# HOUSE BILL REPORT
# ESSB 5286

**As Reported By House Committee On:**
Finance

**Title:** An act relating to intangible personal property.

**Brief Description:** Clarifying the taxation of intangible personal property.

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

**Brief History:**
**Committee Activity:**
Finance: 3/27/97, 4/3/97 [DPA].

## HOUSE COMMITTEE ON FINANCE

**Majority Report:** Do pass as amended. Signed by 10 members: Representatives B. Thomas, Chairman; Carrell, Vice Chairman; Mulliken, Vice Chairman; Boldt; Butler; Kastama; Pennington; Schoesler; Thompson and Van Luven.

**Minority Report:** Do not pass. Signed by 2 members: Representatives Dickerson, Assistant Ranking Minority Member; and Morris.

**Staff:** Bob Longman (786-7139).

**Background:** All property in this state is subject to property tax each year based on the value of the property, unless a specific exemption is provided by law. The state constitution requires that a taxing district apply taxes uniformly to each class of property within the district, and that all real estate be treated as one class. The constitution also allows the Legislature to exempt certain types of property from taxation.

Intangible property is property that has no physical substance and is not susceptible to being perceived by the senses. Some types of intangible property are exempt from taxation: money, mortgages, notes, accounts, certificates of deposit, tax certificates, judgments, government bonds and warrants, stocks and shares of private corporations, private non-governmental personal service contracts, and private non-governmental athletic or sports franchises.

Other types of intangible property are taxable, such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, agreements not to compete, customer lists, and business goodwill.

Factors that affect the market value of real property or tangible personal property, such as location, zoning, or view, are sometimes referred to as "intangibles." However, these factors are not intangible property. These are merely items that buyers and sellers take into account in determining the market value of property. In contrast, intangible property can be bought and sold independently of other property.

Intangible assets are often difficult to identify, locate, and value. The correct treatment of intangible assets for property tax purposes is a matter of some controversy. Recent events have sparked a new level of interest in this issue.

In the late 1980s, the Department of Revenue was sued by Burlington Northern on the grounds that the company was being discriminated against. The taxpayer believed that assessed values established by the department tended to include the value of intangible assets held by the taxpayer, while assessed values established by county assessors did not include the value of intangible assets. This complex litigation was eventually resolved in the department’s favor.

Recently, Congress allowed the cost of some intangible assets to be amortized over a 15-year period for federal income tax purposes. This made it more likely that businesses would show intangible value on their books and that assessors would tend to tax it. Businesses began to complain about the assessment and taxation of previously untaxed property. Businesses also expressed concern that assessors would begin to further tax these and other intangible assets.

The department responded with a letter in January 1996, advising county assessors not to list and separately value intangible assets. In 1996, bills were introduced in the Legislature to exempt all intangibles from taxation, but none of these bills were enacted by the Legislature.

**Summary of Amended Bill:** All intangible property is exempt from property tax. Intangible property includes, but is not limited to, the items exempt under current law and items such as trademarks, trade names, brand names, patents, copyrights, trade secrets, franchise agreements, licenses, permits, core deposits of financial institutions, non-compete agreements, clientele, customer lists, patient lists, favorable contracts, favorable financing agreements, reputation, exceptional management, prestige, good name, or integrity of a business.

Intangible property does not include 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.

The exemption is not intended to preclude the use of generally accepted appraisal practices in the valuation of real and tangible personal property, including the appropriate consideration of licenses, permits, and franchises granted by a government agency that affect the use of the property. The exemption is not to be construed as modifying current rules relating to the treatment of computer software. The act is not intended to incorporate any other state's statutory or case law.

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

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

**Amended Bill Compared to Engrossed Substitute Bill:** The amended bill adds a study by the Department of Revenue and adds language regarding the appropriate consideration of licenses, permits, and franchises granted by a government agency.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Amended Bill:** Ninety days after adjournment of session in which bill is passed.

**Testimony For:** The bill provides consistency, predictability, and equity. Uncertainty over the taxation of intangibles is a problem. It creates difficulties for existing businesses and frightens away businesses that are thinking of locating here. The bill treats all intangibles uniformly. A business should not be taxed on the value of its good name. If intangibles are taxed, there will be confusion and disputes as to value. The bill exempts intangibles but still allows taxable real and personal property to be valued at its full market value. This bill protects the use of the income approach for determining market value. The fiscal note overstates the impact of the exemption. Because most intangibles are not currently being taxed, the bill will not trigger a large tax shift or revenue loss.

**Testimony Against:** Assessors don't believe that intangibles should be separately listed and assessed. However, the bill grants an exemption which will cause problems. The exemption is open-ended. We don't know what the exemption includes. Taxpayers will argue that the exemption extends to intangible attributes of real property. Many new intangibles have been created in the federal income tax system and these may apply to property tax. Assessors will not be able to value these intangibles and may be forced to accept overstated intangible valuations provided by taxpayers. Taxpayers will argue that the assessed value of real and tangible personal property must be reduced by the amount of these inflated exempt intangible values. The impact of the exemption may be much larger than the fiscal note indicates. Homeowner and small business property taxes will go up as a result of this bill. It creates a tax shift. Some taxpayers will pay less but others will pay more. Big business is getting too many tax breaks. The bill should refer to the Uniform Standards of Professional Appraisal Practice, rather than generally accepted appraisal practices. These standards address many of the questions that have been raised by this bill, and are authorized by Congress for purposes of appraisals under federal mortgage loan programs.

**Testified:** Linda Lethlean and Kim Qually, Department of Revenue (pro, with amendment); Mike Bernard, Association of Washington Business; Gary Smith, Independent Business Association; Bob Gee, Washington Retail Association; Barry Bede, U.S. Ecology, Inc.; and Ray Hardee, Engineered Software (all pro); Scott Noble, Jerry Crossler, Paul Easter, and Paul Dossett, Washington State Association of County Assessors; April Cassell, homeowner; Barbara Wagner, Benton County Assessor; Fred Hutchison, property owner; and Jim Irish, Irish & Associates (all con).