

THIS PROPOSED RULE IS SUBMITTED FOR PUBLIC COMMENTS AFTER INPUT FROM INTERESTED PARTIES AND IS TO BE USED SOLELY FOR DISCUSSION PURPOSES AT THE PUBLIC HEARING ON THE PROPOSED RULE. UNDER NO CIRCUMSTANCES IS THIS PROPOSED RULE TO BE USED TO DETERMINE TAX LIABILITY AND OR EXEMPTIONS.

NEW SECTION

WAC 458-50-150 Intangible personal property exemption-- Introduction. (1) **Goal of these rules relative to exemption of intangible personal property.** Although the Washington Constitution allows for property taxation of all property subject to ownership, "whether tangible or intangible," the legislature has exempted some intangible property from property taxation for many years. In 1997, the legislature expanded the exemption for intangible personal property and provided examples of exempt property. The following rules are intended to provide additional clarification of the statute and provide guidelines to be used by assessing officials in determining the taxable value of property. The goal is to ensure, in as fair and equitable a manner as possible, that all taxable value is assessed and all nontaxable value is not assessed.

(2) **Application of these rules.** These rules primarily implement RCW 84.36.070, which establishes a property tax exemption for intangible personal property, but also apply to chapters 84.12 and 84.16 RCW, the statutory chapters dealing with the assessment of public utility, and private car company property, respectively, by the state, and to chapter 84.40 RCW, which deals with assessment of property by the county assessor.

NEW SECTION

WAC 458-50-160 Exempt intangible property distinguished from other intangibles. (1) **Distinction between property, and characteristics or attributes of property.** The statute (RCW 84.36.070) draws a distinction between intangible personal property and the characteristics or attributes of property, both real and personal. Intangible personal property is exempt from property taxation. However, some characteristics or attributes of property, even though intangible, may be considered in establishing the taxable value of tangible property.

(2) **What intangible personal property is exempt?** The listings of examples of intangible personal property contained

in RCW 84.36.070(2) must be consulted, but those listings can be summarized as follows:

(a) Financial intangible property, such as moneys, credits, and publicly issued bonds and warrants, and the bonds, stocks, or shares of private corporations;

(b) Private personal service contracts and athletic or sports franchises, or sports agreements that do not pertain to the use or possession or any interest in tangible personal or real property; and

(c) Miscellaneous types of intangible personal property, such as trademarks, trade names, brand names, patents, copyrights, trade secrets, core deposits of financial institutions, noncompete agreements, customer lists, patient lists, favorable contracts, favorable financing agreements, reputation, exceptional management, prestige, good name, integrity of a business, and other similar types of intangible personal property. Franchise agreements, licenses, and permits that are wholly between private parties are exempt intangible personal property. (Licenses, permits and franchises granted by a government agency are referred to in subsection (5)(b) of this section.)

(3) Is "goodwill" exempt intangible personal property? "Goodwill" is an accounting classification that recognizes the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed, but "goodwill" does not identify specific property to which this classification refers. Therefore, "goodwill" as an unidentified, or otherwise unspecified, residual account is itself not exempt intangible personal property. However, to the extent that components or elements of the "goodwill" residual account can be separately identified and valued by a traded market, they are exempt.

(4) Identifying exempt intangible personal property. Intangible property is only exempt if it is personal property capable of being individually owned, used, transferred, or held separately from other property. The market value of separate items of intangible personal property should not be identified or characterized solely using residual accounting methods, or other indirect techniques, such as isolating "excess earnings," from a total business valuation. Market value of exempt intangible personal property should be verifiable in an openly traded market where the value of comparable intangible properties can be observed and considered.

(5) What intangible characteristics, attributes or other factors affect value and may be considered? Nonproperty intangible characteristics or attributes are elements or components of value associated with a real or tangible asset. These characteristics or attributes are "intangible" but they are not "property" and therefore are not tax exempt intangible

personal property. They are contingent and dependent upon other property and cannot be owned, used, transferred, or held separately from other property. To the extent that these characteristics, attributes, or other factors contribute to, or affect, the value of property, they must be appropriately considered when determining taxable value. They include the following types:

(a) Zoning, location, view, geographic features, easements, covenants, proximity to raw materials, condition of surrounding property, proximity to markets, or the availability of a skilled work force;

(b) Grants of licenses, permits, and franchises by a government agency that affect the use of the property being valued; and

(c) Other characteristics of property, such as scarcity, uniqueness, adaptability, or utility as an integrated unit or going concern.

NEW SECTION

WAC 458-50-170 Valuation principles. (1) **What is meant by "true and fair value"?** One hundred percent of true and fair value is the standard used by assessing officials for valuing both taxable property and exempt property. True and fair value is the same as market value or fair market value. It is the amount of money a buyer of property willing but not obligated to buy would pay a seller of property willing but not obligated to sell, taking into consideration all uses to which the property is adapted and might in reason be applied. This term incorporates all the rights and benefits, present and future, associated with the ownership of property.

(2) **Approaches to value.** All three traditional and generally accepted approaches to value may be used by assessing officials. These approaches are cost, including the actual cost new or historical cost less depreciation, the cost of reproduction new less any depreciation and plus any appreciation; income, including the past, present, and prospective gross and net earnings of the whole system as a unit; and market, including the par value, actual value and market value of the company's outstanding stocks and bonds during one or more preceding years.

(3) **Generally accepted appraisal practices.** "Generally accepted appraisal practices" are the appropriate application in the valuation of real, and tangible and intangible personal property, of accepted standards of professional appraisal

practice as described in the Uniform Standards of Professional Appraisal Practice issued by the Appraisal Standards Board of the Appraisal Foundation or the accepted standards of other nationally recognized professional appraisal organizations.

NEW SECTION

WAC 458-50-180 Appraisal practices relating to valuing intangible personal property. (1) **Unit valuation.** Unit valuation is a method of determining the market value of a company, business, or property as a whole without reference to individual parts or components. For example, a railroad company may have many miles of track, or a pipeline company may have many miles of pipe, but if the track or the pipe is not connected in a useful and interdependent way to the rest of the company's system as a whole, the track or the pipe have considerably less value. However, when all the interdependent assets of a company are working together and functioning synergistically as a unit, the value of the company as a whole is independent of the value of the component parts. Similarly, the roof or the walls of a house may have value independently of the structure as a whole, but the market value of the house, for purposes of taxation, is determined as a unit. Market value is the value of the unit as a whole, not a summation of fractional appraisals of the component parts. The unit value may have enhanced taxable value above what the sum of the value of the component parts may indicate. The department is specifically authorized to take into consideration "the value of the whole system as a unit," when valuing companies with operating property in more than one county or more than one state. (RCW 84.12.300; see also RCW 84.16.050.)

(2) **Situs, allocation, and apportionment.** Property taxes may only be levied upon property having situs in this state, in other words, upon property located in this state. The process of dividing up the unit value of a company among the states where it has a presence is called allocation. The process of dividing up the allocated state value among the taxing jurisdictions within a state is called apportionment. Once the taxable value, meaning the total value of a company's operating property in this state less the exempt value, has been determined, the taxable value is apportioned as required by law.

(3) **Valuation of exempt intangible personal property.** Assessing officials may use one of two methods, as appropriate, to determine the value of intangible personal property that is exempted from a company's unit value. The first method is the

method by which the true and fair value of the exempt intangible personal property is deducted from the true and fair value of the operating property at the system level to arrive at taxable value at the system or entity level. The second method is the method by which the true and fair value of exempt intangible personal property is excluded from the value of the operating property at the system level by using a valuation model that approximates the value of the nonexempt assets only. These two methods are explained in more detail as follows.

(a) The first method is a two step-process that involves valuing the entire company operation, the unit, as the first step, using any or a combination of the three traditional approaches to value. Then the exempt property is separately identified, valued, and deducted from the unit value. In valuing the exempt property, assessing officials use generally accepted appraisal practices, including sales of similar intangible personal property, capitalization rates obtained through those sales, or by identifying cash flows attributable to each intangible personal property asset. When using this method, the value resulting from deducting the exempt value of intangible personal property from the entire company value, is the taxable value at the system or entity level. From that value, the proper value must then be allocated to this state and apportioned to the local taxing jurisdictions by law.

(b) The second method involves an appraisal process using an appraisal model that intrinsically approximates the exclusion of exempt intangible value. This process assumes the existence of intangible personal property in the overall value of the company being valued, but does not specifically identify or value individual intangible personal property assets. Although the model may not actually exclude the value of exempt intangible personal property, it simulates the effect of exempting intangible personal property by producing a lower assessed value equivalent to the exclusion of exempt intangible property. When an assessing official uses this method, he or she must also make a reasonable effort to compare the valuation result reached with the valuation result reached by the method described in (a) of this subsection and place the most consideration and reliance on the value indicator which, in his or her professional judgment, best approximates the taxable value of the company. A showing of a reasonable effort means, at a minimum, documentation of the comparison of the results of both methods.

(4) **Unit value at the county level.** When a business operates in more than one location within a county, but is physically, economically, and functionally integrated, it may also be valued by the assessor as a unit. However, properties that share a name, for example, but are independently operated, such as bank branches, retail outlets, or hotels or motels that

are part of a chain, they should generally be valued as stand-alone enterprises, and not as physically, economically, and functionally integrated units. An assessor should consider the unit being assessed to be the same unit a typical purchaser would consider in an openly traded market. If the property being assessed would typically be purchased as a stand-alone and independent operation without reference to a larger entity, then that is how it should be assessed. If the property being assessed would typically be included in the purchase of a larger entity, then the assessor should consider the influence on value that being included within the larger unit would have on the property being assessed.

NEW SECTION

WAC 458-50-190 Valuation of particular assets. Computer software. (1) Computer software is generally exempt from property taxation. The exemption is specifically dealt with in RCW 84.36.600 (exemption), RCW 84.04.150 (definitions), and WAC 458-12-251. Computer software and embedded software is valued in accordance with RCW 84.40.037. RCW 84.36.070 and these rules (WAC 458-50-150 through 458-50-190) do not apply to computer software, and nothing in that statute or these rules may be construed to amend or modify that existing statute and the rule dealing with the property tax treatment of computer software.

(2) In valuing low income or other housing which qualifies for federal income tax credits, those tax credits are exempt from property taxation when they exist separate from the ownership right in the housing and when they are not inextricably linked to the real property.