

FINAL BILL REPORT

ESSB 5286

C 181 L 97

Synopsis as Enacted

Brief Description: Clarifying the taxation of intangible personal property.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Horn, Benton, West, McCaslin, Wood, Prince, Roach, McDonald, Hale, Sellar, Anderson, Deccio, Johnson, Oke, Morton, Zarelli, Swecker, Hochstatter, Schow and Strannigan).

Senate Committee on Ways & Means

House Committee on Finance

Background: All property in this state is subject to the property tax each year based on the property's value unless a specific exemption is provided by law. The state Constitution defines "property" for tax purposes as "everything, whether tangible or intangible, subject to ownership."

Real property lying wholly within individual county boundaries is valued by the county assessor. Inter-county, interstate, and foreign utility companies are valued by the Department of Revenue. The value of personal property is reported each year by taxpayers to the county assessors.

There are three common approaches used in valuing real property: the sales approach; the cost approach; and the income approach. One, two, or all three methods may be applied to a given parcel. The sales approach is mainly used for residences, the cost approach is used for manufacturing and similar facilities, and the income approach is used principally for commercial property including apartment houses.

A major exemption from the property tax exists for some intangible property. Intangible property is property that has no physical substance and is not susceptible to being perceived by the senses. Exempt intangibles include: money, mortgages, notes, accounts, certificates of deposit, tax certificates, judgments, government bonds and warrants, stocks and shares of private corporations, private nongovernmental personal service contracts, and private nongovernmental athletic or sports franchises. Other types of intangible property are taxable, such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, noncompete agreements, customer lists, and business goodwill.

For property assessed by the Department of Revenue, standard appraisal practices tend to capture intangible value. For locally assessed property, intangible value, when it exists, may be included in the real property value when the income approach or the comparable sales approach is used. Intangible value will also be included when businesses expressly report intangible personal property on their personal property affidavits.

While intangible "attributes," such as location, zoning, or view, often affect the market value of real or tangible personal property, these attributes are not intangible "property" but are merely characteristics that buyers and sellers use in determining the market value of property. In contrast, intangible personal property can be bought and sold completely independently of other property. Therefore, an exemption of all intangibles would not include the exemption of these attributes. For example, under an exemption for intangibles, a business may no longer pay taxes on the value of its trademarks but would continue to pay taxes on the value of having a good business location.

In the late 1980s, the Department of Revenue was sued by Burlington Northern on the grounds that the company was being discriminated against. The taxpayer believed that local values did not include intangible value because counties often rely on the cost approach for valuations. The court stated that the cost approach has a factor for entrepreneurial profit which does incorporate intangibles. The court also found that appraisal methods used by county assessors sometimes captured intangible assets of local businesses but that often intangible assets were overlooked. The remedy for the under-assessment of local property due to this oversight was through an adjustment of the assessment ratio. The taxpayer was entitled to relief only if the under-assessment caused its assessment ratio to be higher than that of locally assessed property.

As a result, the department, as part of the state school levy equalization process, decreased the assessment ratios for many counties because of the failure to tax intangibles. This caused the state portion of the property tax to increase in those counties. At the same time, Congress allowed "goodwill" to be listed as a depreciable asset for federal income tax purposes. This made it more likely that businesses would show goodwill on their books and that assessors would tend to tax it. The combination of falling ratios and the ability to find goodwill on the books of businesses led some assessors to assess the value of previously unassessed intangible property. Businesses began to complain about the assessment (and taxation) of previously untaxed property. Businesses also feared that assessors would begin to further tax these and other intangibles.

The department responded with a letter in January 1996 advising county assessors not to ask for a separate reporting of intangibles on the personal property affidavit as these values would often already be included in the market value of real property. This had the effect of eliminating the possibility that these businesses could be double taxed. However, intangible property remained taxable. In 1996, bills were introduced in the Legislature to exempt all intangibles from taxation, but none of these bills were enacted by the Legislature.

Summary: All intangible personal property is exempt from property tax. Intangible property includes, but is not limited to, the items exempt under current law and items such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, core deposits of financial institutions, noncompete agreements, clientele, customer lists, patient lists, favorable contracts, favorable financing agreements, reputation, exceptional management, prestige, good name, or integrity of a business. Intangible property does not include characteristics or attributes such as zoning, location, view, geographic features, easements, covenants, proximity to raw materials, condition of surrounding property, proximity to markets, and the availability of a skilled work force.

The exemption is not intended to preclude the use of generally accepted appraisal practices in the valuation of real and tangible personal property. Consideration of licenses, permits, and franchises granted by a government agency that affect the use of the property may be considered in applying generally accepted appraisal practices.

By December 1, 2000, the Department of Revenue must submit a report to the House Finance Committee, the Senate Ways and Means Committee, and the office of the Governor on tax shifts, tax losses, and any litigation resulting from the act.

These provisions are effective for taxes levied for collection in 1999 and thereafter.

The act is not intended to incorporate any other state's statutory or case law.

Votes on Final Passage:

Senate	28	21
House	71	27 (House amended)
Senate	30	19 (Senate concurred)

Effective: July 27, 1997