

**PROPERTY TAX EXEMPTION OF
INTANGIBLE ASSETS
Implementation of Chapter 191, Laws of 1997
(ESSB 5286, 1997 Session)**

December 2000

**PROPERTY TAX EXEMPTION OF
INTANGIBLE ASSETS**

Report of the Department of Revenue

*Prepared Pursuant to
Chapter 191, Laws of 1997 (ESSB 5286)*

**Washington State Department of Revenue
Frederick C. Kiga, Director**

**Analysis by the Property Tax, Research, and
Legislation and Policy Divisions**

December 2000

November 21, 2000

TO: The Honorable Hans Dunshee, Co-chair
The Honorable Brian Thomas, Co-Chair
House Finance Committee

The Honorable Valoria Loveland, Chair
Senate Ways and Means Committee

FROM: Frederick C. Kiga, Director

SUBJECT: PROPERTY TAX EXEMPTION OF INTANGIBLE ASSETS

I am pleased to present to you the Department of Revenue's report on the property tax exemption of intangible assets. This study was conducted in response to ESSB 5286, which was enacted in 1997.

Section 7 of the legislation stated the following:

By December 1, 2000, the department of revenue shall 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 this act.

This report answers the questions prescribed in the legislation on tax shifts and losses and litigation. Additionally, it provides background information on Washington's statutes, the property tax assessment process, circumstances in Washington leading up to the 1997 exemption, and national trends in taxation and litigation related to intangible personal property. The appendices include the full text of relevant legislation and the fiscal note on ESSB 5286, a survey of states on taxation of intangibles, detailed information provided by county assessors, and a report on utility valuations prepared by the Department.

The report was compiled by the Property Tax, Research, and Legislation and Policy Divisions. Please call David Saavedra, Property Tax, at (360) 570-5861 or Don Gutmann, Research, at (360) 570-6073 if you have questions about the contents.

cc: Governor Gary Locke

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PROPERTY TAX EXEMPTION OF INTANGIBLE ASSETS
Implementation of Chapter 191, Laws of 1997
(ESSB 5286, 1997 Session)

EXECUTIVE SUMMARY

Washington's 1997 Legislature passed Chapter 181, Laws of 1997, amending RCW 84.36.070 to exempt from ad valorem taxation intangible personal property. Washington's property tax exemption statutes already excluded certain financial intangibles such as cash and accounts receivable from property taxation, but this change in the law significantly broadened the exemption. The exemption became effective for assessments as of January 1, 1998, and taxes collectible in 1999.

Section 7 of the legislation stated the following:

By December 1, 2000, the department of revenue shall 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 this act.

This report answers the questions prescribed in the legislation on tax shifts and losses and litigation. Additionally, it provides background information on Washington's statutes, the property tax assessment process, circumstances in Washington leading up to the 1997 exemption, and national trends in litigation related to intangible personal property. The appendices include the full text of relevant legislation and the fiscal note on ESSB 5286, a survey of states on taxation of intangibles, a report on utility valuations prepared by the Department, and detailed information provided by county assessors.

The Department's response to the study requirements is summarized below:

Changes in Assessed Value for State-Assessed Property (Intercounty Utilities)

- A fiscal note completed before the legislation passed estimated the value of state-assessed properties would decline by \$811 million (6.7 percent) in 1998, the first year.
- Actual state-assessed values in 1998 were \$879 million less than they would have been without broadening the exemption. This represents a 7.1 percent reduction. Assessed values totaled \$11.5 billion rather than \$12.4 billion.
- For state-assessed properties, 1999 assessed values were \$775 million less than they would have been. This represents about a 5.9 percent reduction. Assessed values totaled \$12.4 billion rather than \$13.2 billion.

Changes in Assessed Value for Locally-Assessed Property

- The fiscal note written for the exemption estimated the loss for locally-assessed property at \$1.153 billion for the 1999 assessment year.
- The Department surveyed each of the 39 county assessors and asked if the intangibles exemption resulted in an impact on local assessed values. Six counties responded with an estimate of impacts for the 1999 assessment year as follows:

Adams County	\$20,000,000
Clallam County	25,000,000
Pierce County	8,200,000
Thurston County	8,000,000
Whatcom County	100,000,000
Whitman County	200,000
Total Assessed Value	<u>\$161,400,000</u>

Tax Shifts and Losses

- The primary impact of the exemption on other property owners has been to cause a property tax shift from state-assessed utilities and complex commercial property owners to residential and general commercial property owners. Total tax shifts (state and local) in 2000 are estimated to be \$9.7 million. This translates into a \$2.96 increase in property taxes due for the owner of a residence valued at \$100,000.
- There was no revenue loss to the state General Fund because all of the state impact is represented by tax shifts. Local revenue losses are estimated to be \$1.5 million in calendar year 2000. This local loss is attributable to taxing districts which could not absorb the shift because they are up against their statutory tax rate limit.

Litigation

- There are no recent decisions in the state of Washington that specifically address the inclusion of intangible personal property in assessments. Four cases are pending in boards of equalization in Snohomish, King and Adams Counties, one case in the Board of Tax Appeals in Adams County, and a circumstance in which a taxpayer has paid under protest in Kitsap County Superior Court.
- On a national level, courts have dealt with issues primarily focused on state-assessed valuations and have generally supported current valuation methods used by Washington.

The Department's conclusions and recommendations are summarized below:

- The actual value loss for the 1998 assessment year is somewhat higher than expected for state-assessed property and somewhat lower than expected for the 1999 assessment year. The actual value loss for locally-assessed property is significantly less for those counties that reported to the Department. For state-assessed property the actual value loss was \$879 million compared to a fiscal note forecast of an \$811 million loss. For locally-assessed property the actual value loss was \$161 million compared to an estimated \$1.082 billion.
- The new exemption has not created a litigation backlog in the courts. Aside from a few cases waiting to be heard, this issue has not been litigated at any level in the past two years. Assessors have either maintained their assessment practices or made minor changes to their methods to ensure that intangibles are not assessed.
- The exemption provided by ESSB 5286 is also compatible with the national trend to exempt intangible personal property and, more importantly, is similar to statutes of the fourteen western states.
- Long-term impacts are not known. The trends in other states are fairly recent and do not provide information indicating what could happen in Washington State. It will take several years for the impacts of this legislation to be fully realized or measured. The few cases now pending are fairly recent filings. As time progresses, it is anticipated that the interpretation of this exemption and its implementation by state and local government may be refined by the judicial system.
- Because of this uncertainty over long-term effects, it is recommended that the Department prepare a periodic study of the tax shifts and losses and litigation results.

CHAPTER 1: WASHINGTON STATE BACKGROUND

WASHINGTON STATE LEGISLATIVE BACKGROUND

Under the Washington State Constitution, the term “property” is very broadly defined to “include everything, whether tangible or intangible, subject to ownership.” There are two classes of property: real and personal. Intangibles are usually classified as personal property. However, sometimes certain attributes of intangible personal property influence the value of real property.

Taxable real property is defined in RCW 84.04.090, with certain exceptions, to include:

...the land itself, whether laid out in town lots or otherwise, and all buildings, structures or improvements or other fixtures of whatsoever kind thereon,...

Taxable personal property is defined in RCW 84.04.080 to include:

...all goods, chattels, stocks, estates or moneys;...and all property of whatsoever kind, name, nature and description;...*Provided*, That mortgages, notes, accounts, certificates of deposit, tax certificates, judgements, state, county, municipal and taxing district bonds and warrants shall not be considered as property for the purpose of this title, and no deduction shall hereafter be made or allowed on account of any indebtedness owed.

The first statutory exemption of intangible personal property was enacted in 1931 (Laws of 1931, ch. 96, s. 1.). Financial intangibles such as cash, mortgages, notes, certificates of deposit, judgments, moneys on deposit, stocks and bonds were exempted from property tax. This exemption was codified as RCW 84.36.070 in 1961 (Laws of 1961, ch. 15, s. 15.). In 1974 the Legislature broadened the exemption to also exempt nongovernmental personal service contracts or private nongovernmental athletic or sports franchises and agreements (Laws of 1974, Ex. Sess., ch. 118, s. 1.). At the time RCW 84.36.070 was amended in 1997, statute exempted financial intangibles¹ from property taxation, private nongovernmental personal service contracts, and private nongovernmental athletic or sports franchises and agreements, which did not pertain to the use or possession of tangible personal or real property.

The 1997 amendments to RCW 84.36.070, embodied in ESSB 5286 (see Appendix A), changed the structure of the statute and specifically listed the types of intangible personal property, other than financial intangibles and sports contracts and franchises, that are exempt from property tax (Laws of 1997, ch. 181, s. 1.). Under the revised statute, three different types of intangible personal property are exempt from taxation: (1) financial intangibles; (2) private nongovernmental service contracts and private nongovernmental athletic or sports franchises or agreements that do not pertain to the use or possession of tangible personal or real property; and

¹ Financial intangibles include mortgages, security agreements and security interests under the Uniform Commercial Code, all money on deposit in banking institutions, solvent credits, notes, debentures, shares of capital stock, bonds, deeds of trust, and cash on hand.

(3) other intangible personal property such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, core deposits of financial institutions, noncompete agreements, customer lists, patient lists, favorable contracts, favorable financing agreements, reputation, exceptional management, prestige, good name, or integrity of a business (sometimes referred to as intangible assets). The amended statute specifically does not preclude the use of, or departure from, generally accepted appraisal practices and the appropriate application in the valuation of real and tangible personal property.

Washington deals with property taxation of computer software, which is treated as a subset of intangible personal property in some states, in a separate statute. Certain types of computer software are exempt under RCW 84.36.600 which was enacted in 1991. RCW 84.36.600 specifically exempts all custom software (except embedded software), retained rights in computer software, modifications to canned software (but the underlying canned software is taxable under RCW 84.40.037), and master or golden copies of computer software. (RCW 84.36.600.)

WASHINGTON STATE PROPERTY ASSESSMENT PROCESS

County assessors have the statutory obligation to identify and assess (value) all taxable property, both real and personal, that is located in their county. One exception to this is the valuation of intercounty utilities. Generally referred to as state-assessed properties, they are inventoried and assessed by the Department of Revenue as operating companies. The valuation information is then forwarded to the appropriate counties for placement on the local tax rolls.

The development of an inventory of real and personal property involves three distinct processes.

- For real property, assessors identify every legal parcel of real property and physically inspect it on a regular basis. Statutes mandate that assessors maintain current maps and characteristics of site and improvements. There are requirements in law for regular inspections and routine updates of physical information as well as assessed values.
- For personal property, owners of taxable personal property are required to submit an affidavit to the assessors each year that lists all personal property in their ownership or control.
- For state-assessed properties, each company is required to compile and submit an annual report that includes a significant array of information ranging from asset listings (similar to a personal property affidavit) to audited financial statements and stockholder reports.

The methods for determining assessed value of real and personal property are defined in statute and allow for the use of the three commonly recognized valuation methodologies:

- Sales Comparison Approach--a comparison of a subject property to comparable properties that have recently sold.
- Cost Approach--an estimate of what it would cost to build a comparable structure, recognizing the subject's physical state and position in the market.
- Income Approach--for properties that are typically bought and sold as income-producing assets, an estimate of the net operating income (gross operating revenue less operating expenses) and capitalization of that estimate by a rate developed by the market. This rate is typically developed by analyzing the expectations and actions of buyers and sellers of recently sold, comparable properties. Cash flow expectations for future years can also be analyzed and discounted to the present to estimate the value of income-producing property. This type of analysis is more typical in larger, institutional-quality commercial investments.

The methodologies that are best suited for an individual property or property type are determined by reviewing the actions of the market of relevant buyers and sellers. It is also important to assess the quality of data and analysis that is available to the appraiser at the time of the appraisal. Washington statutes encourage the use of, and reliance on, a sales comparison approach whenever possible, but acknowledge the relevance and necessity of all the noted approaches in certain circumstances.

For residential properties, use of a sales comparison approach is most common. Another popular method is the use of a cost model that has been adjusted to account for the specifics of an area or property type, based on sales in the area. There is typically no intangible personal property associated with the valuation of residential properties.

Simple commercial properties include those properties that are generally leased for business-related purposes, generating rent to the owners. Because this is the viewpoint of the market of buyers and sellers, this has typically been the viewpoint reflected by the valuations generated for assessment purposes. These types of properties can be valued by the sales comparison approach, the cost approach, and by using an income approach that estimates the level of market rent (income) and related expenses that a similar property can be expected to incur in that market. Even if the user owns these types of properties, typical market rent analysis usually can be applied to provide an indication of value that would be relevant to the general marketplace. In the valuation of simple commercial properties, there is also little likelihood of intangible personal property value being included. In the income approach, the income being analyzed is the rent and related expenses associated with the usage of the land and buildings. As such, there is no recognition of any intangible relationships or rights that are being housed in the real estate. The same is true for a sales comparison analysis. Properties with similar characteristics are generally bought and sold exclusive of tenancies by investors, with greater consideration being given to long-term market rent and appreciation potentials. Complex commercial and industrial properties are a unique class of properties where it is more difficult to estimate the value of the real estate exclusive of the user. These are often properties

that in order to have operational value require an inclusion and integration of various real and personal property assets that cannot stand alone. They are also often built by owner-users as an integral part of the business rather than for independent, income-producing potential. Examples of these properties are hotels and resorts, and manufacturing facilities such as sawmills, refineries, and paper manufacturing. All three approaches to value are appropriate for the valuation of these types of properties, but the analysis can be complex. It is often difficult to develop a reliable sales comparison approach for these properties because they are each often unique, the sales are limited in number, and/or the analysis of the sales is difficult or unclear. Cost approaches have been commonly used for these properties in the past. However, it can be difficult to account for all the assets and estimate their value as a component of the overall property. There are also typically significant "soft" costs that are associated with the integration, design, and financing of large projects over a long period of time that can be difficult to incorporate into the final value estimate. Income approaches can be utilized for these types of properties, but it is essential to be clear and consistent in the utilization of an appropriate revenue estimate (and appropriate costs) that are attributable to the property that is taxable.

For central assessments (public utilities assessed by the Department of Revenue) the same issues that are relevant in the valuation of complex properties apply. There is, however, an additional analysis of stock prices and associated company debt that has been noted in statute and has historically been a significant indicator in the valuation of utility companies overall.

In complex industrial properties there is greater potential that intangible personal property may exist. If an income analysis is generated that begins with consideration of business revenue, there is the potential that intangible personal property values may be included. If sales are considered, there is also a potential that the properties that changed hands included both taxable and nontaxable value.

The same is true in any income analysis, sales comparison, or analysis of stock values and related debt that is done in the valuation of state-assessed properties.

Therefore, prior to 1998, the methodologies allowed by statute were only likely to recognize and include intangible personal property incorporated and associated with complex commercial and utility properties. It is also likely that the inclusion of intangible personal property varied depending on the methods utilized by each appraiser or assessor and the skill and quality represented by the individual appraisals.

EVENTS PRIOR TO 1997 EXEMPTION

Changes in IRS Laws Accentuate Presence of Intangible Personal Property

Intangible personal property was legally recognized as taxable prior to 1998. Some assessors included it (at least to some degree) in the assessments of complex properties in some cases where an income approach or sales approach generically recognized related value. Assessors did not inventory and value these assets based on the literal definitions of taxable intangible personal property. Some assessors, until the early 1990s, had little awareness that this property was specifically taxable. No counties actively strove to inventory intangible personal property, or assess it.

Not until the mid-1990s when Internal Revenue Service rules changed did the treatment of intangibles for property tax purposes emerge as a discrete issue with regards to local property assessments. In 1993 the IRS allowed for accelerated depreciation of purchased intangible personal property assets. Owners began to show them more frequently on asset listings and these assets began to appear more frequently on personal property affidavits being submitted to assessors.

For example, if you purchased the practice of a retiring professional (a dentist, for example) you would likely acquire the tangible personal property of the retiring dentist, but a majority of the value would have been the exclusive access to the patient lists. The value associated with the patient lists could be identified as an asset, with a related value, and depreciated over 15 years. Prior to 1993, it was more common to have business transactions with all the value associated with tangible assets because they provided the most advantageous depreciation opportunities.

As these assets began showing up more frequently on the affidavits, some assessors began specifically assessing them as a personal property asset--typically at the original value noted on the affidavit. Property owners who had identified intangible personal property which was being assessed and taxed became disgruntled, not only because they were not aware that these assets were taxable, but also because there was an apparent inequity: patient lists, etc., were not assessed unless they were recently acquired. The same assets owned by a business that had not been sold were unlikely to be listed and assessed.

Assessors, on the other hand, were unable to accurately inventory or value intangible personal property countywide. By definition, these assets have no physical presence and typically cannot be recognized until someone has purchased them and indicated that there is value.

Estimated Universe of Intangible Personal Property Value

The theoretical question has been raised: If county assessors had been able to locate, establish a situs for, and assess all intangible personal property unrelated to real or tangible personal property, how much value was potentially unassessed?

It is extremely difficult to provide a definitive answer because the universe of property is not identifiable. The Department can only provide an estimate of the value of intangible personal property based on some reasonable assumptions.

There are three years of estimates of the valuation of state-assessed properties. These estimates indicate that, overall, intangible personal property assessed prior to the exemption is between 5.6 percent and 7.1 percent of the assessed values that are being estimated currently (subsequent to the exemption).

For complex industrial and commercial properties, a similar range of intangible value could be assumed. This would recognize the full range of intangible personal property assets that could be presumed to exist if property assessments for commercial properties were based on an evaluation of business income rather than market rent or property-related income alone. This would appropriately identify relevant assets such as goodwill, client lists, professional libraries, favorable contracts, and the numerous other intangible personal property assets that had been identified as taxable in the pre-existing statutes.

If this percentage estimate is applied to the statewide 2000 value of commercial and industrial property, the universe of taxable intangible personal property is estimated to range as follows:

At 5.6 percent	\$5.3 billion
At 7.1 percent	6.9 billion

Assessor Use of Income Approach Methods Increases

During the mid-1990s, assessors statewide became more knowledgeable in the application and utilization of income approach methodologies. Where, historically, assessors had typically valued complex commercial property exclusively by the cost approach, they were now more confident in analyzing income and expenses and accounting for the value of the assets as a going concern. In some cases, this resulted in significantly higher assessed values for commercial properties.

Several counties were also requesting income information from tenants of general commercial properties as part of the revaluation process. Some taxpayers became concerned that assessors would value their business income rather than market rents for the real property.

DOR Successfully Defends Taxation of Intangible Personal Property in State-Assessed Properties

Meanwhile, Burlington Northern (BN) challenged the Department on their assessed values and uniform treatment. BN alleged discrimination because the Department's valuation of the company included intangible value, and alleged these values were not assessed at the local level. Thus, they claimed a "de facto" exemption was awarded to properties valued by county assessors. The Federal Court disagreed, stating that county assessors had valued "some" intangibles, and that any discrimination was remedied by the proper application of the equalization process employed by the state.

The equalization process referred to is the Department's annual ratio study of assessed values to determine the level of actual assessment relative to market value in each county. The study is primarily a review of the difference between the sale price and the assessed value at the time of sale for properties that have sold. Two main purposes of the ratio that is developed from this study is to adjust the state school levy in each county to "equalize" statewide collections and to adjust state-assessed utility valuations to the level of assessment in each county.

One aspect of this study is the analysis of personal property. While there is an active and well-documented market of real property transactions, there is little traceable information on the sales of personal property. To analyze this component of the assessment rolls, the Department randomly selects accounts from the personal property rolls in each county and does an account audit. This process includes the request and review of financial information for the business account selected.

The Federal Court's decision in the BN case created a higher profile for this issue. The decision clarified that these assets were taxable and should be inventoried and assessed. The Department included intangible personal property book values in the audits used in the ratio study. The added value in these accounts reduced the ratios in many counties, which resulted in increased state school levy rates in these counties.

In response, assessors began to specifically request inclusion of this information on the affidavits and included it in the assessment roll. Some businesses, in turn, became concerned that assessors would use methods that had commonly been used only on utility properties such as stock and debt analysis. Would assessors start using business income information as a basis for determining intangible personal property values?

Against this backdrop, the makeup of the nation and Washington State's economy was changing with a significant increase in intangible assets, particularly intellectual property. For many high technology and information-based companies, their most valuable assets are intangible assets. This heightened concerns that these assets were becoming susceptible to property assessment and taxation.

DOR Advises Assessors Not to Actively List and Assess Intangible Personal Property for Interim Period of Study

As this issue began to escalate, the Department became concerned that intangible values that may have already been picked up in some assessments of real property might be double assessed if assessors actively pursued listing and valuing personal property. It was felt necessary to maintain the status quo until the issue could be more clearly understood and explicitly addressed. In 1995 the Department wrote a letter to all assessors advising them not to ask for separate reporting of intangibles on the personal property affidavit. In 1996 another memo was sent. Noting the "complex challenges" associated with uniform identification and valuation of intangible personal property, the Department advised the assessors not to list and value intangible personal property separately. The Department also noted that its advice was provisional, since the issue may be addressed by the current legislature.

DOR Sponsors Multi-Stakeholder Task Force

As the controversy intensified, in 1995 the Department decided to work with stakeholders by organizing an independently facilitated task force to study the issue. The group included Department personnel, representatives of county assessors, and representatives of the Association of Washington Business, and was facilitated by Steve Seward, a private attorney from Seattle. The goals of the task force included an initial period of mutual education and research to better understand the scope of the issues. This process and subsequent discussion allowed the group to clarify points of agreement and consider differences.

The group worked for more than a year but was unable to arrive at a consensus recommendation on how to address the issue and whether to seek legislation. However, certain areas of general agreement were reached:

- A significant amount of intangible personal property that was legally taxable in Washington was not, and had never been, assessed.
- It was not feasible to administer a complete inventory of intangible personal property for assessment purposes because of the difficulty of identifying non-physical assets that had not necessarily been sold and, therefore, legally recognized.
- Even if the intangible assets could be generically identified, it would be extremely difficult to value them independently or accurately without sale activity and clear identification.
- Business representatives opposed broadening of the commercial tax base by specifically assessing intangible personal property assets.
- Assessors expressed concern that any solution must not compromise the ability to assess real property at its highest and best use. All parties agreed that assessments of real property continue to utilize generally accepted appraisal practices as outlined by Uniform Standards of Professional Appraisal Practice (USPAP).
- Proposed solutions had to recognize the potential for tax shifts, possibly to residential properties, that could be a consequence of any significant exemption of property value.

The goals of most parties included maintenance of as much of the existing system as possible. This included maintaining the "status quo" of real property valuation processes and procedures, maintaining the assessment of tangible personal property, and not requiring the separate listing and assessment of intangible personal property.

Legislation Proposed in 1996 and Passed in 1997

In 1996, legislation was passed by the Washington House of Representatives, but it did not pass in the Senate. Proponents stated that legislation was needed to prevent intangibles that were currently not assessed from being subject to the property tax in the future. A controversy

centered on whether the legislation would maintain the status quo or compel a change in assessment practices, thus creating unintended consequences.

Legislation was again proposed in 1997. This time it was passed by the House and Senate and signed into law by Governor Locke. The legislation included a provision requiring the Department of Revenue to study the impacts of the bill after implementation and report to the House and Senate fiscal committees and the Office of the Governor on tax shifts, tax losses, and litigation resulting from the act.

CHAPTER 2: RESPONSE TO STATUTORY REQUIREMENTS

STATE AND LOCAL IMPACT OF EXEMPTING INTANGIBLE PERSONAL PROPERTY

This section compares the actual impact of the intangible exemption on assessed values to those expected at the time the legislation was passed. It includes a description of the methodology for estimating the original value loss and the actual value loss. Finally, this section provides estimates of the shifts and losses for state and local property taxes resulting from the exemption for taxes due in calendar year 2000.

State- and Locally-Assessed Value Estimates and Methodology

In the original fiscal note, the Department estimated value loss for state-assessed properties through a series of meetings with representatives of the utilities. Five industry groups were interviewed and asked the impact of removing intangible property from their 1996 assessed value. In all, the Department interviewed 15 companies representing over 62 percent of the total assessed value of all state-assessed companies. The results of the sample data were then applied to the companies not interviewed. The fiscal note estimated the value loss at \$773 million for taxes due in calendar year 1997. Using growth rates contained in the Forecast Council's November 1997 forecast, the estimate grew to \$833 million for taxes due in calendar year 2000.

The fiscal note estimated the loss in value for locally-assessed properties at \$967 million for taxes due in calendar year 1997. The Department estimated this value loss through an analysis of ratio study appraisals. The difference between cost and market value was assumed to be a proxy for the value of intangible assets. It was estimated that 1.7 percent of the commercial and industrial property in each county represented intangible assets. State assessed properties were excluded from this calculation. The estimated value loss for taxes due in calendar year 2000 was \$1.153 billion.

The Department determined actual value loss for state-assessed properties by calculating a value for each state-assessed company with and without the intangible exemption. Utility value estimates were based on the cost, sales comparison, and income approaches to valuation. The actual value loss for taxes due in calendar year 2000 was \$775 million.

The value of exempted locally-assessed intangibles was determined for taxes due in 2000 by a survey of all 39 county assessors. This survey is summarized in Appendix D. Six county assessors responded with an estimate of the value loss. These were as follows:

Adams County	\$20,000,000
Clallam County	25,000,000
Pierce County	8,200,000
Thurston County	8,000,000
Whatcom County	100,000,000
Whitman County	200,000
Total Assessed Value	<u>\$161,400,000</u>

The following table summarizes the estimates for the actual value loss and the estimated loss contained in the fiscal note. All value losses are for taxes due in calendar year 2000.

	<u>Fiscal Note</u>	<u>Actual</u>
State-Assessed Property	\$833,000,000	\$775,000,000
Locally-Assessed Property	\$1,153,000,000	\$161,400,000

The Department's Property Tax Division maintains a database containing the real and personal property values for each state-assessed company across each property tax district within the state. The Property Tax Division calculated the value of exempted intangibles for each company that the Division assesses. This intangible value was allocated to every taxing district by multiplying the company's value of intangibles by the percentage of the personal property owned by a company in that district as compared to the statewide value of personal property owned by the company.

Tax Shifts and Loss Estimates and Methodology

The Research Division maintains a property tax model containing the value, rate and levy for all taxing districts in Washington. The Division also has all the data necessary to compute the maximum allowable levy under statutory levy limitations for all regular taxing districts. This allows the replication of current law property tax levies across the state. The latest information available is for taxes due in calendar year 2000.

Once the intangible values were added to each district's tax base, the allowable levy was recalculated and a new rate was determined with the higher assessed value. For special levies the current law levy was used to compute a new rate by using the increased assessed value. The new recalculated levies and tax rates were compared to the actual levies and tax rates for each taxing district and losses and shifts were computed.

The following tables show local shifts and losses by county and by type of taxing district. For taxes due in calendar year 2000, losses to local property tax districts totaled \$1,466,600 while shifts in local property tax levies were \$6,924,500. Losses generally occur in those districts whose tax rates are at their statutory rate maximums. If the value of the intangibles were added to the tax base the district would have been able to generate additional revenue subject to its levy

limit. Shifts occurred when a district is levying its maximum allowable levy. Any increase in value only results in a lowering of the district's tax rate.

LOCAL REVENUE IMPACT OF EXEMPTING INTANGIBLES BY COUNTY
1999 ASSESSED VALUES FOR TAXES DUE CALENDAR YEAR 2000

<u>County</u>	<u>Loss</u>	<u>Shift</u>
Adams	\$179,100	\$137,500
Asotin	4,000	10,600
Benton	8,800	138,300
Chelan	7,000	91,600
Clallam	16,400	222,300
Clark	71,100	224,200
Columbia	3,200	10,200
Cowlitz	16,300	61,000
Douglas	8,400	28,900
Ferry	9,100	3,900
Franklin	106,100	52,300
Garfield	3,300	3,700
Grant	29,400	60,300
Grays Harbor	7,000	71,000
Island	3,500	45,900
Jefferson	100	29,200
King	80,400	1,494,500
Kitsap	33,700	111,300
Kittitas	500	50,100
Klickitat	3,100	35,800
Lewis	32,000	164,100
Lincoln	27,100	23,200
Mason	2,600	32,400
Okanogan	7,900	38,200
Pacific	2,700	16,100
Pend Oreille	4,900	16,600
Pierce	268,500	581,500
San Juan	200	2,400
Skagit	3,500	179,500
Skamania	3,800	22,500
Snohomish	75,300	467,000
Spokane	32,400	443,300
Stevens	45,400	26,000
Thurston	64,900	270,000
Wahkiakum	100	8,900
Walla Walla	39,300	312,600
Whatcom	78,500	1,205,600
Whitman	11,900	119,000
Yakima	175,100	113,000
Total	\$1,466,600	\$6,924,500

**LOCAL REVENUE IMPACT OF EXEMPTING INTANGIBLES BY DISTRICT
1999 ASSESSED VALUES FOR TAXES DUE CALENDAR YEAR 2000**

<u>District Name</u>	<u>Loss</u>	<u>Shift</u>
County Current Expense	\$133,300	\$1,104,800
County Road	174,000	564,100
Cities	225,800	1,290,200
Local Schools	0	3,163,000
Libraries	233,000	50,200
Hospitals	82,700	67,900
Fire Districts	517,900	305,100
Metro Park	8,900	8,000
EMS	47,900	115,700
Ports	20,100	209,200
Other Districts	23,000	46,300
Total	\$1,466,600	\$6,924,500

The state property tax levy experienced shifts totaling \$2,752,000 for taxes due in calendar year 2000. The state levy was at its maximum allowable levy and any increase in value due to intangibles would only cause a lower tax rate with resulting shifts.

One measure of the impact of the intangibles exemption is its impact on a typical homeowner. What would be the tax savings for a \$100,000 home if the value of intangibles were added to the tax base? The dollar savings for taxes due in calendar year 2000 are estimated at \$2.96.

**LEGAL ACTIVITY RELATED TO THE EXEMPTION
OF INTANGIBLE PERSONAL PROPERTY**

This section contains a description of legal activity in Washington State and nationally with emphasis on the 14 western states.

Legal Activity in Washington State

The Department conducted a survey of 39 counties that revealed few cases or appeals related to intangibles. Four counties responded that they have pending appeals. Most appeals reported in these counties are at the level of the local Board of Equalization.

Kitsap County reported one property owner who has recently paid taxes under protest, an indication of possible future litigation where intangibles are an issue; the amount of value reduction asked for by the taxpayer was not indicated.

Adams County reported that it had three appeals outstanding that are awaiting decisions from the local Board of Equalization and the State Board of Tax Appeals.

King County did not provide details on its current appeals relating to the claim of the unlawful inclusion of intangible personal property in its assessments. However, a Department of Revenue check with the local Board of Equalization indicates that there have been no decisions rendered in King County where intangibles have been raised as an issue. Two property taxpayers, however, have recently petitioned the Board citing intangibles specifically as an issue. The two taxpayers have requested that their assessed values be lowered by a combined \$5.2 million. King County also has at least one outstanding Superior Court case pending where intangibles are cited as an issue and for which a value reduction of \$18 million is being sought.

Snohomish County has an appeal pending in the local Board of Equalization concerning the value of a hotel. The taxpayer alleges an over-assessment of \$1.1 million, of which the inclusion of intangible value is one of several issues.

There have not been any cases at the State Board of Tax Appeals in the last two years (since the legislation passed) in which decisions have been made on the unlawful inclusion of intangibles. The Board's representative indicated that the subject of intangibles has been part of the discussion in several cases. However, no decisions or reductions in value have been directly associated with intangible personal property assets.

Legal Activity in Other States

The Department surveyed other states with emphasis on its western neighbors on current litigation where intangible personal property is an issue. Washington is a member of the Western States Association of Tax Administrators (WSATA) and a related organization called the Western States Association of Tax Representatives (WSATR). The fourteen states represented by both WSATA and WSATR are Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Texas, Utah, Washington, and Wyoming.

The few noteworthy cases in the WSATA/WSATR states include a June 9, 2000, decision from the Utah Supreme Court which issued a determination concerning intangibles and valuation methodologies in Utah Railway Co. v. Utah State Tax Commission, 2000 UT 49, 5 P.3d 652 (2000). Utah Railway contested several aspects of Utah's Property Tax Division's valuation. Specifically, the Railway asserted that the Division employed methodologies that improperly included intangible assets, which are not subject to taxation under constitutional and statutory provisions. The Railway also argued that the Utah State Tax Commission had a constitutional and statutory duty to make practicable and reasonable attempts to segregate intangibles from tangible personal property and deduct their value from the overall valuation of the Railway. However, when this case was argued before it, the Commission did not address Utah Railway's arguments concerning the separation and removal of intangibles for purposes of establishing taxable value, nor did it explain its reasons for refusing to address the issue. Because the Tax Commission failed to address the separation and removal of intangibles from the taxable value of the Railway, the Supreme Court remanded the case back to the Tax Commission. The Tax Commission was ordered to consider the methodologies employed by the Property Tax Division and to determine whether they violated constitutional and statutory proscriptions against the taxation of intangibles.

In Wyoming, RT Communications, Inc. and Union Telephone Co. v. The State Board of Equalization of the State of Wyoming, 2000 Wyo. Lexis 198 (decided on 9/20/00), three telephone utility companies purchased telephone exchanges, distribution, and other assets including certificates of convenience and necessity from a large regional telephone utility. The telephone companies argued that the unitary method of valuation improperly included nontaxable intangible personal property. The court found that the unitary method, which values a company as a whole statewide working unit, was a rational valuation method for determining fair market value. Intangible property can be used in the unitary method as an element in the valuation of the tangible property to the degree that the intangible property enhances the value of the tangible property.

Similarly, in Beaver County, Davis County, Juab County, Millard County, Morgan County, Rich County, Salt Lake County Summit County, Tooele County, and Utah County v. WilTel, Inc., and Utah State Tax Commission, 2000 UT 29, 995 P.2d 602 (2000), the Utah Supreme Court stated that the increase of property value that results from both property and market components, however incorporeal, are not separately quantifiable as intangibles. The value of utility property cannot be regarded as merely land, buildings, and other assets. Its value depends on the interrelation and operation of the entire utility as a unit. Many of the separate assets would be practically valueless without the rest of the system.

Outside of the Western states, the Supreme Court in Wisconsin issued an opinion that supports the income approach in valuing of complex commercial property. In ABKA Limited Partnership v. Board of Review of the Village of Fontana-On-Geneva-Lake, 231 Wis. 2d 328 (1999), ABKA argued that the assessments made by the Board of Review improperly included income from the management of separately owned off-site condominiums and incorporated erroneous data and methodology. ABKA asserted that the income data improperly included intangibles in the valuation of its property. The Supreme Court held that ABKA's management income was income attributable to the land, rather than personal to the owner, and was inextricably intertwined with the land. Therefore, it was transferable to future purchasers. Therefore, it was proper to include the income data in the land's assessment because it appertains to the land and enhances its value.

Very few cases concerning the taxation of intangibles in the WSATA/WSATR states have been argued at the state supreme court, court of appeals, or federal court level since the beginning of 1997. The taxation of intangibles in Wyoming and Utah is similar to taxation of intangible personal property in Washington. The taxation of intangibles in California is so unique that any comparison of the case law from it and the case law from other states will not provide any useful information.

Wisconsin is the only state with litigation involving locally assessed property. The Wisconsin court affirmed the use of the income approach to valuation. In decisions in states outside the Western states, the courts have generally held that the unitary method of valuation is appropriate where intangible personal property is claimed to have been included in an assessment of centrally-assessed utility companies. They have also held that if the intangible attributes of the business enhance the value of the land, the intangibles can be included within the income method

of valuation and do not have to be removed. Accordingly, intangible personal property can be used as an element in the valuation of the tangible property to the extent that it enhances the value of tangible property. These decisions support the current valuation methods used by Washington.

CHAPTER 3: CONCLUSIONS AND RECOMMENDATION

State and Local Impact of Exempting Intangible Personal Property

Although the actual value loss for the 1999 assessment year is somewhat higher than expected for state-assessed property, the actual value loss for locally-assessed property is significantly less for those counties that reported to the Department. For state-assessed property the actual value loss was \$775 million compared to a fiscal note forecast of an \$833 million loss. For locally-assessed property the reported value loss was \$161 million compared to an estimated \$1.153 billion.

For taxes due in calendar year 2000 losses to local property tax districts totaled \$1,466,600 while shifts in local property tax levies were \$6,924,500. The state property tax levy experienced shifts totaling \$2,752,000 for taxes due in calendar year 2000.

One measure of the impact of the intangibles exemption is its impact on a typical homeowner. What would be the tax savings for a \$100,000 home if the value of intangibles were added to the tax base? The dollar savings for taxes due in calendar year 2000 are estimated at \$2.96.

Legal Activity Related to the Exemption of Intangible Personal Property

There are no recent cases in the state of Washington that specifically address the inclusion of intangible personal property in assessments. Cases are pending in boards of equalization in Snohomish, King and Adams Counties, the Board of Tax Appeals in Adams County, and a circumstance in which a taxpayer has paid under protest in Kitsap County Superior Court.

Courts have upheld the unitary method of valuation. They have also held that if the intangible attributes of the business enhance the value of the land, the intangibles can be included within the income method of valuation and do not have to be removed. Accordingly, intangible personal property can be used as an element in the valuation of the tangible property to the extent that it enhances the value of tangible property. These decisions support the current valuation methods used by Washington.

Recommendation

Because of uncertainty over long-term effects, it is recommended that the Department prepare a periodic study of the tax shifts and losses and litigation results.

APPENDIX A
COMPLETE TEXT AND FISCAL NOTE: ESSB 5286, 1997 SESSION

ENGROSSED SUBSTITUTE SENATE BILL 5286

State of Washington
Session

55th Legislature

1997 Regular

By 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)

Read first time 03/10/97.

AN ACT Relating to intangible personal property; amending RCW 84.36.070; adding a new section to chapter 84.48 RCW; and creating new sections.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

Sec. 1. RCW 84.36.070 and 1974 ex.s. c 118 s 1 are each amended to read as follows:

(({- The following -})) {+ (1) I +}ntangible {+ personal +} property (({- shall be -})) {+ is +} exempt from ad valorem taxation(({- : -}))}{+ .

(2) "Intangible personal property" means:

(a) +} All moneys and credits including mortgages, notes, accounts, certificates of deposit, tax certificates, judgments, state, county and municipal bonds and warrants and bonds and warrants of other taxing districts, bonds of the United States and of foreign countries or political subdivisions thereof and the bonds, stocks{+ , +} or shares of private corporations(({- , -}))}{+ ;

(b) P +}rivate nongovernmental personal service contracts (({- or -}))}{+ , +} private nongovernmental athletic or sports franchises{+ , +} or private nongovernmental athletic or sports agreements provided that (({- such -})) {+ the +} contracts, franchises{+ , +} or agreements do not pertain to the use or possession of tangible personal or real property or to any interest in tangible personal or real property{+ ; and

(c) Other intangible property such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, core deposits of financial institutions, noncompete agreements, customer lists, patient lists, favorable contracts, favorable financing agreements, reputation, exceptional management, prestige, good name, or integrity of a business.

(3) "Intangible personal property" does not include zoning, location, view, geographic features, easements, covenants, proximity to raw materials, condition of surrounding property, proximity to markets, the availability of a skilled work force, and other characteristics or attributes of property.

(4) This section does not preclude the use of, or permit a departure from, generally accepted appraisal practices and the appropriate application thereof in the valuation of real and tangible personal property +}.

{+ NEW SECTION. +} Sec. 2. A new section is added to chapter 84.48 RCW to read as follows:

(1) In equalizing personal property as of January 1, 1998, the department shall treat intangible personal property in the same manner as intangible personal property is to be treated after the effective date of this act.

(2) This section expires December 31, 1998.

{+ NEW SECTION. +} Sec. 3. This act shall not be construed to amend or modify any existing statute or rule relating to the treatment of computer software, retained rights in computer software, and golden and master copies of computer software for property tax purposes.

{+ NEW SECTION. +} Sec. 4. Nothing in this act is intended to incorporate and nothing in this act is based on any other state's statutory or case law.

{+ NEW SECTION. +} Sec. 5. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

{+ NEW SECTION. +} Sec. 6. This act is effective for taxes levied for collection in 1999 and thereafter.

--- END ---

Individual State Agency Fiscal Note

Bill Number: E SSB 5286	Title: AN ACT Relating to intangible personal property	Agency: 140 Department of Revenue
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Part I: Estimates

No Fiscal Impact

Estimated Cash Receipts to:

Fund	Fiscal Year 98	Fiscal Year 99	1997-99 Total	99-01 Biennium	01-03 Biennium
GF-STATE Property Tax		\$ (589,000)	\$ (589,000)	\$ (5,712,000)	\$ (15,737,000)
GF-STATE					
GF-STATE					
GF-STATE					
Other (specify)					
Total	0.00	\$ (589,000)	\$ (589,000)	\$ (5,712,000)	\$ (15,737,000)

Estimate Expenditures from:

Fund	Fiscal Year 98	Fiscal Year 99	1997-99 Total	99-01 Biennium	01-03 Biennium
FTE Staff Years	0.14		0.14		
Fund					
GF-State 001-1	\$ 17,900		\$ 17,900		
GF-Federal 001-2					
Other (specify)					
Total	\$ 17,900		\$ 17,900		

The revenue and expenditures estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

- If fiscal impact is greater than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.
- If fiscal impact is less than \$50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).
- Capital budget impact, complete Part IV.
- Requires new rule making, complete Part V.

Legislative Contact: Bob Longman	Phone: 786-7139	Date: 3/21/97
Agency Preparation: Don Gutmann	Phone: 586-0299	Date: 3/24/97
Agency Approval: Don Taylor	Phone: 753-5569	Date: 3/27/97
OEM Review:	Phone:	Date:

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Section 1 adds to the list of intangible personal property currently exempt from taxation under the RCW 84.36.070. Added to the meaning of intangible personal property are intangible assets, which are to include, but are not limited to: trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, customer lists, patient lists, reputation, prestige, and good name.

Section 2 provides that the Department of Revenue, in equalizing the personal property of intercounty and interstate utility that it values shall, as of January 1, 1998, treat intangible personal property in the same manner as provided in Section 1.

Section 3 makes clear that the changes in this measure are not to be construed to amend or modify any existing statute or rule relating to the treatment of computer software, retained rights in computer software, and golden and master copies of computer software for property tax purposes.

Section 4 indicates that this measure is not intended to incorporate, and nothing in the act is based on, any other state's statutory or case law.

Section 6 provides that the measure is effective for taxes levied for collection in 1999 and thereafter.

II. B - Cash Receipts Impact

ASSUMPTIONS / DATA SOURCES

- The loss in value for state assessed utilities is estimated at \$791 million for taxes due in calendar year 1998. This estimate was reached with industry input. Representatives of utility companies were asked what reduction in value would be expected if intangible assets became exempt.
- The loss in value for locally assessed properties is estimated at \$1.018 billion for taxes due in calendar year 1998. This loss was estimated through an analysis of ratio study appraisals. The difference between cost and market value was assumed to represent the value of intangible assets.

AUDIT ASSESSMENTS *(Impact resulting from recent audit activity)*

N.A.

CURRENTLY REPORTING TAXPAYERS *(Impact for taxpayers who are known or estimated to be currently paying the tax in question)*

The state school levy will experience a loss of \$1.1 million for taxes due calendar year 1999. Shifts of property taxes to homeowners and to businesses without intangible assets will total \$5.1 million during calendar year 1999. Losses in calendar year 2000 will be \$1.1 million while shifts will total \$5.5 million.

The effects of this proposal were simulated on local taxing district data for property taxes due in calendar year 1996. Local taxing districts would experience a loss of \$2.5 million with shifts totaling \$13.7 million.

TAXPAYERS NOT CURRENTLY REPORTING (Although some taxpayers may not now be paying the tax in question, some of them will become aware of their liability in the future, as a result of normal enforcement activities or education programs by the Department. The impact for such taxpayers is based on the Department's studies of average tax compliance)

N.A.

TOTAL REVENUE IMPACT:

State Government (cash basis, \$000):

	Loss	Shift
FY 1998 -	\$ 0	\$ 0
FY 1999 -	(589)	2,820
FY 2000 -	(1,093)	5,319
FY 2001 -	(4,619)	2,464
FY 2002 -	(7,685)	0
FY 2003 -	(8,052)	0

Local Government, if applicable (cash basis, \$000): See text above.

II. C - Expenditure Impact (Contact: Jim Thomas, 586-0722)

This proposal would require the amendment of two existing administrative rules. The Department uses administrative rules to explain the net effects of several statutes affecting the same subject. The total cost of drafting the proposed rule changes, holding hearings, printing and distributing copies of proposed and final rules would be approximately \$18,000. These rules would be placed on the agency's rule making docket, and the Department would attempt to absorb the rule making costs. However, should this bill and others pass which require the Department to create or amend additional rules beyond the scope of the agency's existing resources, it is possible that rule making might be delayed or that the agency would need additional resources to complete these rule changes.

Part III: Expenditure Detail

III. A -Expenditures by Object or Purpose:

	Fiscal Year 98	Fiscal Year 99	1997-99 Total	99-01 Biennium	01-03 Biennium
FTE Staff Years	0.14		0.07		
Salaries and Wages	\$ 6,600		6600.00		
Employee Benefits	1,800		1800.00		
Personal Service Contracts					
Goods and Services	8,900		8900.00		
Travel					
Equipment	\$ 600		600.00		
Grants and Subsidies					
Debt Service					
Interagency Reimbursement					
Total	\$ 17,900		\$ 17,900		

III. B - FTE Detail:

Job Classification	Salary	FY 98 FTEs	FY 99 FTEs	1997-99 Total	1999-01	2001-03
Review	\$46,900	0.010		0.010		
Tax policy	\$54,400	0.010		0.010		
TAX POLICY SPEC 3	\$50,532	0.096		0.096		
TAX POLICY SPEC 2	\$44,653	0.010		0.144		
HEARINGS SCHEDULER	\$26,146	0.011		0.02		
TAXPAYER SERVICES						
Total		0.14		0.14		

III. C - Expenditures by Program (optional)

Program	Fiscal Year 98	Fiscal Year 99	1997-99 Total	99-01 Biennium	01-03 Biennium
Total					

Part IV: Capital Budget Impact None.

Part V: New Rule Making Required

This bill would require the revision of two administrative rules, WAC 458-12-005 and 458-12-245. Parties interested in rule making would include county assessors and treasurers, local government officials, businesses, and taxpayer advocacy groups.

APPENDIX B SURVEY OF TAXABLE STATUS OF INTANGIBLES NATIONWIDE

NATIONAL TRENDS RELATED TO INTANGIBLE PERSONAL PROPERTY

A current survey of the constitutions and statutes of other states regarding the taxation of intangible personal property shows that several states exempt only financial intangibles, while other states specifically exempt personal property as a whole or intangible personal property specifically (see Appendix B). Computer software, for property tax purposes, is either considered intangible personal property or categorized as computer software in its own right. A brief overview of the taxable status of intangible personal property follows; any provisions of particular note will be outlined on a state by state basis:

- **Intangible personal property is taxable:** in Connecticut, Kentucky, Maine, Missouri, Ohio, Pennsylvania (except in certain specified counties), Tennessee, Virginia, and Vermont.

Vermont: Personal property owned by businesses is taxable but local government may elect to exempt it. If personal property is taxed, the revenue is to be used for municipal purposes only, not for schools.

- **Combination of taxable and exempt:** In some states, intangible personal property is both taxable and exempt depending on the type of ownership or character of the intangible personal property.

Arizona: According to statute, intangible personal property is subject to taxation but there is no statutory method established to value it, so it is untaxed at present.

Florida: Article VII, section 2 of the Florida Constitution states intangible personal property may be taxed at different rates but the rate shall never exceed 2 mills on the dollar of assessed value. All businesses and individuals in the state are required to file an annual intangible personal property tax return. However, intangible personal property is exempt if it is: (1) owned by a nonprofit organization; (2) owned, managed, or controlled by a trustee of a trust that is exempt from the intangible personal property tax; or (3) a leasehold estate in government property where the lessee is required to furnish space for public use by government agencies at no charge. Additionally, financial intangibles are exempt; these include money, franchises, partnership interests, pension plans or IRA accounts, mortgages, deeds of trust, accounts receivable and stock options.

Kansas: Mortgages, notes, and other evidences of debt are exempt from property tax levied by the state. However, local government may offset the resulting loss in revenue by imposing and levying any other taxes as may be authorized in an amount not to exceed the proceeds of the intangible personal property tax in the year prior to its elimination.

Louisiana: Intangibles are exempt under the constitution except intangible personal property held by the following is taxable: (1) PUD property; (2) loan and finance companies; (3) insurance companies; and (4) banks.

Maryland: Property Tax Code § 6-101 declares that intangible personal property is exempt for assessment and property tax. Nevertheless, Code § 6-301 states the intangible personal property is subject to state property tax at a rate set annually by the Board of Public Works under certain conditions at a rate not to exceed 15 cents per \$100 of assessment. Likewise, Code § 6-302 says that intangible personal property is subject to county property tax under certain conditions at a rate not to exceed 30 cents per \$100 of assessment.

New Jersey: N. J. Statute § 54: 4-1 declares that taxable personal property does not include intangible personal property. However, § 54: 10A-2 requires domestic and foreign corporations to pay an annual franchise tax in-lieu of all other state, county, or local taxes upon or measured by intangible personal property used in the course of doing business within the state.

- **Financial intangibles are exempt** in Alabama, California, Florida, Idaho, Indiana, Michigan, Washington, Wisconsin, and Wyoming.
- **Personal property is exempt as a whole** in Delaware, Hawaii, Illinois, Iowa, New York, Minnesota, North Dakota (except the personal property of entities, other than railroads, which are assessed by the state board of equalization), and South Dakota.
- **Personal property is taxable if local government has decided to tax it in Alaska.**
- **Intangible personal property is exempt** in Alaska, Arkansas, California, Colorado, Georgia, Louisiana, Massachusetts, Montana, Nebraska, Nevada, New Jersey, New Mexico, North Carolina, Oklahoma, Oregon, Rhode Island, South Carolina, Utah, Texas, Washington, and West Virginia. There are several statutory provisions of particular note:

Alaska: Intangibles are exempt in Anchorage and in most other municipalities.

California: The value of exempt intangible assets and rights "shall not enhance or be reflected in the value of taxable property."

Idaho: The legislature has directed the tax commission to adopt rules to provide for the exclusion of exempt intangible personal property from the taxable value of operating property.

Montana: The exemption for intangible personal property that is state-assessed is to be phased in over three years beginning in tax year 2000.

Nevada: Intangible personal property may not be considered in determining the value of taxable property.

Oregon: The intangible personal property of designated utilities is taxable.

West Virginia: The exemption of intangible personal property is currently being phased in - starting in 1998 and ending by tax year 2003.

- **Computer software is exempt** in California, Colorado, Connecticut, Michigan, North Carolina, and Washington. There are several statutory provisions of particular note:

Alaska: Canned computer software is taxable but custom software is exempt from taxation.

California: The storage media for computer programs is to be valued as if there were no computer programs on such media except for basic operational programs.

Michigan: Computer software is exempt unless it is a permanent component of a computer or its cost is included in the price of the computer.

North Carolina: Computer software is exempt unless it is embedded software or purchased or licensed from a person unrelated to the taxpayer and it is capitalized on the taxpayer's books.

Computer software is taxable in Louisiana if it is capitalized on a company's books or included in a depreciation schedule as part of another asset subject to taxation. However, this is not a uniform practice throughout the state; the decision to tax or exempt computer software is made at the individual parish or municipal level.

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
Alabama	Some exempt	<u>Ala Code § 40-9-1</u> : : mortgages, security agreements & security interests under the UCC, all money on deposit in banking institutions & all other solvent credits.		
Alaska	No info			
Arizona	No info			
Arkansas	Exempt	<u>§ 26-3-302</u> eff 1/1/76	<u>Amend. 57 § 1</u> states the general assembly may classify IPP ² for assessment at a lower % of value than other property & may exempt one or more classes of IPP or may tax IPP on a basis other than ad valorem.	
California	Exempt : notes, debentures, shares of capital stock, solvent credits, bonds, deeds of trust, mortgages, cash on hand, and Computer software	<u>Cal Rev & Tax Code § 212</u> “Intangible assets & rights are exempt & the value of intangible assets & rights shall not enhance or be reflected in the value of taxable property.” <u>Cal Rev & Tax Code § 995 & 995.2</u> : “storage media for computer programs shall be valued .. as if there were no computer program on such media except basic operational programs. Otherwise,		

² “IPP” means intangible personal property

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		computer programs shall not be valued for purpose of property taxation.”		
Colorado	Exempt	C.R.S. 39-3-118 exempts IPP from property tax; specifically includes computer software.		
Connecticut	Taxable Computer software exempt	Conn. Gen. State. § 12-71 all personal property is taxable but computer software is exempt effective 10/1/88.		
Delaware	No Info			
DC	No info			
Florida	<p>Taxable – annual intangible return req'd for businesses & individuals w/IPP in state.</p> <p>Exempt when owned by certain nonprofit orgs.</p> <p>Exempt if owned, managed, or controlled by a trustee of trust that is exempt from annual tax.</p> <p>Exempt if leasehold estate in gov't property where lessee is req'd to furnish space for public use by gov't agencies at no charge.</p> <p>Exempt: money, franchises, partnership</p>	<p>Fla. Stat. § 199.052</p> <p>§ 199.103 – basis of valuation;</p> <p>§ 199-106 credit for tax imposed by other states; § 199.183 taxpayers exempt from annual & nonrecurring taxes</p> <p>§ 199.023 defines IPP as personal property which is not in itself intrinsically valuable, but which derives its chief value from that which it represents.</p>	<p>Art. VII § 2 taxes on IPP may be at different rates but shall never exceed 2 mills on the dollar of assessed value.</p>	

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
	interests, pension plan or IRA, mortgages, deeds of trust, accounts receivable, stock options			
Georgia	Exempt	<u>O.C.G.A. §§ 48-6-20 thru 48-6-44</u> Intangible personal property tax repealed eff. 3/21/96.	GA Const. Art. VII, § I, para. III sets tax on intangibles but this tax may be repealed by gen. law on or after 1/1/96.	<u>Collins v. Lombard Corp.</u> , 270 Ga. 120 (1998) notes that IPP was repealed by the General Assembly.
Hawaii	No info			
Idaho	Exempt	<u>Idaho Code § 63-602L</u> (1) specifically exempts certain types of IPP; (2) allows taxpayer to choose one of three methods to use in excluding IPP from its taxable value.		
Illinois	Exempt	<u>Ch. 35, Title 9, Art. 24, § 35 ILCS 200/24-5</u> no ad valorem personal property tax after 1/1/79.		
Indiana	Exempt	<u>Ind. Code § 6-1.1-10-39</u> IPP is exempt – specific types are listed.		
Iowa	No info			
Kansas	Exempt at state level But locals may impose other tax in an amount equal to the amount of IPP in the year prior to its elimination.	<u>K. S. A. § 79-3109b</u> Purpose of IPP exemption. <u>§ 79-3109c</u> Money, notes & other evidence of debt exempt from property taxes levied by state; <u>§ 79-5020</u> local gov't may offset the resulting loss in revenue by		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		imposing & levying any other taxes as may be authorized in an amount not to exceed the amount of the proceeds of the IPP tax in the year prior to its elimination		
Kentucky	Taxable	<u>KRS Title XI, § 132.020</u> State ad valorem taxes – (2) \$0.015 tax on \$100 of value of 3 classes of IPP: 1. Accounts receivable, notes, bonds, etc., 2. Patents, trademarks etc., 3 Shares of capital stock; & 4 tobacco base allotments. Amended in 2000 to exclude shares of capital stock SB 336. <u>§ 132.190</u> all IPP of state residents & of corps organized in state unless it has acquired business situs w/o the state.		
Louisiana	No info			
Maine	Taxable	<u>Title 36, Part 1, Ch. 7 § 176-A:</u> levy upon property – IPP is taxable.	<u>Art. 9 § 8</u> declares that the legislature shall have the power to levy a tax upon IPP at such rate as it deems wise & equitable w/o regard to the rate applied to other classes of property.	
Maryland	Conflicting statutes ?????	<u>Md. Tax-Property Code § 6-101</u> states IPP is exempt from assessment & property tax.		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		<p>§ 6-301 says IPP is subject to state property tax at a rate set annually by the Board of Public Works under certain conditions at a rate not to exceed 15 cents per \$100 of assessment & § 6-301 says the IPP is subject to county property tax under certain conditions at a rate not to exceed 30 cents per \$100 of assessment.</p>		
Massachusetts	Exempt	<p>Mass. Laws ch 59, § 5, sec. 24 – all intangible personal property is exempt.</p>		
Michigan	<p>Exempt</p> <p>But computer software is taxable if it is a permanent component of a computer or the cost of the software is included in the price of the computer. Otherwise computer software is exempt & doesn't affect value of equipment.</p>	<p><u>Title 7, ch 59, MCL § 211.9e - § 7.9(5)</u> IPP is exempt from taxes. Sec. 9e. IPP is exempt from collection of taxes but this section does not affect the taxable status of computer software under section 9d.</p> <p><u>Title 7, ch 59, MCL § 211.9d - § 7.9(4)</u> computer software, exemption as to effect on value of equipment, definition of computer software.</p>		
Minnesota	No info			
Mississippi	No info			
Missouri	Taxable	Title 10, § 146.040 IPP is		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		deemed to have taxable situs & subject to property tax eff. 1947 when legal title is owned by state resident, by a domestic corp., or where IPP acquires a business situs in state. Person having legal title is liable for tax.		
Montana	Exempt Exemption for centrally assessed property to be phased in over three years beg. Tax year 2000	<u>Title 15, ch 6, Part 2, § 15-6-218</u> IPP is exempt for tax – if the property is not tangible personal property & (a) has no intrinsic value but is the representative of value or (b) lacks physical existence, including but not limited to goodwill. <u>The exemption for IPP that is centrally assessed</u> (other than net proceeds of mines or gross proceeds of coal mines) to be phased in over three years beginning in tax year 2000. 10% exempt in 2000, 2/3 is exempt in 2001, & totally exempt eff. 2002.		
Nebraska	Exempt	<u>R.R.S. Neb. § 77-201</u> : only tangible personal property is taxable.		
Nevada	Exempt	<u>Nev. Rev. Stat. § 361.228</u> : IPP is exempt & may not be		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		considered in determining value of taxable property.		
New Hampshire	No Info			
New Jersey	Exempt but in-lieu franchise tax is imposed	<u>N. J. Stat. § 54:4-1</u> declares the taxable personal property shall not include IPP. <u>N. J. Stat. § 54:10A-2</u> domestic & foreign corps. to pay an annual franchise tax eff. 1946. This franchise tax is in lieu of all other state, county, or local taxes upon or measured by IPP used in business by corps. subject to taxation.		
New Mexico	Exempt	<u>N.M. Stat. § 7-36-8</u> states only tangible personal property is subject to taxation.		
New York	Exempt	<u>NY CLS Real property tax law § 300</u> : all personal property (tangible & intangible) is exempt.	<u>NY CLS Art. XVI, § 3</u> : IPP shall not be taxed ad valorem - except income from IPP may be taken in consideration in calculating any excise tax measured by income generally.	
North Carolina	Exempt	<u>N. C. Gen. Stat. § 105-275 sec. 31</u> : IPP (other than leasehold interest in exempt real property) shall not be listed, appraised, assessed, or taxed. <u>Sec. 40</u> excludes computer software & any documentation		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		<p>related to the computer software; however, exclusion doesn't apply to embedded software or software purchased or licensed from a person who is unrelated to the taxpayer & it is capitalized on the books of the taxpayer.</p> <p><u>N. C. Gen. Stat. § 105-275.2:</u> provides a reimbursement formula to counties & municipalities for the repeal of the state tax on IPP.</p> <p><u>N. C. Gen. Stat. § 105-276:</u> exclusion of a class of IPP under <u>§ 105-275</u> doesn't affect the appraisal or assessment of real & tangible personal property.</p>		
North Dakota	Exempt	<p><u>N. D. Cent. Code § 57-02-08 (25):</u> all personal property is exempt except the personal property of entities (other than railroads) assessed by the state BOE.</p>		
Ohio	<p>Taxable</p> <p>Exemption for all tangible & IPP for 501(c(3) involved in library technology</p>	<p>ORC § 5709.02: all money credits, investments, deposits & other intangible property is subject to taxation but good will, license or franchise of a business shall not be</p>		<p><u>Bush & Cook Leasing, Inc., v. Tracy, Tax Commr.</u>, 79 Ohio St. 3d 87 (1997) "Under R.C. 5709.02 IPP of persons residing in this</p>

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
	development [ORC § 5709.72]	<p>considered property separate from the other property used in or growing out of such business.</p> <p><u>ORC § 5709.03</u>: tax levy on intangible property tax list.</p> <p><u>ORC § 5709.04</u>: tax levy on intangible property on classified tax list.</p>		state is taxable in Ohio unless situated in another state as a receivable under R.C. 5709.03(A).”
Oklahoma	Exempt		<u>Okl. Constit. Art. X, § 6A</u> : IPP is exempt from ad valorem or other tax (lists types of exempted IPP).	
Oregon	Exempt except designated utilities	<p>Title 29, ORS § 307-030: IPP is not subject to assessment & taxation except as provided in ORS 308.505 to 308.665.</p> <p><u>ORS § 307-030</u>: property (as used in ORS 380.505 to 308.665) includes all property real & personal, tangible & intangible, used or held by a company as owner, occupant, or lessee for or in use in the performance or maintenance of a business or service or in a sale of any commodity, as set forth in ORS § 308.510.</p>		
Pennsylvania	Appears taxable but the statutes are difficult to untangle but certain	<p><u>Title 53, Pa.C.S. § 2902</u>:</p> <p>All real, tangible or IPP is determined to be taxable by the</p>		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
	<p>types of IPP are definitely exempt from local in certain specified counties</p>	<p>general assembly. <u>Title 72, P..S. § 203:</u> Empowers the DOR to collect tax imposed upon certain personal property. <u>Title 72, P..S. ch 2</u> Personal Property Tax Act. Title 72, P..S. § 3250-10: Scrip, bonds, certificates, evidence of indebtedness are taxable for state purposes except first or nonprofit corporations. <u>Title 72, P..S. § 3244:</u> all personal property enumerated is taxable: mortgages, moneys owing, articles of agreement & accounts bearing interest, public loans, shares of stock, moneys loaned or invested in other states, moneys capital owing to state residents, & principal value of all annuities. <u>Title 72, P..S. § 4731:</u> Exempts mortgages, judgments, recognizances, & moneys owing upon article of agreement for the sale of real estate from all taxation except for state purposes in specified counties.</p>		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
Rhode Island	Exempt	<p><u>R.I. Gen. Laws § 44-3-1</u>: real & tangible personal property are liable for taxation.</p> <p><u>R.I. Gen. Laws § 44-3-2.1</u>: no city or town shall assess any tax on IPP.</p>		<p><u>Computer Assocs. Int'l, Inc. v. City of East Providence</u>, 615 A.2d 467 (R.I. 1992) – computer software constitutes IPP & isn't subject to personal property tax.</p>
South Carolina	Taxable	<p><u>S.C. Code § 12-37-210</u>: real & personal property & all moneys, credits & bonds, stocks, joint-stock companies are subject to taxation.</p> <p><u>S.C. Code § 12-37-940</u>: money, bank bills, credits, contracts for delivery of specific articles; leasehold estates, annuities shall be valued for taxation.</p> <p><u>S.C. Code § 12-37-10</u>: Personal property means all things, other than real estate, which have pecuniary value, & moneys, credits, investments in bonds, stocks, joint-stock companies or otherwise.</p>	<p><u>S.C. Const. Art. § 1</u>: real, personal & possessory property shall be taxed. The general assembly may provide for the assessment of all IPP at its true value for state, county, & municipal purposes.</p>	
South Dakota	Exempt (appears that all personal property is not taxed).	<p><u>S.D. Codified Laws § 10-4-1</u>: all REAL property is subject to taxation.</p>		
Tennessee	Taxable	<p><u>Tenn. Code. § 67-5-501</u>: IPP includes money, any evidence of debt owed, any evidence of</p>	<p><u>Tenn. Const. Art. II, § 28</u>: all real & personal property is subject to taxation. Property</p>	

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		ownership in a corp. or other business & all other forms of property, “the value of which is expressed in terms of what the property represents rather than its own intrinsic worth.” IPP includes all personal property not defined as tangible personal property.	shall be classified into three classes: real property, tangible personal property, & IPP. The Legislature is empowered to class IPP into subclassifications & to establish a ratio of assessment to value for each class or subclass.	
Texas	Generally Exempt; IPP governed by the Insurance Code is taxable if the state has jurisdiction to tax the intangibles.	<u>Tex. Tax Code § 11.02:</u> IPP is not taxable; IPP governed by Insurance Code is taxable unless exempt by law. <u>Tex. Tax Code § 1.04 (6):</u> IPP means a claim, interest (other than an interest in tangible property), right, or other thing that has value but cannot be seen, felt, weighed, measured, or otherwise perceived by the senses, although its existence may be evidenced by a document		
Utah	Exempt	<u>Utah Code § 59-2-102:</u> defines “property” as property that is subject to assessment & taxation according to its value. “Property” does not include intangible property Based on this definition it appears the IPP is not taxable.		

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
Vermont	No info			
Virginia	Taxable	<p><u>Va. Code § 58.1-100</u>: insurance taxes, licenses on insurance companies taxable IPP, rolling stock of operating railroads & all other classes of property not specifically exempted or reserved for local are segregated & subject to state taxation only.</p> <p><u>Va. Code § 58.1-1100</u>: IPP, including capital of a trade or business, except merchants' capital, is segregated for state taxation only.</p> <p><u>Va. Code § 58.1-1101</u>: defines types of IPP that are subject to taxation.</p> <p><u>Va. Code § 58.1-1102</u>: IPP of certain poultry & livestock producers is exempt.</p> <p><u>Va. Code § 58.1-1103</u>: IPP tax doesn't apply to any profession that Va. regulates, to industrial development corps. organized under §§ 13.1-981 thru 13.1-998, or to the business of farming. Property used in such exempt activities are taxable in the actual form in which it exists & not as IPP.</p>	<u>Va. Const. Art. § 1</u> : all property shall be taxed.	

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
Washington	Exempt	See RCW 84.36.070		
West Virginia	Exempt	<u>W. Va. Code § 11-1C-1b</u> : phase out of tax on IPP: IPP with taxable situs that would have been taxable prior to 4/12/97 is exempt from ad valorem property tax beg. tax year 1998 at 50% of AV ³ ; at 40% of AV for tax year 1999; at 30% of AV for tax year 2000; at 20% of AV for tax year 2001; at 10% of AV for tax year 2002; & eliminated completely for tax year 2003.	<u>W. Va. Const. Art. X, § 1a</u> : all IPP shall be exempt from ad valorem property tax.	
Wisconsin	Exempt	<u>Wis. Stat. § 70.112</u> : money & all IPP, such as credit, checks, share drafts, other drafts, notes bonds, stocks & other written instruments are exempt from general property tax.		
Wyoming	Exempt	<u>Wyo. Stat. § 39-11-101(a)(vii)</u> : defines IPP – money & cash on hand, money on deposit, accounts receivable & other credits, bonds, promissory notes, debentures & other evidences of debt, shares of stock, judgments for payment of money, annuities & annuity		

³ “AV” means assessed value.

STATE	TAXABLE OR EXEMPT	STATUTORY PROVISIONS	CONSTITUTIONAL PROVISION	RECENT COURT CASES
		<p>contracts. <u>Wyo. Stat. § 39-11-105(a)(xxix)</u>: IPP is exempt except as specified in W.S. 39-13-103(b)(xi) [applies to water & reservoir rights].</p>		

APPENDIX C
**IMPACT OF ESSB 5286 LAWS OF 1997 EXEMPTING INTANGIBLE
PERSONAL PROPERTY ON STATE-ASSESSED PROPERTIES**

November 15, 2000

TO: Frederick C. Kiga, Director
William N. Rice, Deputy Director

FROM: Sandra G. Guilfoil, Assistant Director
Property Tax Division

**SUBJECT: IMPACT OF ESSB 5286 LAWS OF (1997) EXEMPTING INTANGIBLE
PERSONAL PROPERTY ON STATE-ASSESSED PROPERTIES**

This memorandum summarizes the impact of ESSB 5286, laws of 1997 on assessments for state-assessed (utility) properties for the 1998, 1999, and 2000 assessment years. As required by this legislation, the Department of Revenue (“DOR”) will issue a detailed report to the Legislature in December 2000 on the financial impacts of this exemption.

Exhibit A displays the actual 1998, 1999, and 2000 values for state-assessed properties compared to the estimates provided in the ESSB 5286 fiscal note. (The fiscal note is included as an attachment to this memorandum.) The data indicates that for 1998, 1999, and 2000, intangibles represented an estimated 7.1 percent, 5.9 percent, and 5.6 percent of the total value of state-assessed properties. This compares to an estimated value of 6.7 percent in the fiscal note. The total value of state-assessed properties without intangibles for 1998, 1999, and 2000 exceeded estimated values in each of the three years.

EXHIBIT A – Values For State-Assessed Properties						
	<u>1998 Assessment</u>		<u>1999 Assessment</u>		<u>2000 Assessment</u>	
	Actual (\$ in millions)	ESSB 5286 Fiscal Note Estimate (\$ in millions)	Actual (\$ in millions)	ESSB 5286 Fiscal Note Estimate (\$ in millions)	Actual (\$ in millions)	ESSB 5286 Fiscal Note Estimate (\$ in millions)
Total Value of State-Assessed Property Before Exemption of Intangible Personal Property	\$12,364	\$12,155	\$13,166	\$12,470	\$14,502	\$12,795
Estimated Value of Intangible Personal Property	\$879	\$811	\$775	\$833	\$810	\$858
Intangible Personal Property as % of Value	7.1%	6.7%	5.9%	6.7%	5.6%	6.7%
Total Value of State-Assessed Property After Exemption of Intangible Personal Property	\$11,485	\$11,344	\$12,391	\$11,637	\$13,692	\$11,937

Exhibit B presents the estimated value of state-assessed properties including intangibles for 1998 by Utility Industry Group and compares it to the estimated values after exempting intangibles.

Two sets of value estimates had to be determined for each industry group. 1998 actual values, which exempted intangible personal property, were subject to review and appeal by the companies being assessed. Value estimates including intangibles were also developed by the Department for analysis purposes only. These value estimates were not provided to industry for comment or review.

EXHIBIT B – 1998 Values By Utility Industry Group				
Utility Industry Group	1998 Estimated Value Including Intangibles	1998 Estimated Value Without Intangibles	Implied Value of Exempted Intangibles	Intangible Value as a Percent of Total Value
Airline	\$1,422,202,974	\$1,346,581,213	\$75,621,761	5.3%
Electric	2,896,649,851	2,813,688,622	82,961,229	2.9%
Gas	1,185,679,442	1,125,208,583	60,470,859	5.1%
Pipe Line	657,032,382	591,465,019	65,567,363	9.9%
Private Car	215,548,565	211,352,555	4,196,010	1.9%
Railroad	707,996,251	674,821,251	33,175,000	4.7%
Wireless Telephone	970,092,300	727,421,300	242,671,000	25.0%
Telephone	4,213,523,356	3,899,231,656	314,291,700	7.5%
Water Transportation	<u>95,432,985</u>	<u>95,432,985</u>	<u>\$0</u>	0%
TOTAL	<u>\$12,364,158,106</u>	<u>\$11,485,205,184</u>	<u>\$878,956,922</u>	7.1%

Exhibits C & D present the estimated value of state-assessed properties including intangibles for 1999 and 2000 by Utility Industry Group and compares it to the estimated values after exempting intangibles.

Two sets of value estimates had to be determined for each industry group. The 1999 and 2000 actual values, which exempted intangible personal property, were subject to review and appeal by the companies being assessed. Value estimates including intangibles were also developed by the Department. These values were clearly presented in the appraisal process, allowing companies the opportunity for review and comment.

The year 2000 assessment data presented here does not reflect the implementation of Initiative 722 - An act relating to limiting taxes, passed by the voters of Washington on November 7, 2000.

EXHIBIT C – 1999 Values By Utility Industry Group				
Utility Industry Group	1999 Estimated Value Including Intangibles	1999 Estimated Value Without Intangibles	Implied Value of Exempted Intangibles	Intangible Value as a Percent of Total Value
Airline	\$1,438,760,567	\$1,337,530,340	\$101,230,227	7.0%
Electric	3,207,729,102	3,049,239,102	158,490,000	4.9%
Gas	1,285,115,000	1,211,557,000	73,558,000	5.7%
Pipe Line	683,588,000	639,632,000	43,956,000	6.4%
Private Car	200,372,057	196,474,821	3,897,236	1.9%
Railroad	735,481,041	691,424,041	44,057,000	6.0%
Wireless Telephone	946,447,000	849,826,398	96,620,602	10.2%
Telephone	4,668,997,350	4,415,820,700	253,176,650	5.4%
Water Transportation*	0	0	\$0	0%
TOTAL	<u>\$13,166,490,117</u>	<u>\$12,391,504,402</u>	<u>\$774,985,715</u>	5.9%

EXHIBIT D – 2000 Values By Utility Industry Group				
Utility Industry Group	2000 Estimated Value Including Intangibles	2000 Estimated Value Without Intangibles	Implied Value of Exempted Intangibles	Intangible Value as a Percent of Total Value
Airline	\$1,681,707,539	\$1,551,826,350	\$129,881,189	7.7%
Electric	3,351,399,000	3,159,369,000	192,030,000	5.7%
Gas	1,393,279,000	1,318,108,000	75,171,000	5.4%
Pipe Line	689,322,000	655,326,000	33,996,000	4.9%
Private Car	216,845,850	212,725,779	4,120,071	1.9%
Railroad	791,650,880	765,926,000	25,724,880	3.2%
Wireless Telephone	1,047,510,000	955,211,000	92,299,000	8.8%
Telephone	5,330,738,050	5,074,398,800	256,339,250	4.8%
Water Transportation*	0	0	0	0%
TOTAL	<u>\$14,502,452,319</u>	<u>\$13,692,890,929</u>	<u>\$809,561,390</u>	5.6%

* Beginning with the 1999 assessment year and as a result of HB 2486, the assessment authority of water transportation vessels was transferred from the Utility Valuation Section (RCW 84.12) to the Commercial Vessel Section (RCW 84.40.065). There is no intangible impact with respect to commercial vessel valuation.

Exhibit E presents the actual values of utility industry groups for the period 1995-2000. Actual values represent the market value estimates for the properties prior to equalization. Actual value

was the basis used in the ESSB 5286 fiscal note. Actual values are not necessarily assessed values, which represent values adjusted for DOR estimates of assessment levels in each county. The average annual increase in value from 1995 to 1997, before ESSB 5286, was 7 percent. The average annual increase dropped to 6 percent after consideration of the exemption, which includes years 1995 to 2000.

EXHIBIT E* - Actual Value by Assessment Year						
Utility Industry Group	1995	1996	1997	1998	1999	2000
Airline	\$999,615,381	\$1,149,242,531	\$1,213,086,934	\$1,346,581,213	\$1,337,530,340	\$1,551,826,350
Electric	2,790,307,382	3,056,446,334	3,079,049,992	2,813,688,622	3,049,239,102	3,159,369,000
Gas	879,841,995	1,011,113,957	1,128,346,952	1,125,208,583	1,211,557,000	1,318,108,000
Pipeline	575,913,702	628,243,017	580,053,017	591,465,019	639,632,000	655,326,000
Private Car	147,638,778	192,683,819	192,943,205	211,352,555	196,474,821	212,725,779
Railroad	604,378,121	637,609,789	649,696,718	674,821,251	691,424,041	765,926,000
Wireless Telephone	332,276,801	463,472,089	535,592,914	727,421,289	849,826,398	955,211,000
Telephone	3,780,922,343	4,328,019,443	4,261,366,213	3,899,231,644	4,415,820,700	5,074,398,800
Water Transportation	82,571,664	90,739,357	91,060,413	95,432,985	0	0
TOTAL	\$10,193,466,167	\$11,557,570,336	\$11,731,196,358	\$11,485,203,161	\$12,391,504,402	\$13,692,890,929

*Values for 1995 through 1997 represent values inclusive of intangible personal property. The 1998 through 2000 values exclude intangible personal property.

Exhibit F presents the equalized or assessed values for the period 1995-2000. Equalized values are the actual value estimates adjusted to the individual county ratios of assessed to market values that are used for the state school levy calculations. Equalized values are the basis upon which taxes are levied.

EXHIBIT F*** -- Equalized Value by Assessment Year						
Utility Industry Group	1995	1996	1997	1998	1999	2000
Airline	\$970,615,573	\$1,137,199,993	\$1,117,843,529	\$1,319,134,973	\$1,327,015,969	Data not available on report date.
Electric	2,638,577,987	2,912,126,655	2,866,549,565	2,670,301,827	2,906,016,972	
Gas	843,633,039	969,260,176	1,051,367,794	1,091,651,974	1,179,463,059	
Pipeline	541,909,632	585,926,571	540,230,982	558,371,670	592,092,917	
Private Car	138,081,460	178,181,117	175,104,327	193,935,271	180,915,374	
Railroad	529,129,684	567,475,246	584,011,120	611,244,637	624,836,330	
Wireless Telephone	319,603,464	450,562,739	495,551,245	709,304,131	835,753,620	
Telephone	3,586,580,275	4,101,777,369	3,936,184,047	3,726,851,090	4,235,056,889	
Water Transportation	76,758,435	85,670,618	83,427,906	89,225,166	0	
TOTAL	\$9,644,889,549	\$10,988,180,484	\$10,850,270,515	\$10,970,020,739	\$11,881,151,130	

**Source: Tax Statistics 1995 – 1999, Tables 36-45.

Valuation Process: Utility value estimates were based on the indications and reconciliation of the cost, sales comparison, and income approaches to valuation. Applications and assumptions varied within each approach depending upon the data available and the value being estimated (excluding or including intangible personal property). However, the application of all relevant appraisal methodologies was consistent.

Prior to the exemption of intangible personal property, the application of these three approaches to value (cost, sales comparison, and income) included all the assets associated with the operating properties. The cost approach included booked intangible assets, the sales comparison approach utilized the indications of stock prices, and the income approach considered all income and expenses of the operating property and was capitalized at rates relevant for the unit overall. The reconciliation of these three indications was weighted based on the quality of the data in each approach and their relevance to the property type. With enactment of ESSB 5286, the same three approaches were utilized, but the considerations within each approach varied slightly. In the cost approach, booked intangibles were excluded. The sales comparison approach did not totally rely on stock value indications because it reflected the entire ownership, including intangibles. Finally, the income approach reflected something less than overall value by considering any possible addition to value of the intangible assets. This was done by making adjustments to income, expenses, and/or different capitalization rate assumptions. Again, a subsequent reconciliation of indications created the final estimate of value.

Basis of Fiscal Note: The ESSB 5286 fiscal note estimated an actual value loss of \$811 million (6.7 percent) in 1998. Seven years of fiscal estimates were calculated from the actual 1996 state-assessed value. The Forecast Council official state growth estimates were used through 1999, and in subsequent years, the Department of Revenue’s Research Section assumed the same growth pattern. As part of this forecast, statewide estimates of the value of state-assessed properties and market value were completed. The following chart shows the state-assessed property value loss estimates used in the fiscal note for each of the seven years.

<u>Assessment Year</u>	<u>Estimated Actual Value Loss</u>
1996	\$773 million
1997	\$791 million
1998	\$811 million
1999	\$833 million
2000	\$858 million
2001	\$883 million
2002	\$910 million

To Summarize:

- The actual value loss associated with the exemption of intangible personal property for state-assessed properties in 1998 slightly exceeded the fiscal note estimates; \$879 million versus \$811 million, or 7.1 percent versus 6.7 percent of state-assessed property value.

- The actual value loss associated with the exemption of intangible personal property for state-assessed properties in 1999 was slightly lower than the fiscal note estimates; \$775 million versus \$833 million, or 5.9 percent versus 6.7 percent of state-assessed property value.
- The actual value loss associated with the exemption of intangible personal property for state-assessed properties in 2000 was slightly lower than the fiscal note estimates; \$810 million versus \$858 million, or 5.6 percent versus 6.7 percent of state-assessed property value.
- The actual value of centrally-assessed (utility) property (subsequent to the exemption of intangible personal property) was higher than the fiscal note estimates in 1998, 1999, and 2000 (\$11.485 billion versus \$11.344 billion, \$12.391 billion versus \$11.637 billion, and \$13,692 billion versus \$11,937 billion).
- The assessed value of centrally-assessed (utility) property increased 1.1 percent from 1997 to 1998, and increased 8.3 percent from 1998 to 1999. The assessed values for 2000 and the increase/decrease resulting from this data are not yet available.

SGG:slc
Attachments

APPENDIX D

SURVEY OF IMPACT OF EXEMPTING INTANGIBLE PERSONAL PROPERTY ON LOCAL ASSESSMENTS

In order to answer the question about the impact of ESSB 5286 on local assessments and assessment practices, the Department sent a survey with follow-up contact to each county assessor. The survey consisted of the following four questions:

Question 1: Did implementation of this exemption change your appraisal processes or methodologies? If so, what did the changes look like and what property types were impacted?

Question 2: Did administration of this exemption have an impact on the assessed values? If so, what was the impact and what property types were impacted?

Question 3: Have you experienced any property tax appeals, at any level, of your assessments that were based on the allegations that your assessment office included intangible personal property after the effective date? If so, what were they, what were the circumstances, and has there been an outcome?

Question 4: What do you believe the long-term impact will be from this legislation (5 to 10 years)?

Each county was given the questionnaire, in hard copy, and asked to respond in writing to the Department. The Department followed up by telephone with those counties that did not respond or when additional information was needed to clarify the comments. All interviews were completed by David Saavedra, Program Coordinator for the Department's Property Tax Division.

These survey results presented below are not opinions of the Department of Revenue but represent the specific opinions and estimates provided by each county.

Every county responded to the questionnaire. Some were able to provide more detailed information than others. Every effort was made to obtain as much information as possible. Sometimes obtaining the highly detailed information was impossible due to the fact that few counties had performed a detailed study or analysis on the impacts of excluding intangibles within their own jurisdiction. A study of this sort is complex because the existence of intangibles is only one of many possible influences on the value reflected in assessments. For example an assessment could have been lower after the legislation passed due to a slowdown in the market or a flood or a number of external reasons. Assessors could not assume, simply because a value was lower in 1998 than it was previously, that intangibles were the cause. If a complex property's assessment dropped after the legislation passed, intangibles could be the cause but there could be other causes as well. Isolating value reductions due only to intangibles in this sense was very difficult, and the best effort at estimating the impact of excluding intangible personal property from assessments was made in this survey.

Question 1: Did implementation of this exemption change your appraisal processes or methodologies? If so, what did the changes look like and what property types were impacted?

- Twenty-five counties made no changes to their assessing practices because they did not believe they were assessing intangibles prior to 1998.
- Thirteen counties changed their assessment practices in some way to address ESSB 5286. Most county changes related to the valuation of complex commercial properties, giving more reliance to the value indications of a Cost Approach analysis when more than one approach was used (the other "approaches" being Income and Market Approaches), or solely using a Cost Approach methodology. Cost Approach methods typically used by assessors include accounting for all the hard and soft costs associated with construction of a structure. Assessors do not generally consider any possible additions to the value for any developer's profit. This method, then, tends to be conservative in its estimates of value.
- Two of the thirteen counties indicating changes in methodology stated that they still employed all three valuation approaches (Cost, Income, Market) but altered the Income Approach model to use generic industry income levels rather than actual income developing net operating income estimates for capitalization.

The controversy surrounding inclusion of intangibles in property valuations is most commonly centered on the Income Approach. By changing the Income Approach to recognize typical income of similar property types as opposed to a specific property's actual prior year income, it is more likely to exclude value enhancement associated with the name-brand recognition or superior management.

Some assessors instituted a policy to ask taxpayers whether they believed they had intangibles in their property. If the response was affirmative, then the value of any reported intangibles was removed.

Question 2: Did administration of this exemption have an impact on the assessed values? If so, what was the impact and what property types were impacted?

- Six counties indicated a fiscal impact for 1998 assessed values:

	Assessed Values	Percent of Assessed Value
Adams County	\$20,000,000	2.30%
Clallam County	25,000,000	0.66%
Pierce County	8,200,000	0.02%
Thurston County	8,000,000	0.07%
Whatcom County	100,000,000	0.96%
Whitman County	200,000	0.01%

Most of the impacts reported by the five counties were the direct result of methodology changes in assessment practice, i.e. more of a reliance on the Cost Approach. The most significant assessed value reductions were all in the complex commercial and industrial property types. The percentage range of impact is not consistent because the makeup of property types in each county varies. The existence of a highly valued industrial property in a small county may account for a significant portion of assessable value in that county.

Some counties responded that the legislation represented a "status quo" in their assessment administration practices. There are a number of reasons why a county would report "status quo." They may not have historically-assessed intangibles. This could have occurred if they had not put them on the rolls, even if reported by property owners. This practice ensured the uniformity of assessments at the local level due to the fact that it would be unfair to tax only those taxpayers reporting intangible personal property to the assessor. Another reason for the "status quo" practice for some counties was that their prior and current methodologies already excluded the value of intangibles. This would happen, for instance, if a county only used market rents for income approaches on commercial properties or only used cost approach methods on complex commercial and industrial properties. These methods would not likely have recognized intangible personal property in assessments. Several rural counties also indicated a "status quo" due to the fact that they had no name-brand type of properties situated in their county (i.e. name-brand restaurants, motels). In these counties, passage of this exemption changed nothing about the profile of property types in their county.

Other counties reporting a "status quo" indicated that the proper market data necessary to show whether intangible property existed in their county was not available. The property valuation profession relies extensively on studies of market data to determine property valuations. For instance, the addition of a swimming pool may cost much more than it is worth as recognized by the "market." In the case of intangibles, certain assessors are indicating that the "market" hasn't indicated what an intangible is or how much it might be worth. Until intangible personal property is more readily exchanged on the market, there will not be enough data or market evidence on how to value it for the exclusive purpose of exempting it from assessments.

Question 3: Have you experienced any property tax appeals, at any level, of your assessments that were based on the allegations that your assessment office included intangible personal property after the effective date? If so, what were they, what were the circumstances, and has there been an outcome?

Four counties responded that they have pending appeals. Most appeals reported in these counties are at the level of the local Board of Equalization.

- Kitsap County reported one property owner who has recently paid taxes under protest, an indication of possible future litigation where intangibles are an issue. The amount of value reduction asked for by the taxpayer was not indicated.
- Adams County reported that it had three appeals outstanding which are awaiting decisions from the local Board of Equalization or the State Board of Tax Appeals.

- King County did not provide details on its current appeals, however, King County's response to the Department can be found at the end of Appendix D. A Department of Revenue check with the local Board of Equalization indicates that there have been no decisions rendered in King County where intangibles have been raised as an issue. Two property taxpayers, however, have recently petitioned the Board citing intangibles specifically as an issue. The two taxpayers have requested that their assessed values be lowered by a combined \$5.2 million. King County also has at least one outstanding Superior Court case pending where intangibles are cited as an issue and for which a value reduction of \$18 million is being sought.
- Snohomish County has an appeal pending in the local Board of Equalization concerning the value of a hotel. The taxpayer alleges an over-assessment of \$1.1 million, of which the inclusion of intangible value is one of several issues.

There have not been any cases at the State Board of Tax Appeals in the last two years (since the legislation passed) in which decisions have been made on the unlawful inclusion of intangibles. The Board's representative indicated that the subject of intangibles has been part of the discussion in several cases. However, no decisions or reductions in value have been directly associated with intangible personal property assets.

Question 4: What do you believe the long-term impact will be from this legislation (5 to 10 years)?

Twenty-five counties responded that they do not expect any long-term effects resulting from this legislation. The remaining eleven counties indicate a belief that some tax shifting will result or that there will be a continuing pressure to lower assessed values in the commercial and industrial property types.

Other counties believe that as long as the statute remains as currently written, there should not be any major long-term statewide impact. This is based on the belief that the existing language allows assessment practices to remain as historically performed (i.e., status quo). If the language of the existing statute were to be expanded to allow the exemption of intangible personal property influences on real and tangible personal property, then it is believed that the impact would be substantially increased.

Local Assessment Survey on the Impact of Exempting Intangible Personal Property Resulting From ESSB 5286

Four questions were asked of every county assessment office. An overview of answers is given in Table A, to the extent that explanatory comments which were made are reported in Table B. (Questions and answers are shortened for the purposes of this table.)

- Question 1** *Did implementation of this exemption change your assessment processes or methodologies?*
Question 2 *Did this exemption have an impact on the assessed values? (Overall percentage impact)*
Question 3 *Did your county experience any property tax appeals as a result of this legislation?*
Question 4 *Do you believe there will be long term impacts due to this legislation? (5 to 10 years)*

Table A

County	Question 1	Question 2	Question 3	Question 4
Adams	Yes	Yes	Yes	1 % to 2% overall in the future
Asotin	Yes	No	No	None
Benton	No	No	No	None
Chelan	No	No	No	None
Clallam	Yes	Yes	Yes	Impact will be in shifting
Clark	Yes	No	No	Negligible
Columbia	No	No	No	Maybe
Cowlitz	No	No	No	None
Douglas	No	No	No	None
Ferry	No	No	No	None
Franklin	No	No	No	Uncertain
Garfield	No	No	No	None
Grant	No	No	No	None
Grays Harbor	No	No	No	None
Island	No	No	No	Shifting
Jefferson	No	No	No	None
King	Yes	Yes	Yes	Yes
Kitsap	Yes	Minimally	No	Yes, shifting
Kittitas	No	No	No	Unknown
Klickitat	No	No	No	None
Lewis	Yes	No	No	None

Lincoln	No	No	No	None
Mason	No	No	No	None
Okanogan	Yes	No	No	None
Pacific	No	No	No	None
Pend Oreille	No	No	No	None
Pierce	Yes	Yes	Yes	Yes
San Juan	No	No	No	None
Skagit	Yes	No	No	None
Skamania	Yes	No	No	None
Snohomish	No	No	Yes	None
Spokane	No	No	No	Minimal
Stevens	No	No	No	None
Thurston	Yes	No	No	None
Wahkiakum	Yes	No	No	Unknown
Walla Walla	No	No	No	None
Whatcom	Yes	Yes	Yes	Yes, shifting
Whitman	Yes	Yes	No	None
Yakima	No	No	No	None

Table B - Explanatory Statements and Comments

Some counties provided comments or additional explanation to their answers of the survey questions and are included in paraphrased form in this table.

- Question 1* *Did implementation of this exemption change your assessment processes or methodologies?*
- Question 2* *Did this exemption have an impact on the assessed values? (Overall percentage impact)*
- Question 3* *Did your county experience any property tax appeals as a result of this legislation?*
- Question 4* *Do you believe there will be long term impacts due to this legislation? (5 to 10 years)*

Adams Q.1) Changed the Income Approach from using actual income to one using "generic" income based on market rents. Q.2) Impact was observed, based on changing methodology, 30% to 40% (\$20 million) in the commercial property area. Overall, the impact was about 2% of the total county assessed value. Q.3) Three appeals outstanding awaiting decision from BTA and BOE. They are a tavern, a mini-storage and a fast food restaurant. Q.4) To the extent that "intangibles" show up on company bookkeeping records to gain IRS depreciation at faster rates, then intangibles may likely be claimed as an exemption more often.

Asotin Q. 1) The change in our practice was to remove any reported intangible personal property. Q. 2) Impact minimal, not measurable.

Benton

Chelan

Clallam Q.1) Yes, began using the cost approach primarily, Q.2) Industrial properties impacted, \$25 million in the industrial properties 0.66% overall,

	Q.4) A "dramatic" shift from commercial/industrial to homeowners and smaller businesses.
Clark	Q.1) Yes, intangibles when reported are now removed from personal property affidavits. The county also began to ask taxpayers whether there were any intangibles included in a sale or on a personal property affidavit. For the majority of commercial property transfers, there were no intangibles, therefore there was nothing to include (before the passage of ESSB 5286) and nothing to exempt after passage of ESSB 5286.
Columbia	Q.4) To the extent that property owners report intangibles to the IRS for depreciation purposes, such as goodwill, these intangibles may find their way on property sale documents. For example, a recently reported sale in our county was \$30,000 after claiming a deduction for \$180,000 for goodwill. The total purchase price for this property was \$210,000.
Cowlitz	
Douglas	
Ferry	
Franklin	
Grant	
Grays Harbor	Q.1) Yes, county eliminated intangible personal property off of the personal property rolls. They have not changed any other assessment or appraisal methodologies. Q.4) As long as the current exemption statute stays as it is and does not include language that intangible and any influences intangibles bring to property or assets, then there should be no long term effect. The current language allows a status quo assessment practice.
Island	Q. 4) Owners of intangible personal property will receive a benefit, while others will receive a shifting of tax burden.
Jefferson	Q. 1) Intangible personal property was never assessed prior to the legislation because it could not be applied uniformly.
King	Q. 1) King County utilizes the Cost Approach more often. Q. 2) Impact is unknown Q. 4) Long-term impacts and shifts. See attached letter from King County Assessor Scott Noble.
Kitsap	Q. 3) No formal appeals, however, a large taxpayer (fast food restaurant) has paid taxes under protest, an indication that legal action is imminent, is claiming that use of the income approach impounds intangibles and is asking the county to rely solely on the cost approach. This action will reduce values.
Kittitas	
Klickitat	
Lewis	Q. 1) Since ESSB 5286 passed, the assessor's office now asks taxpayers if intangible personal property is included, and if so, it is removed.
Lincoln	Q. 1) Our county has no name brand properties or ownerships in it. No changes needed.
Mason	
Okanogan	Q. 1) For personal property, once intangibles became exempt, our county stopped assessing them, i.e. goodwill. For real property, we never had or knew of any market information available which indicated what intangibles were or what value they might have. We also were unaware of any "rules of thumb" or appraisal models or methods which provided insight as to how to separate intangibles from property.
Pacific	
Pend Oreille	Q. 1) We do not believe that our county had ever captured any intangible value in our personal property prior to 1998, so no new procedures were implemented.
Pierce	Q. 1) More reliance on Cost approach. Q. 2) Impact is estimated at \$8,200,000 loss overall primarily with commercial. Q. 3) No litigation since the legislation passed. Some litigation prior to its passage where this was an issue. Q. 4) Increasing challenges to assessed values.
San Juan	
Skagit	Q. 1) If intangibles are included, we remove them. Also, the income approach has been modified to use income based on generic market rents, instead of actual income, additionally, cost approach is given primary weighting.

Skamania	Q. 1) Intangible information is now asked for, so that it can be deducted from real property assessments. Q. 2) Types of property impacted are restaurants and motels.
Snohomish	Q. 1) No changes made for personal property or real property. Q. 3) One appeal at the local level (BOE), the board agreed that the county was not taxing intangibles. One pending appeal of a hotel property where franchise is the issue.
Spokane Stevens	Q. 3) Possible sweeping changes in valuation practices could result from future litigation, years down the road.
Thurston	Q. 1) During a period of one or two years the county assessed goodwill, covenants not to compete due to a DOR memo instructing them to do so. Q. 2) After the exemption, the above intangibles were removed, approximately \$8,000,000 in assessment.
Wahkiakum Walla Walla	Q. 1) As a result of the exemption, county now reviewing sales records for the inclusion of intangibles.
Whatcom	Q. 1) Adjustments to reflect presence of known intangibles made, also adjustments within Income and Market approaches made to reflect known presence of intangibles. Q. 2) Impact approximately \$100,000,000. Q. 3) Appeals were primarily a small number of taxpayers who, among other issues, complained about intangibles. Results were to exclude intangibles for the appellants and other similar taxpayers. primarily reflected as a value reduction on 3 or 4 industrial properties. This represents about 0.96% overall.
Whitman	Q. 1) Changed methodologies on fast food restaurants. Use Cost approach, but changed method to reflect more generic costs. Q. 2) Impact is approximately \$200,0000 overall or .01% of total assessed value.
Yakima	



King County
Department of Assessments
King County Administration Bldg.
500 Fourth Avenue, Room 708
Seattle, WA 98104-2384

Scott Noble
Assessor

(206) 296-5195 FAX (206) 296-0595
Email: assessor.info@metrokc.gov

MEMORANDUM

Date: November 1, 2000

From: Scott Noble, King County Assessor

To: David Saavedra, Property Tax Program Coordinator

Subject: Impact of Exemption of Intangible Personal Property

We expect the impact of the exemption of Intangible Personal Property to be of major proportions. This impact, however, will not be from the original context of arguments for and against the legislation.

Overview

The intangibles issue is alive and well across the country. Many lawsuits and court cases occur on this topic. At a recent IAAO legal seminar no less than 35 major court cases were highlighted. As a topic of controversy, the intangibles issue was most recently reported in a front page article of The San Francisco Chronicle, dated September 13, 2000.

The intangibles issue in Washington State has changed direction since the Attorney General's Opinion on the matter dated November 18, 1997. The previous approach concentrated on removing enhancement or contributory value from real property valuations. This approach even extended into fundamental property rights, with an expert in the February 1999 issue of the Property Tax Alert stating "intangibles include the right of ownership of that property—the right to sell it, the right to lease it". Such approaches concerned assessors as "a market value appraisal is always a valuation of specified rights in the subject property, not the physical real estate" (The Appraisal of Real Estate, by the Appraisal Institute).

The new approach is also highlighted in the February 1999 Property Tax Alert. It is reclassifying real property as personal property, or as described in the article "tax engineering".

In the article it also advises readers to “look closely for exempt personal property that may be attached to taxable property”. This new approach is especially prevalent in states where personal property is exempt. The approach is gaining use in states where reclassification may provide ultimate exemption as intangible personal property. Such linkage is related to Section 197 of the IRS Code with at least 159 items listed as Taxpayer-Claimed Intangible Assets (including such line items as Nonunion Status and Manufacturing Process and Procedures). The IRS rules allow accelerated depreciation for such assets.

It is expected King County shall continue the recommended approach to classify fixed industrial machinery and equipment as real property per USPAP and the Appraisal Institute.

Likewise, we do expect litigation in the future on the “intangibles” issue. These actions may well use other terms than intangibles per se, but the professional literature accurately describes such terms as distinctions without a difference. Recently, a well known tax agent has asked for all our public information on all our industrial properties, how much value for each industrial property is listed as fixed machinery and equipment, and whether this fixed machinery and equipment is classified as real property or personal property.

King County Summary

Some general inquiries made to our office highlight the ambiguous nature of the issues:

- One of the nation’s largest publicly held owners of major office properties states the purchase price it pays includes “investment value premium” – which should not be taxed as real property. It should be noted “Premium market revenue asset” and “Equity in unearned premium” are Taxpayer-Claimed Intangible Assets to the IRS.
- Tax agent declares purchase price of major downtown retail facility includes “intangible personal property” because there were leases in place at the time of sale. It should be noted “Leases (general)”, “Leasehold interests/equity”, and “Leasehold improvements” are Taxpayer-Claimed Intangible Assets to the IRS.
- Numerous industrial property owners are seeking fixed machinery and equipment be classified as personal property for faster and greater depreciation. There are concerns should such unwarranted reclassification occur, the fixed machinery and equipment will no longer be reported.
- Agents representing hotels state the deductions made by the assessor to account for any intangible value associated with a hotel’s name or franchise are not adequate and should be increased.

King County has taken every effort to ensure compliance with the law and avoid the possibility or perception intangible personal property is included in real property valuations. Historically, we do not believe items of intangible personal property have ever been included.

Certain property types are now appraised using a cost approach or leased fee income approach and include gas stations, nursing homes, retirement homes and fast food restaurants. Commercial properties whose income could be attributable to such things as ownership or reputation are carefully stratified by location, quality and other real estate attributes. Personal

property affidavits automatically attribute zero value to any category previously assigned to intangible personal property assets such as goodwill, customer lists et cetera.

General Answers to Questions posed

#1. Yes. See above.

#2. Yes, especially in the future.

#3. Yes, and we anticipate many appeals and litigation in the future.

#4. Yes, we anticipate many long-term impacts and substantial tax shifts.

With the potential impacts of “intangibles-influence related cases” rendered largely moot by the Attorney General’s Opinion we expect future impacts to revolve around the real property vs. personal property classification issue, cost segregation study issue (allowed retroactively for three years by the IRS), and intangible influences such as economy and effective demand influences.

Thank you for the opportunity to comment and address this ongoing concern.

Sincerely,

Scott Noble

Enclosure: State Losing Millions in Tax Revenue, San Francisco Chronicle, September 13, 2000.