KANSAS
ASSOCIATION OF
COUNTIES

TESTIMONY OF THE KANSAS ASSOCIATION OF COUNTIES
ON HB 2285
FEBRUARY 21, 2013

Chairman Carlson and Members of the Committee:

My name is Randall Allen and I am the Executive Director of the Kansas Association of Counties. With your permission, I will share my time with our General Counsel, Melissa Wangemann. Our Association of 103 county members opposes HB 2285 in its current form. In a few moments, Melissa will outline an amendment which, if added to HB 2285, would remove our primary objection to the bill.

The property tax base is of considerable importance to county government. Counties –more than any other level of government, including the state and cities—rely on the property tax to finance essential public services. We are apprehensive about the impact of any proposal to narrow the tax base. However, let me state clearly ***we are not here to re-debate the 2006 decision*** of the Legislature to exempt commercial-and-industrial machinery and equipment from property taxation. There were legitimate public policy reasons underlying the Legislature's decision back in 2006, and that is not why we are here.

Rather, we are here because the proponents of HB 2285 are seeking changes to what constitutes real property and personal property, specifically with regard to "fixtures." Decades of case law have established fixtures to be real property and not personal property. Changing where the line divides real and personal property, as is done in HB 2285, would significantly shift the property tax burden even more to residential, agricultural and small commercial taxpayers.

In 1996, residential real estate properties constituted 37.90% of the property tax base. The proportionate share of the total property tax burden borne by residential properties has grown to 48.02% in 2012, and would grow even more with enactment of HB 2285. There is no wonder why homeowners are particularly sensitive about property taxes on their homes. After all, they are shouldering an increasing share of the burden, and HB 2285 would only accelerate this trend.

Beyond the probability of a large shift in the property tax burden, I challenge the committee to consider whether HB 2285 passes a fundamental test of ***bringing greater clarity*** to property taxpayers, tax law practitioners, county appraisers and the Property Valuation Division on what is real property and what is personal property for purposes of taxation. If it does not, HB 2285 could result in a huge increase in property tax appeals. The business community thrives best in a predictable tax climate where surprises are minimized. Governmental entities, including counties and the State, are also best served by drawing bright lines in statute to minimize confusion and

misunderstanding. So, while we are legitimately concerned about a probable shift in the tax burden pursuant to HB 2285, we are also concerned about the bill's failure to diminish uncertainty about what properly constitutes real or personal property.

KAC met with the proponents' litigation attorneys for several weeks, trying to find compromise language. We appreciate these efforts and believe they were helpful for all parties in exploring the legal history of fixtures.

A fixture is a common-law concept that has been in Kansas law for over 100 years. The current language of HB 2285 does not capture the common-law test used by the courts to determine if an item has become a fixture. If an item is a fixture, it becomes part of the real property, and thus taxed as part of the real property. Notwithstanding the proponents' continued assertion that their language simply "clarifies" the law, HB 2285 alters long-standing Kansas law on fixtures.

KAC requests two amendments to clarify that HB 2285 actually captures the common-law test on fixtures. First, we would add the words "or realty" after "significant damage to the item" on page 2, line 15. Second, we would add a new section that clarifies that the intent of HB 2285 is to merely clarify the current law on fixtures and not to change it.

The 2012 Personal Property Valuation Guide published by the Property Valuation Division of the Kansas Department of Revenue supports our amendments as clarifying in nature. Pages iii-v of the Guide reference the three-prong test to be used in determining if an item is a fixture and has become part of the real property. The three-prong test consists of 1) Annexation to the realty; 2) Adaptation to the realty; and 3) Intent of the owner. Under the annexation test, the Guide includes two questions that help explain our amendment:

1. How is the item under consideration physically annexed to the real property? Would removing the item cause a reduction in the fair market value of the realty?

2. Would the item, once removed, require a significant amount of time or cost to restore the realty to its original condition?

The proponents want to rely on intent of the owner –and only intent -- to determine if an item is tax-exempt personal property. According to the PVD Guide, "intent is not determined simply by what a person verbally expresses. Rather, the courts have stated that it is inferred from the nature of the item affixed; the relation and situation of the party making the annexation; the structure and mode of annexation; and the purpose or use for which the annexation was made." In other words, saying the intent was to classify the item as personal property is not enough. The courts look to *objective* factors to determine the true intent. The permanency of an affixed item goes to intent, indicating whether the party truly intended to remove the item at the end of the business. The permanency of an item can be determined by the level of damage it takes to remove it. The current language of HB 2285 classifies as fixtures only those items that sustain

significant damage to the *item* when dissembled or removed; the bill eliminates from the fixtures definition any items that cause significant damage to the underlying building or land when removed. This sentence alters the longstanding classification of fixtures.

In *Shoemaker Miller & Co v. Simpson* – an 1876 Kansas case – the Kansas Supreme Court confirmed "it is a maxim of great antiquity that whatsoever is fixed to the realty is thereby made a part of the realty to which it adheres. . . ." In this case relating to recovery of railroad irons, the Court found the iron to be chattel and not fixtures because the property "can be removed from such real estate without any great inconvenience and *without any substantial injury to the real estate*."

In applying the new fixtures test from HB 2285 to building components that are currently real property, many items will move from the classification of real property to the classification of personal property. The PVD Guide lists catwalks, loading platforms, canopies, elevators, heating and lighting as examples of fixtures that are classified as real property. Can you remove any of these items without damaging the underlying building or land? It is likely possible to remove such items and cause damage ONLY to the items, and thus these items then become exempt personal property under HB 2285. All taxing districts that are supported by property taxes will see a decrease in revenue, attributable to reclassifying taxed items as tax-exempt items.

We appreciate the opportunity raise our concerns about HB 2285, and ask the committee to support our amendments.

Amendments

1. New Intent Clause:

It is the purpose of the amendment enacted in this legislation to clarify the common law on fixtures, which includes 1) annexation; 2) adaptation; and 3) intent. It is not the purpose of the amendment in this legislation to nullify common law on fixtures.

2. Amendment to Current Definition:

After "significant damage to the item" on page 2, line 15, add "or realty."