

Kansas Division of Property Valuation
Informational Briefing Concerning Definitions on Real Property vs. Personal Property
January 24, 2013

The classification of property for property tax purposes in Kansas is addressed in Article 11, § 1 of the Kansas Constitution. Art. 11, § 1 creates two classes of property for property tax purposes, real and personal, and establishes the assessment rates for each.

Class 1 consists of real property and includes the subclass for real property used for commercial and industrial purposes, assessed at 25% of market value. Class 2 consists of tangible personal property and includes the subclass for commercial and industrial machinery and equipment, assessed at 25% of its depreciated retail cost when new.

Personal and real property are defined in statute. K.S.A. 79-102 defines real property to “include not only the land itself, but all buildings, fixtures, improvements, mines, minerals, quarries, mineral springs and wells, rights and privileges appertaining thereto.” Personal property by definition includes “every tangible thing which is the subject of ownership, not forming part or parcel of real property.”

The significance of the classification of real and personal property was magnified in 2006 with the enactment of K.S.A 79-223, the machinery and equipment exemption. K.S.A 79-223 exempts from property taxation all commercial machinery and equipment purchased or leased through an “arms-length” transaction after June 30, 2006, and machinery and equipment transported into Kansas after June 30, 2006 to create a new or expand an existing business. Commercial and industrial machinery equipment acquired prior to July 1, 2006 remains taxable.

The definition of commercial and industrial machinery and equipment provided in K.S.A 79-223 is limited to one statement: “commercial and industrial machinery and equipment means property classified for property tax purposes within subclass (5) of class 2 of section 1 of article 11 of the constitution of the state of Kansas,” the machinery and equipment subclass of the personal property class.

A January 2012 Court of Tax Appeals (COTA) decision from Montgomery County prompted discussion during the 2012 Legislative Session to alter the definitions of real and personal property in K.S.A. 79-102. HB2501 and SB317 were drafted by industry representatives in attempt to better clarify the definition of commercial machinery and equipment and prevent what they feared could be a wide ranging change in the classification of machinery and equipment from personal to real. While taxpayers felt COTA’s classification of the majority of its property as real property was in error, Kansas county representatives were concerned the proposed legislation last session could not only overturn the COTA decision, but also put a large amount of property currently assessed as real at risk to be reclassified as personal, and exempt if acquired after June 30, 2006.

While neither HB2501 nor SB317 were passed, the Legislature did request the Legislative Post Audit Division (LPA) to conduct a study to evaluate if commercial machinery and equipment used in large manufacturing operations are being properly and consistently classified and appraised and estimate what affect different classifications and valuation methods might have on tax revenues.

The Division of Property Valuation (PVD) has been actively involved in assisting LPA in their review of procedures, guidelines and regulations concerning the classification of machinery and equipment. As an oversight agency of the Kansas appraisal system, suggestions and comments from the report will likely influence our actions in coming months.

In recent weeks, PVD has been involved in numerous meetings and discussions with taxpayer, industry and county government representatives to attempt to arrive at compromise language which would better clarify the definition of machinery and equipment. From the definition in K.S.A 79-223, the only guidance given in statute is that commercial and industrial machinery and equipment must be classified as personal property. Further clarification has been historically provided by court cases and guides issued by PVD. The fact is, for some items, primarily some fixtures; it is simply not clearly evident if they are real or personal property. Fixtures are defined in The Dictionary of Real Estate Appraisal of the American Institute of Real Estate Appraisers as an “article that was once personal property, but has been installed in or attached to the land or building in some more or less permanent manner, so that it is regarded in law as part of the real estate” and fixtures are included in the K.S.A. 79-102 definition of real property. Thus for the fixtures not easily and clearly defined, classification determination for fixtures can be based on subjective opinions and interpretations of a three part test examining the annexation, adaptation, and intent of a property item.

It seems from the surface it may be an easy task to define fixtures, machinery and equipment and real and personal property, but there are difficulties in agreeing on a comprehensive standard for determining if personal property has been intended to remain personal property or has been implemented in such a way that it is common to buildings and intended to primarily benefit the real property. Attachment of machinery and equipment to the real property has never been presented by PVD as the sole criterion. Current guides emphasize “the basic factor for classifying items as real or personal property, are their designed use and purpose.” Annexation and adaptation are often viewed as evidence of the intent.

As of today, we believe both sides are still open to negotiation of language for proposed machinery and equipment legislation. Regardless of the fact if an agreement is reached, PVD believes the meetings and discussions have been productive and beneficial, and all parties have shown a good faith effort to resolve the issue. While discussions continues on defining words such as “substantial damage” and “permanent vs. non-permanent” and the interpretation of the recent court decision continue, there are a number of points PVD believes agreement has been reached on:

- (1) Proposed legislation should be prospective only.
- (2) The classification issues under debate are limited to a relatively small group of properties, primarily complex manufacturing facilities.

- (3) All parties do not desire to present legislation that would alter the current classification of the commercial and industrial machinery and equipment for the vast majority of the typical commercial and industrial operations in Kansas.
- (4) With or without new legislation, PVD needs to adopt rules, regulations and/or directives prescribing appropriate standards for the classification of property and appraisals for the complex special use properties.
- (5) Clarifying the definition for real and personal property and eliminating unexpected changes in classification benefits all.
- (6) A more complete review of the classification of property listed on Industrial Revenue Bonds (IRBs) and Economic Development Exemptions (EDXs) during the ten-year exemption period is prudent.

In summary, the property at issue is limited to a relatively small group of properties, primarily complex manufacturing facilities. It seems the center of the debate is over the classification of complicated assemblages of interrelated parts that produce a final product. Examples in our state would be petroleum refineries, ethanol plants, gas processing plants, nitrogen fertilizer plants and cement manufacturing plants. The common thread in these types of facilities is processing raw stocks of materials into a refined final product.

The struggle has been to draft language that helps add clarity when defining all types of commercial and industrial machinery and equipment. Any definition needs to rely on current law, including case law and perhaps a fair measure of common sense.

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