

SENATE BILL REPORT

SHB 2745

As Reported By Senate Committee On:
Ways & Means, March 7, 1996

Title: An act relating to intangible personal property.

Brief Description: Clarifying the taxation of intangible personal property.

Sponsors: House Committee on Finance (originally sponsored by Representatives Horn, Lisk, Ballasiotes, L. Thomas, Backlund, Mastin, Reams, D. Schmidt, Delvin, Hankins, Foreman, Cooke, Mulliken, Blanton, Hymes, Thompson and Elliot).

Brief History:

Committee Activity: Ways & Means: 2/22/96, 3/7/96 [DPA].

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: Do pass as amended.

Signed by Senators Rinehart, Chair; Loveland, Vice Chair; Bauer, Cantu, Drew, Finkbeiner, Fraser, Hargrove, Hochstatter, Kohl, Long, McDonald, Moyer, Quigley, Roach, Sheldon, Snyder, Spanel, Strannigan, Sutherland, West, Winsley and Wojahn.

Staff: Terry Wilson (786-7433); David Schumacher (786-7474)

Background: All property in this state is subject to the property tax each year based on its 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." The Constitution also states that "such property as the Legislature may by general laws provide shall be exempt from taxation."

Real property lying wholly within individual county boundaries is valued by the county assessor. Inter-county, interstate, and foreign utility, transportation, and telecommunications 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 is 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 not exempt from tax, such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, noncompete agreements, customer lists, and business goodwill.

While intangible "attributes" affect the market value of real or tangible personal property, such as location, zoning, or view, 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 property can be bought and sold completely independently of other property.

In 1994, some county assessors were considering putting language on the 1995 personal property tax affidavits specifically requiring the listing of intangible personal property. Because intangible property values may be included in the valuation of the real property, requiring the separate identification and taxation of intangible property could result in double taxation. In addition, the valuation and location of intangible property is difficult. The Department of Revenue issued a letter at the end of 1994 and again in 1996 requesting county assessors not to require the separate listing of intangible property for 1995 and 1996 taxes and stating that the department and the county assessors would work with the business community to resolve the issues.

Summary of Amended Bill: For property taxes due in 1997 and 1998, the state and the county assessors must list and assess intangible personal property in the same manner and to the same extent as intangible personal property was listed and assessed for taxes due in 1996.

The Department of Revenue must conduct a study of the current state and local taxation of intangible personal property. To perform this study, the department must form an advisory study committee with balanced representation from different segments of government and the business community. The advisory committee is to include two members from the House of Representatives, two members from the Senate, representatives of both small and large businesses, representatives of cities, counties, and other taxing districts, a representative of the county assessors, a representative of the appraisal industry, a representative of the Department of Revenue, and tax policy experts from the academic, legal, and business communities.

The Department of Revenue must provide staff for the purpose of the study.

The Department of Revenue must present a final report of the findings of the study to the committees of the Legislature that deal with revenue matters no later than December 31, 1996.

Amended Bill Compared to Substitute Bill: Under the original bill, intangible 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, noncompete agreements, customer lists, good name, and integrity of a business. For purposes of determining the market value of real property and tangible personal property, the presence of intangible assets shall be considered in determining the highest and best use of the property, which is

defined as the functional use for which the taxable property is employed without regard to the specific identity of the user. The market value of real property and tangible personal property must reflect 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.

These provisions are effective for taxes levied for collection in 1997 and thereafter.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect immediately.

Testimony For: People have been complaining about the counties starting to require the listing and taxing of intangible property. This started because businesses can now depreciate intangible property for federal tax purposes and the assessors see these assets listed with values. We should only tax them to the extent they are reflected in income. This brings fairness and consistency to the tax system. The inconsistent treatment of intangibles will result in litigation. This does not change current assessment practices. The intent was to codify the status quo. This eliminates double taxation. It is an invasion of privacy to request income tax returns in valuing property. Property valuation should not depend on profitability. Highest and best use has always been a generic use. The Task Force that studied this agreed that intangible property should not be taxed.

Testimony Against: Intangible property value should be included in valuations to the extent they reflect market value. This exemption means that market value is no longer the standard for appraisals. This will cause a huge shift in taxes to residential property. Exempting intangibles causes the same problems this is designed to remedy because the separate listing and valuation of intangibles will be necessary to pull it out of the valuation. This will require greater access to a companies tax records to value and extract intangibles. One landfill is valued at \$26 million, and most of the value is in the intangible permit to use it for that purpose. The value will decrease to \$9 million if this bill passes. The double taxation problem has been fixed. This bill is not necessary. This bill will result in a lot of litigation to determine what this means. Using the Burlington Northern case, they argued they had 25 percent intangible value. If you apply the same percentage to all centrally assessed property and use just 5 percent for the other property, \$8 billion is exempted resulting in a potential shift to homeowners of \$80 million which is greater than the tax cut the Senate enacted. Good property tax law doesn't raise questions, it answers them.

Testified: Len McComb, Will Rice, Department of Revenue (pro); Steve Seward (pro); Tom Dooley, AWB (pro); Bruce Reid, Microsoft (pro); Roy Wiseman, TOSCO Refining and Marketing Co. (pro); Leo Bowman, Leo's Lineup & Tires (pro); Gary Smith, Ind. Bus. Assoc. (pro); Jan Gee, WA Retail Assoc. (pro); Krista Eichler, Seattle Chamber of Commerce (pro); Terri Hotvedt, WA Assoc. of Realtors (pro); Trevor Sandison, Jim Irish, Appraisers Coalition of WA (no position); Alan Schipp (con); Jerry Crossler, Adams County Assessor (con); Gail Rauch, Snohomish County Assessor (con); Paul Easter, Grays Harbor County Assessor (con); Brent Wilde, M.A.I., Chief Appraiser, King County (con); Gary Foreman, Industrial Appraiser, Pierce County (con); Lynn Gering, Chief Deputy Appraiser,

King County (con); Bob Dick, Deputy Prosecuting Attorney, Pierce County (con); Carol Belas, Kitsap County Assessor (con); Jack Westerman, Jefferson County Assessor (con); Elizabeth Pierini, Senior Lobby Tax committee (con); Jan Maureen Morris, AWC (con); Gene Lux, People for Fair Taxes (con).