instructions for the DMS switch to become functional, a set of user application instructions is required to make the telephone system



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operate. Both basic and application software are required for a telephone system to provide an ordinary telephone service.

Inadvertently, Telus may have misconstrued what basic in terms of telephone service is and what basic in terms of software structure is. This misconstrual may be based on the specifications of a DMS described with a standard software base that would be considered basic. Even though that is the standard basic software, which every switch comes equipped with, in fact this standard (basic) switch is equipped with more than basic software. In addition to the standard base software that is required for a telephone system to function, optional base software to enhance the telephone system customer service is made available. This optional base is described as feature software that provides optional services in addition to basic telephone service. The standard and feature software is part of the DMS switching installation, as an operational unit. In turn, this operational unit performs the function of emitting telecommunications, the transmission of telecommunications and the reception of telecommunications.

Mr. Forest clarified that to complete a local or long distance telephone call, the functions of all the layers are required (from SOSBilge up to and including applications). Application software is an intimate and essential part of a DMS switch and require a complex underpinning of other software layers to make it function properly. The hardware and software on the DMS – 100, 200 must have the capability to supply or potentially supply local and long distance features demanded by the customer. According to Mr. Forest, Telus also makes use of many operational, administrative and maintenance features on the DMS switch which are contained in the basic and application software. These features become a part of Telus' operation as a telecommunication carrier.

Telus submitted that since a telephone call can be completed by use of basic software, that software can be considered assessable and since application software is not required to complete a telephone call that software should fall to the non-assessable category. The testimony of the Respondent has clearly established that the use of basic software cannot serve to complete a telephone call. In fact, the evidence is that in addition to basic software most of the application software, referred to in this hearing, is required to complete a telephone call. This is not only supported by Mr. Forrest's testimony but also by various authorities as cited by the Complainant. It is the Respondents' position all software be it software to complete a telephone call or other software used to provide special feature services to customers, it is being used for the transmission, emission, reception of telecommunication.

The fact that all of the software at issue is used as part of a telephone system, the question is what is the value of the software as part of a DMS installation when costing the software component. Ultimately, the value of the software seems irrelevant since Telus did the costing and the Assessor accepted those costs. The question is, should those costs remain assessable or should they be removed. Even though the value seems irrelevant, that is not to say there is no

value. Clearly, there is a value to all of the software which is evidenced by the fact Telus pays certain sums to Nortel to use it.

**Intangible/Intellectual Property/Business Value**

Telus submits that software and associated costs are intangible and therefore not subject to assessment. The Act does not distinguish between tangible and intangible property. Ultimately, the question is whether or not these costs are used as part of a telecommunication system. It is submitted that the evidence, as entered by Mr. Forrest, has shown that all software, be it basic or application, may have tangible and intangible aspects. Some of the tangible components of software was described as ferrite particles with the intangible aspect being the intellectual component required to arrange those particles into a set of instructions which can be used to make a switching installation perform a certain function. It is the cost of all aspects of a DMS which are necessary to make it function, whether it is tangible or intangible, that is subject to assessment.

Where certain property is identified as tangible and intangible in other jurisdictions, by statute, there may be a right of assessment exemption. In Alberta, tangible and intangible properties are not identified, rather the Act describes what is assessable. The provision is, anything used in the transmission, emission or reception of telecommunications is part of a telecommunications system and, therefore, assessable as linear property.

For purposes of assessing a telecommunications system such as Telus, a depreciated replacement costs method is used to determine assessed values. This method considers typical costs which gives consideration to actual costs less all abnormal or non-assessable costs. All assessments determined by this method are treated in the same manner that ultimately provides an equitable costs basis for assessment and taxation purposes. The question is, what are typical costs of a system “intended for or used in” the transmission, emission, or reception of ... telecommunications? It follows that the intention of use or actual use is the test prescribed in section 284 (1)(w) of the Act. Logic dictates that if a DMS and the software in the switch are being used or intended to be used as part of a telephone system, then they are assessable as linear property. For purposes of deciding this complaint, the words “transmission”, “emission” or “reception” should be interpreted in a manner that is consistent with their plain and ordinary meaning. To construe these words in any other fashion would subvert and violate the plain meaning of the Act.

The fact that DMS switches, including all associated software, are part of the Telus telecommunications system is sufficient to dispose of the complaints as filed. The same conclusions can be made on examination of the meaning of linear property under section 284(1)(k). This meaning defines linear property as telecommunication systems and provides a number of examples of what is intended to be included in a telecommunications system. It is important to note that the word “including” is used. The plain and ordinary meaning of this

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word indicates the examples are not intended to be exhaustive as the Complainant suggests. Rather, the definition specifies a number of items that are included and it is submitted that the switches referred to come within a number of these items. Installation, devices, apparatus, appliances and machinery and equipment all can be used to describe the DMS costs at issue.

### **SPAG – Assessable & Non-Assessable Costs**

Under the category of assessable costs, the guide identifies costs for computer hardware and software, either owned or leased, which is used to monitor and control machinery and equipment that form an integral part of an operational unit. These assessable costs closely compare to the DMS switch hardware and the software at issue in this case. The uncontradicted evidence in this hearing is that each DMS switch is monitored and controls other switching installation. So at the very least, the software in a DMS switch monitors and controls. From this example, it can be seen all hardware and software, either owned or leased that are used as part of telecommunication systems, are assessable.

Telus argued that certain application software costs are in fact associated with business value and therefore non-assessable. While the value of such things is managerial skills, trained workforce, goodwill etc. are examples of business value, to simply say that the so-called “applications” software costs represent business value is far from being sufficient and this argument should be rejected. A calculation of value by the cost approach automatically excludes any notion of a business value. The cost approach is a physical rendition of installed component costs and does not incorporate any managerial or entrepreneurial value or any intangible value. The Complainant has not presented any evidence to show that in fact the income from any software feature or otherwise has been included in the reported base assessment costs in this case. It can be, therefore, concluded that the total installation costs of any and all software costs associated with DMS switching installation in a telephone system should be included as assessable base costs.

### **FINDINGS**

1. Basic and application software cannot operate independently of each other as part of a DMS switch.
2. Applications software forms an integral part of an operational unit intended for or used in a telecommunication system.
3. The licensing fee associated with software, including application software, is an assessable cost.

## **REASONS**

### **Basic & Feature Software not Separable**

Unlike the 1996 hearing, the MGB in the 1997/1998 hearings had considerable testimony on how the DMS switch operates in relation to operating software (SOSBilge), basic and application software. Although the Respondent in the 1996 hearing did put forward the position that basic and application software were not separable, the Respondent in the 1996 hearing lead little evidence to support this proposition. This is in direct contrast to the 1997 and 1998 hearings. The 1996 decision focused largely on the question of legislative interpretation, however, the evidence in this hearing requires the MGB to carefully examine whether basic and application software are in fact separable and how the application software operates in relation to the DMS switch and its relationship to basic software.

The MGB in reaching its decision in this subject appeal placed considerable weight on the testimony of Mr. Forest because of his technical knowledge of software in the telecommunications industry. The MGB now understands that an operating system like SOSBilge is needed to allow basic and application software to operate the various elements of a telecommunication system. The MGB accepts that application software is an intimate and essential part of a DMS switch and requires the complex underpinning of all the other software layers. By the evidence presented, the MGB accepts that the DMS switch must be equipped with the full capability to perform POTS and application features since the switch must be able to nearly respond instantaneously depending on the demand of the customer. The MGB also accepts the testimony of Mr. Forest that Telus itself uses the software loaded on the DMS switch to perform various operational, administrative and maintenance features using both basic and application software and this further blurs the distinction between basic and application software. The MGB also heard how in reaction to ever changing market place and technological world various features are added to application software and features from application software then migrate to be included as part of the basic software. This further convinces the MGB that the distinction between basic software and application software is not as clear as accepted in the 1996 decision, the software relationship appears to be constantly evolving and changing. Although Telus did make the point that POTS can be provided by basic software, this in itself is not sufficient to convince the MGB that the complex layers of software are so independent that software can be separated from each other in such a precise fashion. The testimony of Mr. Forest convinced the MGB that the workings of the computer software within the DMS switch are far more integrated and dependent on each other to continue to accept that a distinction made for administrative purposes can actually be used to describe the workings and interrelationship of the software.

Having determined that basic and application software cannot be effectively separated, the MGB examined whether or not the activities facilitated by the software came within the definition of a telecommunication system. The MGB was not convinced by any argument or evidence of Telus

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that any of the activities related to POTS and those feature activities (e.g. call waiting) were not telecommunication transmission, emissions or receptions. The MGB was satisfied that these activities are part of a telecommunication system and are either intended or used for transmission, emission or reception. Even though some of the software may sit dormant on the DMS switch until it is activated, it is still intended for transmission, emission and reception of telecommunications.

The MGB reviewed with care the Apple Computer case submitted by Telus, however concluded that the context of this case was not within the context of the subject case which is the application of assessment and taxation legislation. Therefore, the MGB placed little weight on this case.

### DMS Switch

Telus reports the DMS installation as "inside plant switching equipment" in the replacement costs report submitted to the linear assessor. As well, the letters of complaint filed for both years under complaint referred to the linear property as switching machinery and equipment as being overstated.

Machinery and equipment is given meaning under AR 365/94. The meaning is given inter alia as, material, devices, fittings, installations, appliances, apparatus ... and any other thing prescribed by the Minister that forms an integral part of an operational unit, intended for or used in a telecommunications system.

From this meaning, a number of questions surfaced which require an answer.

- Has the Minister prescribed any other thing?

There is no evidence to show the Minister has prescribed "any other thing" relative to the meaning of machinery and equipment.

- Is the DMS equipment intended for or used in a telecommunications system?

Based on the evidence and argument, the MGB is convinced that the DMS switch plays an integral role to the total telecommunication system. The DMS switch is the critical mechanical devise that transmits the various software instructions to the correct component parts. Now that it has been established that the software is not separable into distinguishable parts, all the software serves to make the DMS switch function as a critical element in the total system. Even if the MGB examine the issue from the perspective of whether or not the software is an integral part of the DMS switch only, the same conclusion is made since the evidence has convinced the MGB that the application software is interdependent with the

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basic software. There can be no doubt that all of the software forms an integral part of the operational DMS switching equipment.

This leaves the question, is the DMS switching equipment machinery and equipment?

The evidence is that the DMS switching equipment, made up of hardware and software, is intended for or used in providing POTS and feature telephone services. As such it can be concluded the DMS equipment is intended for or used in the transmission, emission or reception of telecommunications and is, therefore, part of the telecommunications system as defined.

- Is the DMS equipment an integral part of an operational unit?

The term integral in ordinary usage means part or constituent component necessary or essential to complete the whole [Black's Law Dictionary - Sixth Edition]. The evidence is that without the software required to provide basic (POTS) telephone service there can be no transmissions, emission or reception of telephone telecommunications. From this it can be concluded the software is essential to complete the whole and is, therefore, integral to the operational units. This same reasoning can extend to the application (feature) software. It is an essential component necessary to provide feature services to telephone customers and is, therefore, integral.

- Can the DMS switching equipment be described as material devices, fittings, installations, appliances, and apparatus?

To answer this question, reference is made to the Webster's New Collegiate Dictionary, where the following words are given meaning.

Material - means the elements, constituents or substance of which something is composed or can be made; apparatus for doing or making something.

Device - can mean a piece of equipment or mechanism designed to serve a special purpose to perform a special function.

Fitting - is a small often standard necessary part such as plumbing or electrical fitting.

Installation - is given to mean the state of being installed for use.

When regard is given to the meaning of the words describing, in part, machinery and equipment, it is clear that the DMS switching equipment can be considered an apparatus for doing something, as mechanism designed to serve a special purpose or perform a special function, a necessary part or something that is installed for use.

### **Intangibles as an Assessable Cost**

Before addressing which costs may or may not be considered assessable, it may be helpful to consider, what are the costs associated with the replacement cost method to valuation? Generally, it can be said that the costs required to create "material worth" for the ad valorem tax system considers the cost of material (unassembled), labour, overhead and profit. In addition, costs related to engineering and architect fees for supervision and intellectual instruction provided (encoded) on paper in the form lines, numbers, angles, etc. (blueprints), computer software tapes and disks, etc. are costs considered in the replacement cost methodology. The material is clearly a tangible component of replacement cost. While the result of labour, overhead, profit, engineering and architect fees, is a tangible asset having material worth, these labour replacement cost components can be identified as intangible costs. From these general statements it can be concluded that "material worth", be it an electric power generation plant, an office tower, a pipeline or a DMS, is created by a combination of tangible and intangible costs.

The question is not whether the software costs are intangible, rather, are they assessable costs? While they may have "always been" assessed as assessable costs, that is not a reason to continue assessing the costs if they are non-assessable. The fact these costs are specifically identified in the 1999 Guidelines as being assessable cannot be accepted as reason to find they were assessable in 1997 and 1998. Obviously, the 1999 Guidelines was not available in determining the subject assessment and, therefore, will be considered post facto evidence and will receive no weight in deciding the matter.

The Respondent took the position that the software costs are leased fee costs which increases the value of the DMS by allowing the computer switch to perform additional (feature) functions rather than fees for the right to use a particular process. With respect to the business value argument presented by Telus it was suggested business value only occurs from the income generated by use of the feature software and that linear property value is increased as a result of feature software being activated. In any event, software costs, whether they are basic or application, they add value to the operational unit.

By adding application software to provide feature services it clearly allows the operator of the telephone system to generate income in addition to POTS income. The customer feature options made available as a result of the additional software are certainly a normal and typical service provided by modern day telephone operators.

In direct testimony, the Taxation Advisor for Telus stated both basic and application software are leased from Nortel and that a one time fee is payable to Nortel for the cost of the leases. These fees are not for the right to use a particular process rather they are for the right to use certain intellectual instruction to enhance the process. The fee charged for the computer technology

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intellectual instruction by Nortel can be equated to the fee charged by engineers and architects for their intellectual instructions.

The instruction required for either basic or application (feature) telephone service is the result of intellectual (Nortel) labour. If the intellectual labour costs are accepted for basic software as assessable costs, it does not seem reasonable to argue that additional feature intellectual labour costs, which add material worth to the DMS, are not assessable costs, especially after determining that the software is not separable.

From the testimony there can be no doubt that the software and associated one time lease fee costs at issue, as well as other (basic) software are "computer costs either owned or leased" as provided in the assessable costs category of the SPAG guidelines. In the SPAG, assessable computer costs are further identified as software used to monitor and control machinery and equipment. The evidence is that the software at issue is used to provide intellectual instruction, which is necessary to monitor and control the DMS equipment for purposes of telephone customer feature services. As such, the software costs become part of the DMS switching equipment.

### **Computer Costs Assessable**

The MGB was convinced that the software was a component cost of the DMS switch. The remaining question that the MGB had to answer was whether or not the cost of the software is assessable. Having been convinced that the software is not separable, the MGB looked to the legislation, regulations and other guiding documents to determine what are assessable costs. Specific weight was placed on the Special Property Assessment Guide and the reference to non-assessable computer costs being accounting and business like software. The MGB is satisfied that the software in question is used for providing feature telecommunication services rather than performing an accounting as business function and is, therefore, like the software identified in SPAG as being assessable costs. Having accepted that the software is not separable, the evidence shows that the software controls the machinery and equipment, namely the DMS switch, which is a critical component of the total telecommunications system.

Telus went to great lengths to provide supporting case law to illustrate that application software is intangible, intellectual property and adds to business value and is not an assessable cost. This case law largely originated in the United States where taxation and assessment regimes are different. The MGB was not convinced that the regimes referred to in these cases captured the same legislative framework and specifics as the legislations, regulations and Guidelines exist within the Alberta context. Once the MGB was convinced by the expert witness of the Respondent that the software is not separable, it became clearer that the intention of the legislature was to include as an assessable costs software which was used to control machinery and equipment. It is clear the only excluded cost is accounting and business operating like software, the software in question is not of the accounting and business operation character.



## **PART III – FAIRNESS AND EQUITY**

### **Background**

Telus and other like telecommunication carriers such as AT&T, Rogers, Cantel, Call-Net and Microcell, have comparable software for the purpose of operating DMS switching equipment. The switching equipment together with the software costs are reported to the DLA and are included in the respective linear property assessments. While Nortel retains ownership of the intellectual content of the software in question by way of a lease agreement, Telus has possession of the software to be used for its intended purpose.

### **Issues**

In order to decide the questions related to fairness and equity the MGB must address the following issues:

1. Is it fair and equitable to assess certain application software costs and licensing agreement fees to Telus? In order to decide this issue the following sub-issues must be examined.
  - (a) Does the linear assessment of other telecommunication carriers include the application software and associated costs?
  - (b) Is a telecommunication carrier such as Telus similar to a cable distribution undertaking such as Shaw Cable for the purposes of linear property assessment?
  - (c) Do telecommunication carriers and cable distribution undertakings use similar software to operate their systems?
  - (d) Has the software for both telephone and cablevision systems been included in the linear property assessment?
  - (e) Is Telus properly recorded as the assessed person for purposes of linear property assessment?

### **Legislation**

In order to decide these issues, the MGB examined, in addition to the legislation already identified, the following specific parts of the Act and the Regulations.

#### ***Municipal Government Act***

The assessor including the DLA must apply the regulations in a fair and equitable manner.

- 293 (1) *In preparing an assessment, the assessor, must, in a fair and equitable manner,*
- (a) *apply the valuation standard set out in the regulations, and*
  - (b) *follow the procedures set out in the regulations.*

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*(2) If there are no procedures set out in the regulations for preparing assessments, the assessor must take into consideration assessments of similar property in the same municipality in which the property that is being assessed is located.*

*284 (1) In this Part and Parts 10,11, and 12,*

- (d) “assessor” means a person who has the qualifications set out in the regulations and*
- (i) is designated by the Minister to carry out the duties and responsibilities of an assessor under this Act ... .*

*The MGB must not alter an assessment which is fair and equitable.*

*499 (2) The Board must not alter*

- (a) any assessment that is fair and equitable, taking into consideration assessments of similar property in the same municipality, ... .*

In order to decide the issue of whether or not Telus is the correct assessed person, the MGB examined the definition of assessed person, section 304 (1) of the Act in relation to the sections related to the assessment of linear property.

*1 (1) In this Act,*

- (u) “owner” means*
- (iii) in respect of property other than land, the person in lawful possession of it; ... .*

*284 (1) In this Part and Parts 10, 11, 12,*

- (a) “assessed person” means a person who is named on an assessment roll in accordance with section 304*
- (b) “assessed property” means property in respect of which an assessment has been prepared or adopted.*
- (c) “assessment” means a value of property determined in accordance with this Part and the regulations;*
- (p) “operator”, in respect of linear property, means*
  - (ii) for other linear property*
    - (A) the owner, or*
    - (B) the person who has applied in writing to and been approved by the Minister as the operator.*

*304(1) The name of the person described I column 2 must be recorded on the assessment roll as the assessed person in respect of the assessed property described in column 1.*

<i>Column 1</i>	<i>Column 2</i>
<i>(i) linear property</i>	<i>(i) the operator of the linear property</i>

## **COMPLAINANT'S POSITION**

### **Equity**

With respect to the issue of fair and equitable assessments, reference is made to two general principals that are applicable to every taxpayer. These principals provide that there is a right to an assessment that is not in excess of that which can be regarded as equitable and there is a right not to be assessed in excess of actual value. These principles have been clearly set out in the Bramalea Ltd. v. British Columbia (Assessor of Area #9 - Vancouver) (1990) case. In this case, the definitions of linear property is broad and there is no reference to computer software nor, it is submitted, was it ever the intention of the Legislature to assess application software. This species of property is unique to the telecommunications industry and it is not clear whether or not it is assessed on a consistent basis. This type of situation was of particular concern to the Court in Bramalea, supra, "where the taxpayer subjected to the higher assessment is in competition with others of the same class, and is for this reason unable to pass on the extra tax burden to customers, the unfairness of such a result becomes blatant."

As a matter of law, Telus is therefore entitled to succeed on the fairness and equity issue in this complaint if, inter alia:

- Application software licensed by Telus is held to fall outside the definition of linear property or
- Application software is held to be linear property but the assessment procedures are held to be inequitable.

Even if application software used pursuant to a licence agreement is found to be linear property, Telus has a right to an equity remedy since other similar properties have not been assessed for similar software. The current administrative practice of the DLA is that license fees paid by other cable companies are not subject to assessment yet it is trying to assess fees paid by Telus. It is argued that the fees paid by Telus are no different than the licence fees paid by cable companies.

Since structures that are buildings are not assessable as linear property, only these structures that are not buildings, such as poles, etc. are subject to linear property assessment. Basically, all those items that form an integral part of an operational unit used for the emission, transmission of a telecommunication signal is what is subject to assessment. Once it is determined what is subject to assessment, the valuation standard as regulated must be applied. The valuation standard for purposes of the subject assessments is that calculated in accordance with Guidelines.

Guidelines have been established for both the 1997 and 1998 assessment years that are at issue in this hearing. It is noted that no schedule of base cost rates have been supplied for telephone systems. In the absence of a base cost rate, the instructions are that those base costs for

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telecommunication systems such as Telus are to be established in a manner that is fair and equitable with the base costs for linear property that is described in a schedule of costs. A schedule of costs has been supplied for electric power systems, cable television systems and pipelines. These base costs are representative of 1983 replacement cost for the 1997 guideline and 1994 replacement cost for the 1998 guideline. To determine a fair and equitable replacement cost for a telephone system, regard should be given to the method of determining base costs for other special purpose type property.

### **Assessed Person**

While the switching hardware is purchased and owned by Telus, the software that is required to make the hardware function is not. Under agreement certain conditions apply to all software supplied by NTCL (Nortel) to AGT (Telus). The agreement provides a software right to use. NTCL grants to AGT a non-exclusive, perpetual, irrevocable, fully paid license and right to use the software upon and subject to terms and conditions set forth in the agreement. In part, the agreement provides that title and ownership rights to software shall remain in NTCL's parent company et al and the license shall not convey any title in software to AGT.

Telus could sell the switching hardware to whoever wanted to purchase it. However, because the software is not owned by Telus, the person who purchases the hardware would have to make arrangements with NTCL to obtain all the software for their own use.

Even if the application software is found to be linear property, it must be determined whom the assessed person should be. By virtue of section 304(1)(i) and section 284(1)(p) of the Act, the person who should be assessed is the owner of the linear (application software) property. The software, both system and application, is licensed to Telus by Nortel. Pursuant to the DMS Purchasing Agreement, as originally made by AGT with Telus becoming the predecessor, Telus has no right to ownership. Telus only holds a license to the application software and as such it is submitted that the property interest held by Telus is not subject to assessment. Although the basic software is also licensed, it is functionally integral to the DMS installation and for linear property assessment purposes and should be treated as part thereof.

Pursuant to section 304(1)(i) and section 284(1)(p), the assessed person is the owner of the property which in the case of the application software is not Telus.

## **RESPONDENT'S POSITION**

### **Assessed Owner**

The issue of ownership in respect of the licensing arrangement between Nortel and Telus was presented for consideration. It is the Respondent's position that Telus is ultimately the owner for assessment purposes in this case. This position is supported when regard is given to certain

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provisions of the Act. In deference to the Complainant, the applicable provision is firstly section 304(1) where it states the assessed person of linear property is the operator of the linear property. Under section 284(1)(p)(ii)(A) operator means the owner. Owner under section 1(1)(u) means in respect of any property, other than land, the person in lawful possession of it. This section (section 1) applies to the entire statute, including the assessment and taxation parts. Telus is in lawful possession of all the installations at issue including all the software that is used. Since Telus is in lawful possession, either through direct purchase or through a lease agreement, under the Act they are the owner. As the owner, Telus is considered the operator of the linear property and, therefore, must be recorded on the assessment roll as the assessed person. With these provisions of the Act in mind, the Complainant's position on this issue cannot succeed even if Telus is found not to be the owner of certain software and associated costs. The Respondent takes the position that the software and associated costs at issue are, in fact, owned by Telus and, whether or not they are owned by Telus, these costs are assessable as linear property to Telus.

### **Equity**

The Respondent submitted that generally, linear property assessments are prepared in two ways. Either they are complete by use of a regulated schedule of rates or by reported costs converted to an assessment level. In both the regulated schedule and the reported cost way of preparing an assessment, the goal is to arrive at a typical or normal assessable cost. This typical or normal cost is determined in consultation with the respective interested party. As such, various incurred costs require study and review to establish those costs that may or may not fall to property assessment. To assist in establishing those costs the assessment authority as well as the assessed/taxed party uses certain procedures and guidelines. In particular, the document referred to in this hearing as SPAG has been universally used to determine those costs which should be included as assessable and those costs which should be excluded. This guide, over time, has evolved to become part of a Special Property Assessment Guide. In turn, this guide was referred to and used in the preparation of the Guidelines known as the 1997 and 1998 Linear Property Assessment Manuals.

The Act, under section 292, provides that each assessment must reflect the valuation standard set out in the regulations for linear property. Under the Valuation Standard Regulation, linear property assessments are to be calculated in accordance with the procedures set out in the Alberta Linear Property Assessment Minister's Guidelines. A guideline under the Regulation has been established for both the 1997 and 1998 assessment years. The assessments that are at issue in this hearing would have been subject to assessment as linear property under these Guidelines. The Guidelines include a schedule of rates to be used in determining the base costs, assessment year modifier, depreciation and additional depreciation. For purposes of assessing a telephone system there is no base costs schedule of rates, therefore, a reported cost method in determining base costs, is adopted. The reported costs are adjusted to reflect all the same considerations that are applied in the schedules of regulated cost rates found in the Linear Property Assessment Manual.

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In both 1997 and 1998, a number of telephone provider companies reported one or more DMS switching installations for linear property assessment purposes. Companies such as AT&T, Rogers Cantel, Call-Net, Microcell, etc. are assessed in the same manner that includes reporting the same type of switching equipment as Telus. All of these telecommunication (telephone) companies are requested by the DLA to submit all basic and feature software costs which are part of DMS switching equipment. These software costs are included in the respective linear property assessments on the same basis as Telus.

This reported cost method of determining base costs is completed through discussions with all the concerned parties. Base assessment year modifiers are also established as a result of these discussions. Once the cost for a particular assessment year has been established, consideration for loss in value due to depreciation is provided. Historically, for telephone systems, depreciation was applied at a 75% remaining, fixed and immediate allowance. This depreciation allowance would continue to be applicable for the assessment years under complaint. With respect to additional depreciation, it appears there may be provision to consider additional depreciation under the 1997 assessment manual, however, the 1998 manual specifically provides that additional depreciation is not allowed for telephone systems.

Even though the noted software costs are integral to the telephone system operations, the question remained are those costs assessed in a manner that is fair and equitable. To decide this matter, it may be helpful to consider the SPAG referred to in this hearing and used when determining assessment by the replacement cost less depreciation method of assessment. While this guide does not have any legislative sanction, it is used universally in Alberta in determining those costs that are assessable and non-assessable.

Even though this guide was established for purposes of determining costs for property assessed under the *Municipal Taxation Act* (repealed) it may have some relevance with respect to costing telecommunicators equipment. Testimony by both parties to this complaint hearing acknowledged SPAG as being useful in determining assessable and non-assessable costs. In particular, the costs associated with computer costs are addressed in the guide. By analogy, the computer costs referred to in the guide can be applied as comparable to the software costs at issue in this case. The issue of fairness and equity is combined with the proposition that comparable or like property components are to be treated in the same manner for assessment purposes. For example, if comparable items are assessable in the case of other linear type property then they should also be assessable in the case of telecommunication linear type property. The Complainant was correct when it was submitted certain computer costs were non-assessable. However, the costs were not the same as the subject computer (software) costs. In the guide, the non-assessable computer costs were identified as costs incurred exclusively for accounting functions. This is not the case in this instance, the subject computer (software) costs are incurred to make the DMS switching equipment function for the operation of a telephone system.

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There is a uniform approach on this matter where not only is Telus subject to those assessable costs, so are all the other telephone companies subject to linear property assessment in Alberta as evidenced by Mr. Husar, the Minister's Designated Linear Assessor. By not assessing the software costs at issue, inequities would result at several levels. Other telcos would have a higher proportionate assessment in relation to Telus. It would also be inequitable in relation to non-linear property where these software costs are assessable.

By removing the software costs at issue in this case, it would provide preferential treatment to Telus, which is against the principals of depreciated replacement cost approach to value and create an inequitable assessment.

### **Findings**

1. Telecommunication carriers similar to Telus have application software and associated costs included in their linear property assessment.
2. A telecommunication carrier such as Telus is not similar to a cable distribution undertaking such as Shaw Cable for purposes of the 1997 and 1998 linear property assessment.
3. Telecommunication carriers and cable distribution undertakings both use software to operate their systems, however, for purposes of linear property assessment, the software is not similar.
4. The software used by both telephone and cablevision systems have been included as assessable costs for purposes of the 1997 and 1998 linear property assessment.
5. The inclusion of certain application software and associated licensing agreement fees, as assessable costs, results in a cost base for the subject linear property that has been determined in a manner that is fair and equitable.
6. Telus is properly recorded as the assessed person for purposes of the 1997 and 1998 linear property assessment.

### **REASONS**

#### **Assessed Person**

While Telus only reports things used in a telecommunications system, the evidence is that a DMS is clearly a device or an installation that forms an integral part of an operational unit intended for or used in the transmission, emission or reception of telecommunications. As such, the subject software and associated costs are part of assessable costs of machinery and equipment. Machinery and equipment are identified as part of the "including" part of a "telecommunication system". Since linear property means a telecommunications system, the software costs at issue are clearly within the meaning "linear property."

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The Complainant submitted even if the software costs at issue are found to be linear property, Telus is not the owner and, therefore, not liable to the linear property assessment. The Respondent argued that Telus is the person liable to assessment as the "operator of the linear property" pursuant to section 304(1)(i) of the Act. In support of this argument it was offered that operator is defined under section 284(1)(p)(ii)(A) in respect of linear property as meaning the "owner." Owner is given meaning under section 1(1) of the Act. Since the meaning under section 1 applies to all parts of the Act, Telus as the person in legal possession of the software is the owner. The Complainant argued Telus is not in possession of the software once it is programmed into the DMS it can be discarded and Nortel continues to own the intellectual worth of the software.

In view of the legislation referred to by the parties to this hearing, it appears only the wording in section 1 of the Act is at issue. In particular, is Telus in legal possession of the software at issue.

The lease agreement Telus has with Nortel respecting the switching software and associated costs leads to the conclusion that Telus is in lawful possession of the software used to provide telecommunications services. The fact that once the intellectual instruction is loaded into the DMS, the software is redundant and can be discarded, was not disputed. This would be similar to engineer and architect intellectual instructions, once they are used to complete an operational unit such as an electric generation plant etc. they may not be no longer required and the intellectual worth remains with the engineering or architectural firm or person.

By discarding the software the cost of the intellectual instruction it not lost or returned. In fact, it remains with the DMS switching installation as added material worth. This added material worth is supported by the ability of Telus to provide not only basic telephone service, which may also have the software discarded, but also feature telephone services. The Respondent's position on the ownership issue is accepted as compelling.

Telus would like to narrow this question to the referenced linear property being the software itself. The MGB does not accept this argument. The MGB was convinced that the DMS switch is the part of the linear property that is being assessed and that the costs of the software are just a single element of the costs of the DMS switch and the DMS switch is just a part of the equipment of the telecommunication system which is the linear property referenced in section 304. The MGB does not accept Telus' narrow examination and takes a broader examination of what the reference to linear property is within section 304 of the Act in this case. In this case, the linear property is the "telecommunication system" which is owned by Telus.

As well, the MGB accepts the argument of the Respondent that the definition of owner in the Act "means in respect of any property, other than land, the person in lawful possession of it" which makes Telus the correct assessed person. The evidence clearly shows that Telus is in lawful possession of the software. In this case, there is no question that the owner of the



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telecommunication system is Telus and they are in lawful possession of the software. Thus, the assignment of Telus as the assessed person is correct, fair and equitable.

Telus is clearly the owner for purposes of matters relating to the Act and as the owner is the operator of the linear property in question and, therefore, must be recorded on the assessment roll as the assessed person pursuant to section 304(1)(i) of the Act.

### **Fair and Equitable Treatment with other Carriers**

With respect to this issue, there is a presumption that a taxpayer has a right to a fair and equitable assessment.

The Complainant cited various case law in support of this presumption and, in particular, the Bramalea Ltd. v. British Columbia [Assessor Area #9 - Vancouver] 1990 case which set down two principles which are applicable respecting fairness and equity. These principles have established that unless otherwise provided in legislative authority, property subject to tax shall be assessed at actual value and, secondly, that there be equity as between assessed value of similar property.

### **Fairness**

Section 292(2) provides that each assessment must reflect the valuation standard set out in the regulations for linear property. Under section 6(1)(2) of the *Standards of Assessment Regulation AR 365/94*, the valuation standard for linear property is that calculated in accordance with procedures set out in the Alberta Linear Property Assessment Minister's Guidelines. The Guidelines for linear property assessment have been published for both the 1997 and 1998 assessment years setting out procedures to be used in preparing assessments. The procedures as set out are described as firstly establishing a base replacement cost of linear property, converting that base cost to assessment year replacement cost less an amount for depreciation to determine (actual) assessed value.

The base replacement costs for certain linear property are described in a base replacement cost schedule of rates. Other linear property such as telephone systems, electric power generating facilities and electric power substations do not have a replacement cost schedule of rates provided in the Guidelines. For linear property not described in a base cost schedule of rates, the provision is that the base costs "shall be determined in a manner that is fair and equitable with the base cost for linear property described" in a schedule of costs in the Guidelines.

The subject linear property replacement costs are not listed in a schedule of rates and, therefore, fall to the "not described" provision of the Minister's assessment guide. To determine the linear property assessments, annually by way of a report, requested pursuant to section 292 of the Act,

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Telus provides an assessment rendition for the designated assessor's use. On receipt of the rendition, the assessor examines the report to confirm legislative compliance.

The evidence is that the rendition as provided, is based on a calculation which includes establishing the linear property base replacement costs for those things "used in" the telephone system, converted to assessment year base replacement costs less a factor amount attributable to depreciation. This method of calculation to determine telephone systems assessment is consistent with the method that had always been used for purposes of property tax under the *Electric Power and Pipeline Assessment Act*. By the fact that Telus continues to report only those things "used in" rather than those things "intended for or used in" as prescribed under the applicable legislation, may make one question whether or not the assessment procedures respecting estimating the subject linear property replacement costs have been fairly reported.

Both parties to this hearing offered that it was intended the new consolidated (Act) legislation would accommodate the continuation of the same assessment procedures under the now repealed *Electric Power and Pipeline Assessment Act* where only the things "used in" the transmission or sale of telecommunication services were considered assessable. Even though the Act is clear that linear property means those things "intended for or used in" the communications systems, neither party to this hearing argued or submitted evidence that the fair value of the DMS equipment, or any of the inside and outside plant equipment reported to the assessor was not fairly determined. Without the evidence or argument it is concluded from the facts that the DMS equipment costs established to determine the final linear property assessed value does not exceed actual replacement costs. By including the value of the software costs at issue the actual value of the switching component of the telephone system is fairly determined. The not fair submission put forward by Telus is, therefore, not supported.

### **Equity**

While the not fair submission is unsupported, have the DMS equipment costs been equitably established and reported to the assessor?

For purposes of equity, the MGB is convinced that before a reasonable equity determination can be made, similar linear properties must be ascertained and based on comparable reported base costs.

### **Similar Properties**

While both telephone and cablevision installations fall to the meaning of "telecommunication systems", the MGB is not convinced they are similar for purposes of assessment equity. To determine the matter of similarity, the statutory provisions are given consideration. It is apparent that standardized assessment rates have been prescribed for certain parts of a cablevision system while telephone systems have no prescribed schedule of rates, rather the assessment is based on a

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base reported cost method. In addition, the Act specifically describes “cable distribution undertakings” and “telecommunication carriers” as distinct communications systems. It is the MGB’s understanding from the evidence before it that a telephone system is a two-way audio system with some visual display ability, whereas a cablevision system is a one-way audio/visual system. These communication systems have some comparability, however, based on the evidence, the MGB is satisfied they are different for purposes of assessment equity. The best comparable systems for assessment purposes are other like telephone systems such as AT&T, etc.

### **Comparable Base Cost Reported**

As stated, the best comparables are other telephone system assessments. The evidence is that Telus reports only those costs associated with installations that are “used” in their telecommunication system, which is what they have always done. The evidence also shows that, unlike Telus, all of the other telephone companies submit costs based on installations “intended for or used” in their telecommunication systems. When regard is given to the way Telus submits reported costs in relation to competing similar telephone carriers, the MGB is not convinced the taxpayer in this case is subjected to a higher assessment than its competitors.

In direct testimony, the designated assessor stated all other telephone companies, having linear property, submit the same switching equipment type costs, that Telus does in their annual assessment report and that the reports are checked and reviewed for compliance.

The testimony given by the Respondent was not refuted nor was there evidence presented to show the testimony to be in error, therefore, it is accepted that the Telus replacement costs, as reported for the switching equipment, have been determined in a manner that is equitable with similar telephone and cable television liner property replacement costs.

In this case, this application software falls within the meaning of linear property and the replacement costs procedures have been determined in a manner that is fair and equitable. The result being that Telus is not entitled to succeed on the replacement costs fairness and equity issue.

## **PART IV – APPLICATION OF DEPRECIATION**

### **Background**

Linear property is assessed based on a regulated scheme of costs and regulated rates including prescribed rules related to depreciation. The Guidelines for the preparation of linear property set out different rates of depreciation depending on the type of linear property.

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### Issues

In order to decide the matters related to depreciation, the MGB must address the following specific issues.

1. Is the method of determining depreciation the same for the 1997 and 1998 assessment years?
2. For the 1998 assessment year, has the depreciation factor of 0.75 been applied in a fair and equitable manner?
3. For the 1997 assessment year, has the application of a fixed depreciation factor of 0.75 been determined in a manner that is fair and equitable with the depreciation factor in Schedule C of the 1997 assessment manual?
4. Can depreciation based on an age/life schedule be applied to a DMS switch in place of a depreciation factor of 0.75 for either the 1997 and 1998 assessment years?
5. Is additional depreciation for the DMS switching equipment warranted for the 1997 assessment year?
6. Is additional depreciation for the DMS switching equipment warranted for the 1998 assessment year?

### Legislation

In order to decide these issues, the MGB examined the legislation already referenced and, specifically, the following sections of the Act and the Regulations dealing with depreciation.

#### *Municipal Government Act*

An assessor must apply the regulations in a fair and equitable manner and if no procedures exist the assessor must take into consideration assessments of similar property.

*293(1) In preparing an assessment, the assessor must in a fair and equitable manner,*

- (a) apply the valuation standards set out in the regulations, and*
- (b) follow the procedures set out in the regulation.*

*(2) If there are no procedures set out in the regulations for preparing assessments, the assessor must take into consideration assessments of similar property in the same municipality in which the property is located.*

*An assessor includes as assessor designated by the Minister.*

*284 (1) In this Part and Parts 10,11, and 12*

- (d) "assessor" means a person who has the qualifications set out in the regulations and*
  - (i) is designated by the Minister to carry out the duties and responsibilities of an assessor under the Act.,*

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As stated earlier in this Order, the Act requires that the valuation standard be set by regulation. *Alberta Regulation 395/94* sets the valuation standard as the procedures outlined in Guidelines. The Guidelines set up a procedure based on replacement cost new less depreciation. Specific directives on the application of depreciation is contained in the specific Linear Property Assessment Manual for 1997 and 1998.

Schedule C sets out specific depreciation tables for electric power, hydro generation plants, wind generation plants, and cable television systems. No depreciation table or factor is described for telephone systems in the 1997 assessment manual.

### **1997 LINEAR PROPERTY ASSESSMENT MANUAL**

#### **SCHEDULE C - DEPRECIATION**

The depreciation factor for linear property that is not described in Schedule C shall be determined in a manner that is fair and equitable with the depreciation factors in Schedule C.

##### **Electric Power**

The depreciation factor for electric power is .75, unless otherwise specified in this section.

##### **Thermal Generation Plants and Substations**

A specific age/life depreciation table is provided for Thermal Generation Plants and Substations (for brevity purposes this table is not reproduced).

##### **Hydro Generation Plants**

A specific age/life depreciation table exists (for brevity purposes this table is not reproduced).

##### **Wind Generation Plants**

A specific age/life depreciation table exists (for brevity purposes this table is not reproduced).

#### **CABLE TELEVISION SYSTEMS**

The depreciation factor for cable television is .75, unless otherwise specified in this section.

##### **Service Drops, Transmission and Distribution Line**

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Depreciation of cable television systems shall be determined using the table and formula below.

FORUMULA: Penetration Rate Percentage = (total operational services divided by the total services per cable system) X 100

### **CABLE TELEVISION TRANSMISSION & DISTRIBUTION LINE DEPRECIATION TABLE**

(for brevity purposes a copy of this table is not included in this order, however the table is based on a depreciation factor applied to a customer penetration rate)

Application of additional depreciation is specified in Schedule D

#### **SCHEDULE D - ADDITIONAL DEPRECIATION**

For any depreciation that is not reflected in Schedule C and Schedule D, the assessor designated by the Minister may adjust for additional depreciation provided acceptable evidence of such loss in value exists, unless otherwise specified in this section.

Specific additional depreciation tables are provided for pipelines and wells only. (For brevity purposes these tables are not reproduced)

#### **1998 ALBERTA LINEAR PROPERTY ASSESSMENT MANUAL**

Schedule C sets out the depreciation to be applied to various linear property types. Specific depreciation is set out for electric power systems, hydro generation plants, wind generation plants and telecommunication systems as was the case in the 1997 manual. The key difference between the 1997 manual and the 1998 manual regarding depreciation is that in 1998 a specific depreciation factor is included for telephone systems under Schedule C.

### **3. SCHEDULE C - DEPRECIATION**

#### **3.1.1 Thermal Generation Plants and Substations**

A specific depreciation factor table exists (for the brevity purposes this table is not reproduced.).

#### **3.1.3 Wind Generation Plants**

A specific depreciation factor table exists (for the brevity purposes this table is not reproduced.).

### 3.2 TELECOMMUNICATION SYSTEMS

#### 3.2.1 Telephone Systems

The depreciation factor for telephone systems is 0.75.

#### 3.2.2 Cable Television systems

The depreciation factor for cable television systems is 0.75.

Schedule D sets the rules for applying additional depreciation

### 4. SCHEDULE D - ADDITIONAL DEPRECIATION

For any depreciation that is not reflected in Schedule C Tables 3.1.1 and 3.1.3 only, the assessor designated by the Minister may adjust for additional depreciation provided acceptable evidence of such loss in value exists.

#### 4.2 TELECOMMUNICATION SYSTEMS

##### 4.2.1 Cable Television Systems

###### 4.2.1.1 Service Drops, Transmission and Distribution Line

Additional depreciation for cable television systems shall be determined using the table and formula below. (table not duplicated for brevity purposes, depreciation factors are applied to the customer penetration rate )

Note: Formula to Determine Penetration Rate Percentage - total operational services divided by total services per cable system) x 1000

Additional depreciation tables are provided for pipelines and wells. For brevity of this order, these depreciation tables are not included.

## **COMPLAINANT'S POSITION**

### **Depreciation**

Telus argued that the evidence as submitted is compelling and reasonable for depreciation to be different than the 25% allowed. This is supported by the lack of sufficient consideration being given to functional depreciation that is a result of loss of utility, which occurs rapidly and requires continuous updates of the various components of a DMS. The schedule of depreciation rates that is acceptable to the CRTC should, therefore, be accepted as being reasonable. It is also requested that the Complainant's 1997 and 1998 linear property assessment be varied by the removal of application software from the assessment base on one or more of the grounds as entered in this hearing.

The Complainant submitted that the cost analysis of the various telecommunication assets is reviewed with the objective of determining the life expectancy of the telephone system components. This analysis is used to allocate costs attributable to customer users over the useful life of the component. The costs attributable to the customer include those costs associated with depreciation of an asset. The Canadian Radio and Telecommunication Commission (CRTC) uses this information in establishing telephone rates.

DMS switches would be an example of an asset that is analysed to determine a historical retirement pattern. The study results indicated a nine-year average service life. In addition to historical studies, studies are also undertaken to determine the future trend and projected life of a particular switch. As a result of all the studies, both historical and future, it was concluded the appropriate average service life of a DMS switch would be 10 years.

This 10-year age/life determination was presented to the CRTC during a general rate application in 1996. The outcome of the presentation was that the 10-year life was appropriate for purposes of Telus DMS switching depreciation account. There were fewer upgrades on the Telus (Edmonton) assets and, therefore, the results of a separate study indicated a 14-year useful life for the history of the switching account. Since a number of upgrades were anticipated for the Telus (Edmonton) asset, it was concluded the appropriate useful life would be 11 years.

For purposes of this hearing, the two average age/life expectancies determined as appropriate are: 1) December 31, 1997 life expectancy is determined to be 6.7 years and 2) December 31, 1998 is determined to be 7.1 years.

Based on these studies and the CRTC acceptance, it appears the depreciation rate of 25% as applied in the subject assessment is not appropriate. Rather, a depreciation age/life table based on a 10-year life curve would be more appropriate. By using this method of depreciation, once a DMS switch account reaches the age of say five years, the accumulated amount of depreciation would be 50% compared to the 25% provided in the assessment. A DMS switch, which reaches



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a state where additions and retirements are approximately the same, would be considered a mature account. This mature account occurs approximately in the 50% accumulated depreciation range, or in the fifth year of a 10-year age/life.

Based on the above, the Complainant suggested the depreciation rate for DMS switches, for assessment purposes, should be in the 50% range. The Complaint argues that telecommunications equipment is subject to significant technological change, obsolescence and economic pressures. As an example, Telus purchases switching hardware with a two to three year window where the switching hardware is functional. After two years, the hardware would not be supported by the software supplier.

The Complainant points out that the 1997 Manual and the 1998 Manual treat depreciation differently in each year. In the 1997 Manual, telecommunications systems are not specifically addressed, depreciation must be applied in a manner that is fair and equitable with those items listed in Schedule C of the Manual. Schedule D allows for the application of additional depreciation provided evidence of such loss exists.

Where a depreciation factor has not been identified for certain linear property, then depreciation shall be determined in a manner that is fair and equitable with the depreciation factors found in a schedule for other linear type property. No depreciation factor has been provided for telephone systems type linear property in the 1997 Assessment Manual. In the depreciation portion of the manual, reference is made to certain definitions that apply. The applicable definitions include "Age" and "Effective Age". It appears when depreciation is being determined in a manner that is fair and equitable, regard must be given to Age and Effective Age as defined. Age is simply defined as meaning chronological (actual) age or its effective age, in years. Effective age means the estimated age of linear property based on its condition design features and other things. Effective age may be less than greater or equal to its physical (actual) age.

To determine a fair and equitable depreciation amount for a telephone system, regard is given to depreciation factors applied to other linear type property as found in the assessment manual. Electric power installations have a depreciation factor of 0.75 or 25% applied unless otherwise specified. The exception (otherwise specified) is generating plants and substations that receive depreciation on an age/life sliding scale percent remaining basis. The depreciation factor for pipeline type linear property is 0.75. The depreciation factor for cable television systems is 0.75 unless otherwise specified. In the 1997 Manual, cable television systems have a separate specified depreciation formula that considers a "Penetration Rate". This formula gives regard to installations in use as opposed to installed for use.

To achieve a fair method of determining depreciation for a telephone system, consideration should be given to the method used to determine depreciation for similar type property. Pipelines and electric power lines would not be considered comparable type property. Cable television systems have some similarities, however, a telephone system includes things such as

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switching equipment that is more mechanized. The installations in a telephone system are more like machinery and equipment used in a process. A loss in value due to depreciation, for machinery and equipment type property, is allowed based on an age/life table. It follows that a telephone system should be depreciated for loss in value based on an age/life system. That age/life system could be determined by using information that is available from telephone companies such as Telus. For loss in value purposes, due to depreciation this age/life schedule should be applied to both the 1997 and 1998 base replacement costs to determine a fair and equitable assessment.

It is noted that, notwithstanding an age/life table method of depreciation would result in a fair assessment, the 1998 Guidelines provide an initial depreciation factor for telephone systems at 0.75.

This 1998 Manual seem to be in conflict with the requirement to assess in a fair and equitable manner. Since a fair and equitable depreciation schedule would have been established for the 1997 assessment based on an age/life schedule, it seems reasonable that for purposes of the 1998 assessment, in the interest of fairness and equity, depreciation should continue to be determined on an age/life basis rather than the fixed rate of 0.75.

It is noted that in the 1997 Manual there is provision to allow adjustments for additional depreciation. The 1998 Manual seem to have an "additional depreciation" policy change where only electric power generating facilities and cable television systems may receive an adjustment for additional depreciation. The electric power generating system's additional depreciation is contingent on acceptable evidence, whereas the cable television system is based on a penetration rate formula table. Generally, in the interest of fairness and equity, if there has been any functional or technological change, adverse wear and tear or any external forces beyond what would be considered a normal loss in value, additional depreciation should be considered and applied to the property being assessed.

For purposes of replacement cost valuation, a fair and equitable base cost must be determined and the base cost is then modified to reflect the assessment base year value. By applying a depreciation factor to the base year value, a final assessed value is determined. This final valuation is based on the physical component only and does not include any business enterprise value.

The Respondent's suggestion that generic terms were adopted to ensure "any and all" components of the system under review were assessed, is flawed. The Act and Regulations are specific on what is assessable and how it is to be assessed. Rather than any or all, the legislative directive is to assess the physical components integral to an operation. In following the statutory directive rather than broadening the meaning of certain wording, as the Respondent suggests, an assessor is confronted with strictly applying a narrow meaning of the wording.

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Telus submits the depreciation based on a factor fixed at 0.75 remaining for DMS switching equipment is not applied in a manner that is fair and equitable. In support of the submission, it was argued, in part, to be equitable. The switching equipment at issue should be depreciated on an age/life basis similar to electric power generation facilities and cable television systems. The DMS switching equipment is an operational unit and, therefore, should be depreciated separately from other inside and outside plant equipment. Numerous court rulings have dealt with the matter and in particular, the Strathcona No. 20 (County) v. Shell Canada Ltd. et al (1995) case should be accepted as analogous to the Telus DMS switching units depreciation submission.

### **RESPONDENT'S POSITION**

#### **Depreciation**

Historically, telecommunication systems linear type property is depreciated at a fixed 25% depreciation allowance. Subject to limited exceptions, this 25% depreciation allowance is applied to all linear property.

The Respondent submitted, once the base cost has been determined there is a requirement to apply a loss in value to the base cost due to depreciation. For purposes of special type properties such as cable television systems, electric power transmission and distribution lines, and pipelines a fixed type of depreciation is commonly applied. It is a broad average measure of typical or normal loss in value and is determined and applied as an administratively simple assessment procedure. To accommodate this simple procedure, a fixed rate of depreciation has been determined and identified under the Guidelines. The Guidelines stem from the applicable regulation.

In this case, the regulation states the assessor must follow the procedures set out in the Guidelines. The 1997 Guidelines provide, under a schedule, for depreciation a factor of 0.75 (75% remaining fixed and immediate) for electric power property other than generating plants and substations, cable television systems and pipelines. Since telephone systems are not described in the schedule, the Guidelines provide that the depreciation factor shall be determined in a manner that is fair and equitable with the depreciation factor as provided in the schedule of rates. As noted, the schedule of depreciation rate that is provided indicates a factor of 0.75 remaining.

For the 1998 assessment of linear property, the Guidelines have provided a depreciation factor of 0.75 in the schedule of depreciation rates for telephone systems. This is a regulated rate that must be applied by the assessor. Historically, this same depreciation factor (0.75) has been applied to telephone systems property in the last some 20 years.

With respect to the issue of depreciation, as brought forward by the Complainant, it is not clear whether the request is to change the method of depreciation from a fixed rate remaining to an

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age/life table method or if additional depreciation is sought due to underutilization, abandonment, etc. of the telephone system.

In this case, there has been no evidence presented to show the assessments are excessive as a result of underutilization, abandonment, etc. and, therefore, the additional depreciation argument is not supported. The depreciation factor of 0.75 remaining is a regulated amount that must be applied by the assessor in determining the final assessed values whether or not we agree with the factor.

Telus is also claiming that the 0.75 remaining allowance is not fair and equitable. A simple answer to this claim is that depreciation is regulated under the Guidelines. The Guidelines specify the amount of depreciation that is applicable to particular linear type property. Electric generating plants, electric power transmission and distribution lines and cable television systems all are specifically provided a depreciation factor of 0.75 remaining under a depreciation schedule given in the Guidelines. For purposes of the 1997 assessment, a telephone system is not specifically mentioned with respect to a depreciation allowance. However, the depreciated schedule provides that where rates of depreciation are not prescribed, then depreciation shall be determined in a manner that is fair and equitable with the depreciation rates that are prescribed in the schedule. The depreciated rate that is described in the 1997 Guidelines is in fact 0.75 remaining for other linear properties that can be equated to a telephone system for purposes of fairness and equity. The depreciation allowance for telephone systems is specifically shown at a factor of 0.75 remaining in the depreciation scheduled of the 1998 Guidelines.

Even though Telus may not agree with the depreciation allowance provided, the fact is the regulated rate at 0.75 remaining is mandatory and applied fair and equitable with other linear type properties. Until the Minister changes this depreciation rate, the assessor must apply the rate as prescribed in the schedule of depreciation.

There is a provision to allow additional depreciation in certain circumstances. This additional depreciation is in the form of abnormal depreciation. The 1998 guideline has clearly identified the circumstances when abnormal depreciation should be considered. In this case, for Telus to argue that there is an entitlement to additional depreciation, it must be shown that DMS switches etc. suffer an abnormal loss in value due to economic or functional obsolescence. No evidence has been entered by Telus to show abnormal loss in value rather it was argued the fixed and immediate depreciation allowance should be replaced with an age/life table method of depreciation. As long as the depreciation schedule, as regulated by the Minister, prescribes that rate to be 0.75 remaining, the argument put forward by Telus respecting depreciation must fail.

The Respondent countered that the DMS switching units cannot be considered operational units and, therefore, the particular Strathcona County case cited by the Complainant cannot be accepted as analogous to this case. The DMS equipment is integral to the telephone system and it is the telephone system as a whole that is the operational unit. This matter has been resolved

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by various Alberta Court decisions such as the BC Forest Products case where the entire saw mill was the operational unit and certain cranes were part of the operational unit much like the DMS equipment in this case is part of the operational unit (telephone system). Depreciation attributable to a telephone system is regulated and must be applied as regulated, to all the linear property that is reported and accepted as assessable replacement costs, on the same basis. In this case, the regulated depreciation rate is a factor of 0.75 that must be applied to all of the telephone system.

In closing, it is the Respondent's position that the application of a depreciation factor at 0.75 remaining as applied to the 1997 and 1998 Telus linear property subject to assessment, has been applied in a fair and equitable manner. As well, by including all of the software costs which are at issue in this case as assessable costs, the result is a base cost for linear property assessment purposes which has been determined in a manner that is fair and equitable.

### **Findings**

1. For the 1998 assessment year, the depreciation factor of 0.75 has been applied in a fair and equitable manner.
2. The method of determining depreciation for the 1997 is worded differently than for 1998, however, the depreciation allowance is the same for both years.
3. For the 1997 assessment year the depreciation factor of 0.75 has been determined in a manner that is fair and equitable with the depreciation factors pursuant to Schedule C of the 1997 Manual.
4. Depreciation based on an age/life table cannot be applied to the DMS switching equipment component of the Telus telecommunication system in either the 1997 and 1998 assessment year.
5. Additional depreciation for the DMS switching equipment is not warranted for the 1997 assessment year.
6. Additional depreciation is not warranted for the 1998 assessment year.

### **REASONS**

#### **Depreciation**

For purposes of the replacement cost method of estimating actual value, depreciation is generally considered a loss in value from all causes. Depreciation (loss in value) has been separated into three categories. The categories include physical deterioration, functional inutility (functional obsolescence) and locational loss in value (economic obsolescence). These forms of depreciation are described as being normal or abnormal and may be curable or incurable.

While assessors and appraisers give consideration to these forms of depreciation in estimating real property (real estate) market value, linear property is valued, for municipal taxation

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purposes, by a replacement cost method which considers depreciation pursuant to a regulated valuation standard (*AR 365/94*) and in accordance with procedures set out in the Guidelines.

### **METHOD OF DETERMINING DEPRECIATION ALLOWANCE FOR 1997 IS WORDED DIFFERENT THAN FOR 1998**

#### **Complainant's Position**

Telus submits that while there may be some guidance in the application of depreciation amounts for the 1998 assessment year, there are no depreciation scheduled provided for the 1997 assessment year. The method of determining a depreciation allowance is, therefore, for the MGB to decide.

#### **Respondent's Position**

Depreciation is regulated under the Guidelines for both the 1997 and 1998 assessment year. The method of determining depreciation is clear for both years and the MGB is not at liberty to decide a method of depreciation in this case. The method of determining depreciation is different for 1997 than for 1998.

#### **Finding**

The method of determining the depreciation allowance is worded differently for the 1997 and 1998 assessment years. The different wording does not result in different depreciation amounts for 1997 and 1998.

#### **Reasons**

It is evident that for the 1997 year telephone systems did not have a depreciation allowance described. It is also evident that for the 1998 year a depreciation factor for telephone systems was described. The fact that in 1998 a depreciation factor was "described" and in 1997 depreciation "shall be determined" leads to the conclusion that different wording is to be applied for purposes of depreciation.

### **IF THE WORDING TO ESTABLISH DEPRECIATION AMOUNTS FOR 1997 AND 1998 IS DIFFERENT, WHY ARE THE DEPRECIATION ALLOWANCES THE SAME AT 0.75 REMAINING FOR 1997 AND 1998?**

#### **Complainant's Position**

The evidence supports a depreciation allowance for DMS switching equipment at a rate greater than the 25% allowed in the assessment. DMS equipment is subject to rapid technological

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change resulting in accelerated loss in utility. This loss results in functional depreciation which has not been considered in the depreciation allowed. Since there is no schedule of depreciation rates in the Guidelines for telephone installations, to be fair and equitable depreciation for DMS switching equipment should be determined by use of telephone industry depreciation scheduled as demonstrated in the evidence as submitted.

### **Respondent's Position**

Depreciation is regulated under the Guidelines. The Guidelines specify the amount of depreciation to be applied and where it is not specified, it must be determined in a manner that is fair and equitable with depreciation that has been prescribed in a schedule. Other linear property which equates to a telephone system have a depreciation factor of 0.75 remaining. It follows that the application of a 0.75 depreciation factor would be fair and equitable for the 1997 assessment year.

### **Finding**

For the 1997 assessment year the depreciation factor at 0.75 has been determined in a manner that is fair and equitable with the depreciation factors pursuant to Schedule C of the 1997 Manual.

### **Reason**

The MGB accepts that the Complainant's evidence supports a depreciation amount different than the 25% allowed. It is not accepted, however, that the application of a different depreciation amount would result in a fair and equitable depreciation factor within the context of the regulated linear property assessment. The Guidelines provides instructions respecting the determination of depreciation amounts for the various linear properties. While it may be shown those amounts are different than those allowed by non linear assessment jurisdictions such as the CRTC and Revenue Canada, the MGB is satisfied that for purposes of linear property assessment, depreciation can only be determined pursuant to the Guidelines.

For the 1998 assessment year, the property in question is specifically covered by the Guidelines which calls for a depreciation factor of 0.75. For 1998, this has been applied in a fair and equitable manner. By 1998 the legislators not only set a factor of 0.75 but the legislators choose a factor approach to depreciation for the subject type property rather than an age/life or table approach for this type of property. This gives the MGB comfort in exercising its discretion in 1997 in choosing the factor approach for the 1997 assessment year.

For the 1997 assessment it is true that depreciation has not been described in a schedule, however, the Respondent's position is accepted as being valid. Where depreciation is not specified it must be determined in a manner that is fair and equitable with depreciation that has

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been described. In this case, consideration is given to the wording in Schedule C and, in particular, what is meant by “determined in a manner that is fair and equitable with depreciation factors in Schedule C”. The MGB notes that depreciation under Schedule C is described as “age/life depreciation”, “factor depreciation” and “table and formula depreciation”. The only factor depreciation specified under Schedule C is 0.75. The MGB is satisfied that, since the only depreciation factor specified is 0.75, it must be applied to be fair and equitable.

In order to determine which depreciation should be applied for 1997, the MGB examined the types of properties and how the different systems of depreciation are applied to in the Guidelines. The MGB observes that the age/life system of depreciation is applied to property types like hydro, wind power, thermal power generation plants and substations. The MGB finds that these types of properties are the least analogous to the subject property. In fact the MGB finds that the most analogous type of property for the purpose of determining depreciation within the noted schedule is cablevision undertakings. The depreciation prescribed to be applied to cablevision entities is a depreciation factor of 0.75, the same factor which was applied to the subject property in 1997. Thus, the MGB is satisfied that application of a depreciation factor of 0.75 is equitable within the context of Schedule C.

Within the 1997 Schedule C, the factor depreciation is applied to all linear property “unless otherwise specified”. The “unless otherwise specified” accommodates a depreciation table for certain electric power installations and a table and formula depreciation for cable television systems. A telephone system is not identified under the “otherwise specified” category. The table and formula depreciation for cable television systems incorporates a customer penetration rate percentage with the .75 depreciation factor. Cable television installations which are in place (intended for) but not in use, are based on a prescribed formula and the assessment is reduced based on a penetration rate. By comparison, Telus does not report or receive an assessment for any linear property installed which is “intended for” the telephone systems use. Any loss in value due to functional inutility (penetration rate) is, therefore, considered in the way the reported costs are submitted to the DLA.

### **FOR THE 1998 ASSESSMENT YEAR HAS THE DEPRECIATION FACTOR OF 0.75 BEEN APPLIED IN A FAIR AND EQUITABLE MANNER?**

#### **Complainant’s Position**

It is not fair and equitable to apply a depreciation rate of 25% when consideration is given to the rapid technology change in DMS switching equipment. This rapid change results in accelerated functional depreciation which should be considered. The evidence in this case supports a depreciation allowance greater than 25%.



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### **Respondent's Position**

Depreciation allowances for purposes of linear property assessment is provided under a regulated rate scheme. The depreciation allowance for telephone systems is specifically shown as a factor of 0.75 remaining in the depreciation schedule of the 1998 Guidelines. These Guidelines must be followed and cannot be altered without ministerial approval.

### **Finding**

For the 1998 assessment year, the depreciation factor at 0.75 has been applied in a fair and equitable manner.

### **Reasons**

The Complainant's position that DMS switching equipment suffers accelerated functional depreciation may have merit. The MGB, however, accepts the Respondent's position that depreciation can be adjusted only through a regulatory change. To deviate from the 0.75 factor that has been applied to other like linear property would result in an inequitable assessment. The fact that a depreciation factor of 0.75 has been applied for the Telus 1998 assessment would indicate a depreciation allowance which has been determined in a manner that is fair and equitable with other like linear property.

### **CAN DEPRECIATION FOR DMS SWITCHING EQUIPMENT BE DETERMINED BASED ON AN AGE/LIFE TABLE FOR THE 1997 OR THE 1998 ASSESSMENT YEAR?**

#### **Complainant's Position**

Based on depreciation allowances accepted by various telephone industry authorities, the depreciation rate of 25% as applied is not appropriate for either the 1997 or 1998 assessment. A depreciation age/life table based on a 10-year life curve would provide an appropriate indication of depreciation. By using the age/life method of depreciation, once a DMS switching equipment reached the age of five years, the depreciation would be 50% rather than the 25% allowed. Since there is no depreciation schedule for the 1997 assessment year, the information that is available from telephone companies such as Telus should be used to determine loss in value due to depreciation. A fair and equitable assessment would result from the use of the age/life method of determining depreciation. The 1998 Guidelines are in conflict with the requirement to assess in a fair and equitable manner. By establishing the depreciation based on an age/life table for the 1997 assessment, it is reasonable and in the interest of fairness and equity depreciation should continue to be determined on an age/life basis for the 1998 assessment.

**Respondent's Position**

For special type property such as linear property, depreciation has been identified and determined under prescribed guidelines and the assessor must follow the procedures set out in those guidelines. For purposes of the 1997 Guidelines, the assessor shall determine depreciation in a manner that is fair and equitable with the depreciation factor that is provided in the schedule of depreciation. The 1997 depreciation factor of 0.75 is prescribed for cable television, pipelines and electric distribution systems and since telephone systems are not described in the schedule, to be fair and equitable, a factor of 0.75 must be determined. A depreciation factor of 0.75 remaining has been provided in the 1998 Guidelines for telephone systems and the assessor has no choice but to apply the regulated rate. Even though the Complainant may not agree with the depreciation allowance provided at the rate of 0.75 remaining, the fact is that it is mandatory and only the Minister can change the depreciation rate. The depreciation schedule as regulated prescribes a rate of 0.75 remaining. Until the rate is changed by regulation to an age/life table as suggested, the argument that the Complainant is making respecting depreciation amounts and the matter of fairness and equity must fail.

**Finding**

Depreciation for both the 1997 and 1998 assessments cannot be determined based on an age/life table.

**Reasons**

For the 1997 assessment, a depreciation factor for a telephone system is not described in a depreciation schedule. As a result, the regulated instructions are that depreciation is to be determined in a manner that is fair and equitable with depreciation factors found in the schedule. On close review of the Guidelines, it is apparent that depreciation is described as “factor”, “age/life” and “table and formula” depreciation. If the intention was to provide an age/life or table-and-formula depreciation amount for telephone systems, it would have surely so stated. Rather, it specifically states “fair and equitable with the depreciation factors”. The only factor depreciation provided under the schedule is shown as 0.75 and the MGB is satisfied to be fair and equitable, the depreciation factor for a telephone system must be 0.75. For the 1998 assessment, there can be no doubt that the depreciation factor for a telephone system is 0.75 when regard is given to the prescribed Guidelines.

**IS ADDITIONAL DEPRECIATION BEYOND THE 0.75 FACTOR DEPRECIATION WARRANTED FOR EITHER THE 1997 OR 1998 ASSESSMENT YEAR?**

**Complainant's Position**

There is a provision for an adjustment to consider additional depreciation for the 1997 assessment. In the 1997 Guidelines, cable television systems have a separate specified formula to consider: "Penetration Rate" depreciation. This formula considers installations in use as opposed to installed for use. To be fair, a telephone system should receive the same formula depreciation consideration for both the assessment years under complaint.

**Respondent's Position**

The 1997 Manual has a provision to allow for additional depreciation providing evidence of such loss in value exists. The issue of depreciation as submitted by the Complainant is not clear as to whether the depreciation allowance should be based on an age/life table or if additional depreciation due to under-utilization abandonment, etc. should be considered. The Complainant has not provided evidence to show the assessments are excessive as a result of under-utilization, etc. and the additional depreciation argument is therefore not supported. The 1998 Guidelines have identified the circumstances when abnormal depreciation should be considered. The Complainant has not provided any evidence to show abnormal loss in value, but rather argued that an age/life method of depreciation should be employed. The determination of depreciation at a factor of 0.75 remaining for both years considers all of the depreciation which is attributable to a telephone system.

**Finding**

Additional depreciation beyond the 0.75 factor depreciation is not warranted for either the 1997 or 1998 assessment year.

**Reasons**

The MGB accepts the concurrence of both parties that there is provision to consider additional depreciation for the 1997 assessment. Pursuant to Schedule D, an adjustment may be made for additional depreciation provided acceptable evidence exists. It is noted that the cablevision penetration rate formula depreciation is allowed under Schedule C and only depreciation not reflected in Schedule C and D may be adjusted for additional depreciation. In this case, the MGB accepted that DMS switching equipment suffers accelerated depreciation when regard is given to other authorities such as the CRTC and Revenue Canada. In the MGB's view, this accelerated depreciation is considered normal given the technological change. Additional depreciation is considered abnormal and includes functional inutility and locational (economic) loss in value. There was no evidence presented to suggest that Telus' telephone system is not

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well located in Alberta. The evidence is that Telus reports only the portion of the installations that are used for purposes of providing telephone services. This fact confirms that any abnormal depreciation due to inutility has been fully considered in the initial report to the DLA where all of the installations “intended for” are not reported. It is the MGB’s considered opinion that any additional depreciation such as a penetration rate has been fully allowed by virtue of how the cost report to the DLA is made.

With respect to the 1998 assessment, the Guidelines specifically identify that any deprecation that is not reflected in tables 3.1.1. and 3.1.3 of Schedule C only, an adjustment to the assessment may be made. On close reading, 3.1.1. includes Thermal Generation Plants, and Substations and 3.1.3. includes Wind Generation Plants. The MGB is satisfied from these instructions under Schedule D of the 1998 Guidelines, that additional depreciation can be applied only to those facilities identified under 3.1.1. and 3.1.3 in addition to those installations referred to as cable television systems, “Penetration Rate” formula, and pipelines and wells additional depreciation tables. There is no reference to telephone systems under the additional depreciation scheduled portion of the 1998 Guidelines and, therefore, under a regulated depreciation scheme no additional depreciation is applicable.

### **CAN A DMS BE CONSIDERED AN OPERATIONAL UNIT AND BE SUBJECT TO DEPRECIATION SEPARATE FROM A TELEPHONE SYSTEM?**

For purposes of the 1996 hearing, a DMS was considered an operational unit, however, the matter of depreciation was not addressed in the decision.

#### **Complainant’s Position**

The DMS switching equipment is an operational unit and should be depreciated separately from other plant installations. The evidence submitted supports an age/life depreciation method of determining loss in value which should be applied in this case. Court rulings have dealt with this matter and in particular the 1995 Shell Canada Ltd. v. County of Strathcona No. 20 case supports the Telus separate DMS switching depreciation submission.

#### **Respondent’s Position**

The DMS switching units cannot be considered operational units as the switches are integral to the telephone system and it is the telephone system as a whole that is the operational unit. Since the DMS switching equipment is not an operation unit, the 1995 Shell Canada Ltd. v. County of Strathcona No. 20 case cited cannot be analogue to this case. Depreciation is regulated and must be applied at the regulated rate to all linear property reported for assessment purposes on the same basis. The regulated depreciation rate is a factor of 0.75 which must be applied to all of the telephone system.

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### Finding

A DMS cannot be considered an operational unit for purposes of linear property assessment. Depreciation cannot be considered for a DMS separately from telephone system as a whole.

### Reasons

While the MGB has concluded that the software at issue is an integral part of a DMS, no conclusion has been made as to whether or not a DMS is an operation unit. The testimony given by Mr. DeFleming for the Complainant shows that a DMS is not operational unless a DC (Direct Current) electrical current is supplied for the switch to function. Even though the switch could be turned on as a result of the electric supply, the evidence is that it could not transmit emit or receive telecommunications. These facts alone are sufficient to make the finding that a DMS is not an operational unit. This finding is further supported by the evidence that only after a set of paired telephone lines are installed can a DMS perform its intended function. In this case, the operation unit is the telephone system as a whole. The electrical installations, the switching material, devices, fitting, etc. together with all of the other installations, such as paired wires, form an integral part of the telephone system.

With respect to the 1995 Shell Canada Ltd. v. County of Strathcona No. 20 case, on review it was found that a part of the Oil Refinery identified as the Styrene Plant was in fact an operational unit, separate from the other refinery installations and, therefore, depreciation could be considered separately. Even though the Styrene Plant was part of the total refinery complex, it could operate independently as an operational unit because it received raw material, processed it into styrene separate and apart from the other facilities at the refinery. This cited case is unlike Telus where none of the individual parts perform the process of transmission, emission, or reception of telecommunications. With the foregoing in mind, the MGB is satisfied that a DMS is not an operational unit and a depreciation allowance can only be considered for the telephone system as a whole.

Upon hearing and considering the representations and the evidence of the parties shown on Appendix "A", and upon having read and considered the documents shown on Appendix "B" and "C" attached, the MGB makes the following decision.

### DECISION

1. The 1998 Telus Communication Inc. complaint, against the 1997 linear property assessments respecting the 275 municipalities, shown on the list of complaints as filed, is denied. (See Appendix "D".)
2. The values placed against Telus' property in three Indian Reserves and one Metis Settlement, as shown on the 1998 linear property complaint list, are not part of this decision.

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3. The 1998 Telus Communication (Edmonton) Inc. complaint against the 1997 City of Edmonton linear property assessment is denied.
4. The 1998 Telus Mobility Inc. complaint, against the City of Edmonton and City of Calgary 1997 linear property assessment is denied.
5. The 1999 Telus Communications Inc. complaint, against the 1998 linear property assessments respecting the 273 municipalities, shown on the list of complaints as filed, is denied. (See Appendix "D".)
6. The values placed against Telus' property in three Indian Reserves and one Metis Settlement as shown on the 1999 linear property complaint list, is not part of this decision.
7. The 1999 Telus Communications (Edmonton) Inc. complaint against the 1998 City of Edmonton linear property assessment is denied.

Accordingly, the 1997 and 1998 linear property assessed values, as recorded for the municipalities on the Telus lists of complaint, are hereby confirmed.

It is so ordered.

Costs pursuant to section 504 of the Act may be addressed pending a cost hearing request by either party to this complaint hearing on or before May 6, 2005.

Dated at the City of Edmonton, in the Province of Alberta, this 8th day of April 2005.

MUNICIPAL GOVERNMENT BOARD

(SGD.) J. Schmidt, Presiding Officer

**APPENDIX "A"**

**APPEARANCES**

<b>NAME</b>	<b>CAPACITY</b>
A. Friend	Legal Counsel for the Complainant
G. Johnson	Legal Counsel for the Complainant
M. Cosentino-Fast	For the Complainant
R. DeFleming	For the Complainant
K. Shaw	For the Complainant
L. Burgess	Legal Counsel for the Respondent
J. Husar	For the Respondent
R. Gagné	For the Respondent
M. Forest	For the Respondent
I. Johnson	Legal Counsel for the City of Edmonton
K. Lemke	For the City of Edmonton
S. Trylinski	Legal Counsel for the City of Calgary

**APPENDIX "B"**

**DOCUMENTS RECEIVED AT THE HEARING AND CONSIDERED BY THE MGB:**

<b>NO.</b>	<b>ITEM</b>
Exhibit A-1	Appellant's submissions - Volume 1 - Application software
Exhibit A-2	Appellant's authorities - Volume 1 - Book 1
Exhibit A-3	Appellant's authorities - Volume 2 - Book 2
Exhibit A-4	Appellant's submissions - Volume 2 - Depreciation
Exhibit A-5	Appellant's authorities - Volume 2
Exhibit A-6	Appellant's rebuttal
Exhibit A-7	Resume of Maria Cosentino-Fast
Exhibit A-8	Letter to the Minister dated June 1, 1994
Exhibit A-9	Resume of Rick DeFleming
Exhibit A-10	Photographs of equipment
Exhibit A-11	DMS 100 software diagram
Exhibit A-12	Examples of Optional Services offered to Telus Customers
Exhibit A-13	Letter from Nortel Networks dated May 29, 2000
Exhibit A-14	Feature planning guide
Exhibit A-15	Functional group mapping to NTX code for basic software packages
Exhibit A-16	Resume of Kenneth Shaw

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Exhibit A-17	Report dated March 2000
Exhibit A-18	Resume of Leslie Grajkowski
Exhibit R-1	Special property assessment guide
Exhibit R-2	Extracts from "depreciation systems" and "public utility depreciation practises"
Exhibit R-3	Submissions of the Respondent
Exhibit R-4	Authorities of the Respondent
Exhibit R-5	Submission of M. Forest dated April 10, 2000
Exhibit R-6	Resume of Rene Gagne
Exhibit R-7	AEC Valuations report dated April 2000
Exhibit R-8	Summary of depreciation (1997-1998) - linear property - Alberta Assessment Manual
Exhibit R-9	Linear property assessment reporting procedures handbook 1999
Exhibit R-10	Ministerial Order 248/97
Exhibit R-11	Ministerial Order 538/98

### **APPENDIX "C"**

#### **DOCUMENTS RECEIVED AFTER THE HEARING AND CONSIDERED BY THE MGB:**

Transcripts of the hearing - Volumes 1 to 6B

Supplementary submissions of the Respondent received October 30, 2000

Supplementary submissions of the Complainant received November 15, 2000

### **APPENDIX "D"**

#### **LIST OF PROPERITIES UNDER COMPLAINT AND IMPACTED MUNICIPALITIES**

Due to the volume of records for each year under complaint, the list of specific properties and the list of impacted municipalities is not included within this Order. A list can be obtained from the Edmonton offices of the MGB.