SESSION OF 2013

SUPPLEMENTAL NOTE ON HOUSE BILL NO. 2285

As Recommended by House Committee on Taxation

Brief*

HB 2285 would amend KSA 79-102 to insert new language defining "commercial and industrial machinery and equipment" beginning in tax year 2013 to mean such machinery and equipment used directly in commercial, manufacturing or processing activities to produce income. Qualifying items of machinery and equipment would not become fixtures or improvements for property tax purposes if they may be disassembled, detached or removed from real property without causing significant damage to the items. Fixtures common to buildings and intended to primarily benefit real property rather than the trade or business conducted on the premises would be specifically excluded from the definition of "commercial and industrial machinery and equipment."

The Director of Property Valuation would be required to adopt rules and regulations or appraisal directives to administer provisions of the bill.

The bill would be in effect upon publication in the *Kansas Register.*

Background

A Legislative Post Audit (R-13-003) presented to the Legislature in February questioned whether certain machinery and equipment was being appropriately and consistently assessed across the state.

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*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at http://www.kslegislature.org

Generally, the distinction as to whether commercial and industrial machinery and equipment would be classified as "fixtures" (determined by state law enacted originally in 1866 to be part of real property) became increasingly important after a property tax exemption was enacted in 2006 for certain machinery and equipment acquired on and after July 1 of that year.

Part of the instructions that the State has provided to county appraisers under current law involves a "three-part" test to determine whether personal property has in fact become a fixture to real property. That test includes (1) annexation to the realty; (2) adaptation to the use of that part of the realty with which it is attached; and (3) the intention of the party making the annexation. All three parts must be met for the personal property to be construed as a fixture. This three-part test relative to the determination of fixtures has been cited by the Kansas Supreme Court as far back as 1872.

The fiscal note from the Department of Revenue raised the potential constitutional concern that the bill could depart from what voters therefore would have commonly understood the distinction between real and personal property to be when the property tax classification amendment was adopted in 1986.

Proponents of the bill argued that similar types of property were being assessed as real property in some counties and as personal property in others; and that some counties were being too aggressive with the application of the three-part test in an effort to assure that certain property would remain taxable as real estate (and not qualify for the 2006 exemption).

Opponents argued that the three-part test has long standing precedent in case law and state statute; and that moving away from the guidelines promulgated by the State under current law would further narrow the tax base and shift the tax burden on to other classes of property, especially residential.

The fiscal note provided by the Department of Revenue indicated the bill would be expected to reduce total statewide assessed valuation by $583.6 million. This would reduce receipts from the mandatory school district general fund property tax levy (20 mills) by $11.673 million annually; and from the levies for state building funds (1.5 mills) by $0.875 million annually. The reduction of funds from the 20 mills would reduce school finance local effort and necessitate increased State General Fund (SGF) expenditures by the same amount under the assumption that the intent would be to fully fund the school finance formula at the level recommended by the Governor.

The following table summarizes the fiscal impact through FY 2018:

($ in millions)

		FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	5-yr total
20 mills	(SGF)	$ (11.673)	$ (11.673)	$ (11.673)	$ (11.673)	$ (11.673)	$ (58.365)
1.5 mills	(Building Funds)	(0.875)	(0.875)	(0.875)	(0.875)	(0.875)	(4.375)
Total	**(All Funds)**	**$ (12.548)**	**$ (12.548)**	**$ (12.548)**	**$ (12.548)**	**$ (12.548)**	**$ (62.740)**