

Minutes of the Meeting of the
Legislative Committee to Study the
Distribution Among Local Governments of Revenue
from State and Local Taxes, NRS 218.5388 to 218.53886, inclusive (S.B. 253)

June 3, 1998

Carson City, Nevada

The fifth meeting of the S.B. 253 Committee was called to order by Senator Ann O'Connell, Chairman, on Wednesday, June 3, 1998, at 9:30 a.m., in Room 4100 of the Legislative Building, 401 South Carson Street, Carson City, Nevada.

COMMITTEE MEMBERS PRESENT:

Senator Ann O'Connell, Chairman
Assemblywoman Joan A. Lambert, Vice
Chairman

Senator Ernest E. Adler Assemblyman Bob
Price

Assemblywoman Vivian L. Freeman

Assemblyman P. M. Roy Neighbors

COMMITTEE MEMBERS EXCUSED:

Senator John B. (Jack) Regan

Senator John C. Porter

ADVISORY COMMITTEE MEMBERS PRESENT:

Michael Alastuey, Clark County

Michael Pitlock, Department of Taxation

Gary Cordes, City of Fallon

Mary Henderson, Washoe County

Guy Hobbs, Hobbs, Ong & Associates

Rick Kester, Douglas County School District

Marvin Leavitt, City of Las Vegas

Terri Thomas, City of Sparks

Linda Ritter, City of Elko

Mary Walker, Carson City

Janet Murphy, (Designee) Tahoe-Douglas District

LCB STAFF PRESENT:

Kevin Welsh, Deputy Fiscal Analyst, Fiscal Analysis Division

Ted Zuend, Deputy Fiscal Analyst, Fiscal Analysis Division

Kim M. Guinasso, Principal Deputy Legislative Counsel, Legal Division

Jeanne Peyton, Secretary, Fiscal Analysis Division

OTHERS PRESENT:

Glenna Adams, Nevada Bell

Paul Bancroft, P.C.

Bill Bartlett, Churchill County

Larry Bennett

Dana Bennett, Research By Design

Tyrone Brooks, Washoe County

Sharon Buram, Newmont Gold

Barbara Byington, Douglas County

Tim Callicrati

Ramona Cruz, Incline Village General Improvement District (IVGID)

Les Dunn, Nevada Association of Counties

Jeanine D'Errico, Clark County

Jim Endres, AT&T

Russ Fields, Nevada Mining Association

Bob Gastonguay, Nevada State Cable Communications Association

Theresa Glazner, Nevada's Department of Taxation

Tom Grady, Nevada League of Cities

Celeste Hamilton, Pershing

Brian Herr, Nevada Bell

Hal Holmquist, Sprint

Brent Hutchings, City of Ely

Janelle Kraft, City of Las Vegas

Dave Kruse, IVGID

Gail L. Krolick

Neena Laxalt, Sparks Regional Transportation Commission

Barbara Leonard, City of Ely

Stephanie Licht, Elko County

Barbara McKenzie, City of Reno

Margaret McMillan, Sprint

Susan Miller, Sierra Pacific Power Company

Robert A. Ostrovsky, Prime Cable and Nextlink

Rick Oxoby, Nevada's Department of Transportation

Karen Peterson, Allison, MacKenzie, Hartman, Soumbeniotis & Russell, Ltd.

Ron Reynolds, Nevada Bell

Riho Saffen, Nevada Assembly Candidate

Stuart Schillinger, City of Reno

Mark Schofield, Clark County

Bob Shriver, Commission on Economic Development

Carole Vilardo, Nevada Taxpayers Association

Walt Vodrazka, Jr., University of Nevada, Las Vegas (UNLV)

EXHIBITS

Exhibit A - Meeting Notice and Agenda

Exhibit B - Attendance Record

Exhibit C - Testimony and overhead slide presentation of Terry E. Rubald, Supervisor, Centrally Assessed Properties, Nevada's Department of Taxation.

Exhibit D - Presentation and recommendations from Paul Bancroft, Attorney, Tucson, Arizona.

Exhibit E - Letter from Guy S. Hobbs of the Technical Advisory Committee, regarding the issue of exemptions.

Exhibit F - Outline from Marvin Leavitt regarding tax rates.

Exhibit G - Memorandum from Linda Ritter to Senator Ann O'Connell, regarding the discussion of the S.B. 253 Technical Advisory Committee on June 3, 1998, relating to Net Proceeds of Mines Taxes.

CALL TO ORDER

Chairman O'Connell called the meeting to order and noted that a quorum was present. She informed the committee and members of the public that the committee would be working through lunch.

NOTE: Portions of the following minutes have been transcribed verbatim and are italicized or placed in quotes.

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APPROVAL OF THE MINUTES FROM THE APRIL 23, 1998, MEETING

Chairman O'Connell requested a motion for approval of the committee's minutes from the April 23, 1998, meeting.

ASSEMBLYWOMAN LAMBERT MOVED TO APPROVE THE MINUTES FROM THE COMMITTEE'S APRIL 23, 1998, MEETING. ASSEMBLYWOMAN FREEMAN SECONDED THE MOTION, WHICH CARRIED UNANIMOUSLY.

DISCUSSION OF CENTRAL/LOCAL ASSESSMENT OF UTILITIES

Terry Rubald

Ms. Rubald, Supervisor, Centrally Assessed Property, Department of Taxation (Department) provided the committee with an overview of central/local assessment of utilities through an overhead slide presentation (see Exhibit C).

According to Ms. Rubald, appraisal theory is used to generate estimates of value for ad valorem taxation purposes. The Latin term ad valorem means "according to value." More than a century ago when the ad valorem tax was first put to use in the United States, the tax was based on the principle that the amount of tax paid should depend on the value of the property owned and ownership of property was seen as a measure of ability to pay taxes. Ms. Rubald explained to the committee that, at that time:

- The property tax was considered to be the fairest possible tax because each person would pay a tax based on the value of property in his or her possession.
- Property, both tangible and intangible was to be included in the tax base, and the property tax was to be the major source of revenue for state and local governments.

Ms. Rubald explained that in order to establish value for real and personal property, appraisers have liberally borrowed concepts from economic theory. Appraisal, which is the act of estimating the price at which a parcel of real property or a piece of personal property would sell is an application of economic theory. Economists study the trend of the marketplace using concepts of supply and demand, utility, scarcity, and the desire to describe how objects available for sale and purchase are valued in the marketplace. Appraisers also use these concepts to establish market value for real and personal property. The concept of supply and demand is incorporated into appraisal models called cost approach, income approach, and sales comparison approach.

Defining property, Ms. Rubald said:

- It is not something that you can see or touch, but it is the rights flowing from ownership or possession of land, improvements to land, heavy equipment, and so on.
- The concept of property consists of three components, which are:

1) The economic dimension is its value — property is an element of wealth.

2) The legal dimension — people can gain the right to possess, enjoy, and dispose of things, which is typically called the "bundle of rights" associated with ownership of property.

3) The physical dimension is when people gain rights over things which may be tangible or intangible.

Ms. Rubald noted that when an appraisal estimating value is made, all three components are considered. The first task of an appraiser is to identify what is being appraised and to whom this property has value. In a unit appraisal, the value of the whole property is estimated without regard to individual parts making up the whole. Many kinds of property could be considered a unit, including: (1) a home is a unit consisting of land, concrete, bricks, etc.; and (2) a hotel is a unit made up of land, improvements, furniture, fixtures, equipment, working capital, and in some instances the name of the chain it may be associated with.

Defining "unit value" further, Ms. Rubald said that the essence of a market approach is for an appraiser to estimate the value of a property. The appraiser establishes a unit value by looking at market sales to see the prices at which similar properties with the same or similar characteristics of land, location, and type and condition of improvements are being sold. The unit appraiser values the land and improvements together for a total appraised value without consideration of the individual parts.

Continuing, Ms. Rubald said that a cost approach is when an appraiser totals the value of the land as if it were vacant and later adds the depreciated cost of all the expenditures necessary to complete construction of an improvement. This approach is also known as a summation appraisal, where the fractional appraisals of two or more parts of the property are summed together for a total valuation.

Ms. Rubald informed the committee that local assessors are directed by statute to perform the cost approach in order to determine value; however, the income and market approach may be used if there is a concern that the taxable value as calculated using the cost approach exceeds market value. Unit appraisal is the technique of valuing a group of items as one. The opposite of unit appraisal is summation appraisal, which attempts to value each part within the whole. However, the summation technique usually does not enhance the unit and misses how the unit works together to supply a product or service.

Quoting Thomas Tegarden, a nationally known appraisal expert on unitary valuation, Ms. Rubald said:

Although it is possible to reach fair market value by the use of a fractional or summation method, in reality, it is doubtful whether market value could ever be achieved in the appraisal process for public utilities without using the unit method.

Continuing with her presentation, Ms. Rubald said that *in Nevada there are several appraisal reasons beyond the legal reasons why unit appraisal is used. The first issue is to try to emulate the market, to discover what the market says the value is, and what drives the market. We ask how do buyers and sellers perceive the property; would it normally be sold as separate pieces, or would it be sold as a larger unit? Then we ask, "can the unit perform its function if the questioned component were missing?"*

For example, One writer on the subject described telecommunications as the transmission of energy from one location to another, by a medium. The medium can be hard and visible, such as copper wire or fiber optic, or soft and invisible, such as the airwaves. The signals can be analog, like waves, or digital, as in packets of information. There is little physical difference in the electricity distributed to customers through an electrical generation/distribution plant and cable television signals except the frequencies and strength of the signals being transmitted. The thing that most telecommunications property has in common is that it is part of a system or network composed on individual parts working harmoniously. The networks can even overlie and be linked to one another, as in the case of the personal communications systems networks. An individual telephone pole is worth practically nothing, but as part of a communications delivery system, it is worth a great deal more.

Unit appraisal was originally devised and basically has been supported by the courts for over a hundred years, because components of a system are often located in more than one taxing jurisdiction, such as when an electric utility generating plant is located in one jurisdiction, transmission lines are located in several other jurisdictions, and all the

customers are located in yet other jurisdictions. The courts have understood for years that assets taken separately have little value, but the value of assets working together may have tremendous value and should be allocated amongst the jurisdictions.

One court has said: "But the value of property results from the use to which it is put and varies with the profitability of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determines the value, and if property taxed at its cash value it is taxed upon something which is created by the uses to which it is put."

Ms. Rubald said that the courts recognized that piecemeal valuations for property of an interstate or intercounty nature were administratively difficult, and to value anything less than the whole unit places the appraiser in the position of making arbitrary distinctions as to the value of the piece and what its contribution may be to the whole.

In Ms. Rubald's opinion, there are many advantages to unit valuation. If each county were to value a portion of an interstate company, the company would receive hundreds of tax bills. Unit valuation promotes uniformity in methodology and value. Interstate companies are typically large in size and have many assets located all over the country. Since financial information is important to unit valuation, it is also important to have access to the audited reports submitted to regulating agencies. Without access to the data obtainable from regulatory agencies, it would be difficult to verify the accuracy of the reports submitted by each company.

Ms. Rubald apprised the committee that under the current statutes, the Department is directed to use the unit approach to appraise property of an interstate or intercounty nature. According to both the Western States Association of Tax Administrators and the National Conference of Unit Valuation States, the unit value concept is superior to fractional or summation appraisals for valuing public utility service-type properties because it properly captures "going concern value."

Regarding intangibles, Ms. Rubald said that going concern value has been defined by the Appraisal Institute as including "an intangible enhancement of the value of an operating business enterprise which is produced by the assemblage of the land, building, labor, equipment, and marketing operation. This process creates an economically viable business that is expected to continue. Going concern value refers to the total value of a property, including both real property and intangible personal property attributed to business value."

Ms. Rubald explained that unit appraisal includes intangibles. It has been argued that those intangibles should be deducted to reach the real market value of the property. In reviewing the arguments brought forth by the telecommunications industry in the courts, the courts have been asked to find an "intrinsic value" rather than what people actually pay for such property in the open market. In several important decisions, the courts have found that intangible values cannot be separated from the value of tangible property.

Continuing, Ms. Rubald said that there are three generally accepted types of intangibles, as identified by the National Conference of Unit Valuation States. They are:

- Specific identifiable intangibles such as cash and accounts receivable;
- Intangibles that represent intellectual property rights and influence the value of tangible assets, such as software, contracts, patents, and copyrights; and
- Intangibles that are not separate or divisible from their influence on the value of the underlying tangible assets (i.e., location, assemblage, franchise, goodwill, et cetera.).

According to Ms. Rubald, another possible set of criteria used in identifying the existence of intangible assets might include assets that must be legally recognizable and capable of being specifically identified. The intangible must be capable of private ownership and capable of being financed or sold separately from the tangible property. It must also possess value in its own right as being capable of earning an income.

Ms. Rubald informed the committee that a review of the values that the Department calculated in 1997 found that when

more than the cost approach was performed, the companies had a reconciled value that was less than the cost approach (for example: both a cost and an income, or a stock and debt approach were calculated). These companies included:

- Ninety-one percent of electric companies;
- Approximately 50 percent of telecommunications companies;
- One out of seven gas and pipeline companies; and
- Seventy-four percent of the large airline companies.

In closing, Ms. Rubald asked the committee to maintain an independent verification process when considering changes to the law regarding intangibles and how the Department should value centrally assessed property. She noted that if the committee decided to abandon the unit valuation approach, and rely strictly on the cost approach or the summation value as reported by companies, there will definitely be a loss to many taxpayers because they had the benefit of the income approach. Ms. Rubald stated that her greatest concern is that this would cause an enormous administrative burden on the Department when trying to identify what part of the costs are intangible and what might be tangible.

Paul Bancroft

Mr. Bancroft, an attorney from Tucson, Arizona, whose practice primarily encompasses the areas of state and local taxation, testified on behalf of a number of companies who have historically been assessed by the Department of Taxation for property tax purposes. These companies include: AT&T, Nevada Bell, Nevada Power, Sierra Pacific Power Company, Southwest Gas Company, Sprint, and Union Pacific Railroad Company.

According to Mr. Bancroft, for property tax purposes, the value of these companies is determined by the Department of Taxation instead of the county assessor. Together these companies represent over 60 percent of the centrally assessed property tax base. He explained that he was here today to convey a common goal of each of these companies, which is "to achieve a property tax policy that treats all taxpayers in a nondiscriminatory manner."

In Mr. Bancroft's opinion, property in the hands of one taxpayer should be valued the same as similar property in the hands of another taxpayer. This is necessary to achieve a fair and equitable system. He expressed the need for a nondiscriminatory property tax system as a goal because it is not currently a reality.

Mr. Bancroft noted that his goal today is to:

- Explain why the property tax system is resulting in an unequal tax burden.
- Propose a solution, which this committee could recommend and the Legislature could implement
- Address the financial impact of the proposal.

According to Mr. Bancroft, the analysis of the financial impact concludes that it is immaterial. He explained that the main issue is that the *Nevada Constitution* requires that all property be treated in a uniform and equal manner so that a just valuation of all property may be determined. The two exceptions to this requirement are: (1) mines and mining claims; and (2) agricultural and open space. All other property must be treated as a single class with a uniform plan for its valuation and appraisal. Consequently, a cable, a building, or a parcel of land should be valued the same regardless of whether the business is a casino, a grocery store, or a power company. He explained that Nevada uses two separate valuation methodologies, one which is used by the county assessors and another by the Department of Taxation; it is the conflict between the constitutional requirement that all property be treated as a single class and the presence of two valuation methodologies that is the root of the problem.

Mr. Bancroft stated that with the passage of the tax shift legislation in 1981, Nevada moved all property valued by a county assessor to a replacement cost approach. Generally, a replacement cost indicator of value is based on the principal of substitution, which states that one would not be justified in paying an amount for property higher than what

would be required to obtain equivalent property from another source. The cost approach provides the upper limit of value for the tangible property. Consequently, since 1981, the county assessors have calculated the taxable value of property by adding together the fair market value of land; the replacement cost new, less depreciation of improvements; and the replacement cost new less depreciation of personal property. This valuation approximates the cost of substitution (for example: the cost of recreating the physical attributes of the property). The county assessor does not attempt to derive a business or going concern value. The county assessor is authorized to consider an income approach to valuation. Generally, an income indicator is calculated by applying a capitalization rate, which is appropriate for the risk attributes of the particular business to the net income generated by the business. This indicator of value measures the value of all assets which contribute to production of income and would include the intangible property of the business. In applying the income indicator of value, the county assessor can reduce the taxable value of the property, but not increase it.

Referring to Exhibit D, which illustrates the county assessment, Mr. Bancroft said the chart on page 1 depicts the valuation of property by a county assessor. The taxable value is determined by adding together the fair market value of land, replacement cost of the improvements, and replacement cost of personal property. If this hypothetical business was a casino with an established client base or a nationwide reservation system, its income indicator may well be higher than its cost indicator. The chart on the left side of page 1 (Exhibit D) illustrates a cost indicator of 80 and an income indicator of 100. If that were the case, the taxable value would not be increased and would remain at 80. If the casino did not have a nationwide reservation system or existing customer base, it is likely that the income indicator would be lower than the cost indicator. Referring to the chart on the right side of page 1 of Exhibit D, the income indicator illustrated is 70. If that were the case, the county assessor could reduce the taxable value to 70. In this instance, the reduction reflects obsolescence in the property.

Mr. Bancroft noted that Mark Scofield, Clark County Assessor and Kit Weaver, Carson City Assessor (in the audience) were more capable of explaining the local assessment process.

In Mr. Bancroft's opinion, Mr. Scofield and Mr. Weaver would probably confirm that the replacement cost approach has provided a relatively uniform and fair evaluation methodology, which their offices can implement in the valuation of property. They should also be able to confirm that they do not use an income indicator to increase taxable value above the cost indicator. Whether they are valuing a casino, a local power producer or an intracounty telecommunication company, the same approach is used, thus, achieving a level of uniformity and equality.

According to Mr. Bancroft, the movement to replacement cost as the main indicator of taxable value did not affect those companies valued by the Department of Taxation. At the time of the tax shift, a majority of these companies exhibited monopolistic characteristics and were rate-base, rate-of-return regulated. These companies were able to pass along their costs, including tax increases to the consumer in the form of higher rates. The quasi-monopolistic characteristics of these companies has either been eliminated or is in the process of being eliminated. It is in this new competitive environment that we must consider the valuation methodology employed by the Department. The Department is authorized to consider three indicators of value: (1) the cost indicator, (2) an income indicator, and (3) a stock and debt indicator. The appraisal community, the Department, and the industry agree that the stock and debt indicator is the least applicable evaluation method. For the 1998-1999 tax year the Department calculated a stock and debt indicator for less than one-third of the centrally assessed companies. The Department mainly relies on the cost and income indicators.

Mr. Bancroft explained that the same indicator is used by the county assessors, but with a significantly different goal. The county assessors attempt to derive a substitution value for the property. The Department attempts to replicate a business or going concern value. Consequently, on occasion, the Department will arrive at a taxable value in excess of the cost indicator of value. Referring to the illustration on page 2 of Exhibit D, Mr. Bancroft said that a company operating in multiple jurisdictions that is valued by the Department and having a cost indicator reflecting a value of 80 and an income indicator with a value of approximately 100 — unlike the county assessor, the Department can assign a taxable value in excess of the cost indicator. Since the cost indicator is an attempt to approximate the value of the land, the improvements, and the personal property value, the portion of value in excess of the cost indicator is associated with intangible property, which depending on the company could be attributable to goodwill, customer lists, patterns, trademarks, trade names, copyrights, franchises, licenses, etc.

According to Mr. Bancroft, this type of property is present in the example of the casino valued by the assessor, but is not subject to tax. Consequently, we have a property tax system that is systematically discriminating against centrally assessed taxpayers by subjecting their intangible property to property tax while not taxing similar property at the local level. This is a problem many states have addressed.

Mr. Bancroft's recommends that this problem can be solved by amending two sections of the statutes and adding a section (see Exhibit D). Noting that the material to be deleted has been placed in brackets, Mr. Bancroft proposed that Section 361.320 of *Nevada Revised Statutes* (NRS) be amended by:

- Deleting the term "franchise" in Sections 1, 2, and 4. The common meaning of the term franchise is "the right or privilege to operate a business you are not otherwise authorized to conduct." For example: A franchise is required to operate a McDonald's Restaurant. The Department has used the term franchise to justify the taxation of all intangibles. Therefore, if "franchise" is deleted from the statute governing centrally assessed properties, it will bring a level of parity between local and central assessment.
- Delete "stock and debt", in Section 4 of NRS 361.320, as one of the indicators of value to be considered.
- Insert at the end of Section 4, "but the taxable value determined by these formulas shall not exceed the cost indicator of value." This language would prevent the Department from assigning a taxable value in excess of the cost indicator. This would transmit a level of equality between valuations performed by the county assessors and those produced by the Department.
- Insert as a new Section "7. As used in this section, 'property of an interstate and intercounty nature means tangible property, which crosses a county or state boundary.'" This new language will clarify who is subject to central assessment. Mr. Bancroft stressed that the main issue is to develop a uniform system of taxation for all taxpayers, regardless of if they are centrally or locally assessed. The language suggested for Section 7 would not change who is currently centrally assessed and who is locally assessed. The language is based on the physical attributes of the companies, which has been the historic standard applied by the Department and would not cause any companies to be moved from local to central assessment.
- Delete Section 5 of NRS 361.260. This section instructs the county assessor to consider the intangible or franchise element when valuing an intracounty utility. Intangible property is present for all taxpayers and if it is valued for one taxpayer, it should be valued for all taxpayers.
- Add a new statute titled "Exemption of Intangible Personal Property." (See Exhibit D.) This

statute would include:

"1. All intangible personal property is exempt from taxation. Intangible personal property includes, without limitation, the following items:

(a) Shares of stock, bonds, mortgages, notes, bank deposits, book accounts and credits, and securities and chooses in action of like character; and

(b) Goodwill, customer lists, contracts and contract rights, patents, trademarks, custom computer programs, copyrights, trade secrets, franchises and licenses.

2. In establishing the valuation of real property, improvements and tangible personal property, the value of assemblage, being the value associated with installing or applying the tangible property, may be considered in valuing the tangible property. The value of intangibles shall not otherwise enhance or be reflected in the value of tangible property."

Mr. Bancroft explained that taxable property is defined as all property which is not otherwise exempt, meaning that intangible property is taxable property. The property listed in Section 1(a) (i.e., shares of stock, bonds, mortgages, notes, etc.), is based on the constitutional exemption of certain types of property; and the language in Section 1(b) is based on

similar intangibles legislation, which was passed in the Spring of 1998 by the State of Idaho. Section 2 recognizes that there is some semblance of value that is included in the valuation of the tangible assets.

Continuing, Mr. Bancroft noted that the above changes can be implemented with minimal fiscal impact. Also, since the county assessors are not currently adding an intangible or franchise element to intracounty utilities, the deletion of Section 5 of NRS 361.260 should have no fiscal impact.

He further explained that the amendment of NRS 361.320, and the addition of the new statute exempting intangibles will have a fiscal impact. The amount of this impact is uncertain and cannot be calculated with precision. Those companies with a reconciled value in excess of their cost have been reviewed to try to estimate the fiscal impact.

Senator Adler questioned if exempting all intangible property could cause a decrease in tax revenues. He commented that if a shift in the manner companies conduct business will occur if all intangible property becomes exempt. For example, a company could broadcast over an airwave rather than installing a wire, therefore, replacing a tangible property with an intangible property.

Responding, Mr. Bancroft said that any tax policy which is implemented may have an impact on how businesses operate. In his opinion, a suitable tax system will encourage economic development and growth.

Mr. Bancroft pointed out that currently many companies have intangible value, which is not being taxed. Although, for centrally assessed companies, intangibles are being taxed. He noted that his goal is to bring a parity between the two systems.

Responding to Senator Adler, Mr. Bancroft said that utilities are in the process of deregulating. About 392 telecommunications companies are authorized to do business in Nevada. Some companies are centrally assessed, but most are being valued at the local level. He noted that earlier in 1998, the Clark County Assessor identified 90 telecommunications companies as being locally assessed.

Mr. Bancroft suggested another solution, which would be to tax the intangibles of all taxpayers.

Continuing, Mr. Bancroft explained that the fiscal impact of the proposal is associated with the amount by which centrally assessed companies have a reconciled taxable value in excess of their cost indicator. This is a rough methodology for approximating the value of intangibles. As Ms. Rubald pointed out, not all centrally assessed companies have a reconciled value in excess of their cost indicator. After reviewing the actual appraisal work papers for each company valued on a unit basis by the Department, 22 companies were identified whose intangible property was being valued for tax purposes. This research was conducted to identify each company with a reconciled value in excess of the net book value of its tangible property (see Exhibit D).

Referring to the chart titled "Annual Taxable Values," in Exhibit D, Mr. Bancroft noted that the assessed value associated with this issue is approximately \$40 million, which is less than 1/10 of 1 percent of the statewide property tax base. The chart illustrates that each year the tax base has grown about \$2 to \$3 billion. During the past year, the tax base grew by almost \$3.45 billion, which represents an increase of 9-1/4 percent. If the proposed legislation had been approved by the 1997 Legislature, it would just now be implemented for the 1998-1999 tax year. If that were the case, the growth of \$3.45 billion would have been reduced by the \$40 million which is associated with the intangible issue. Even with the \$40 million reduction, the statewide tax base would have grown by over \$3.4 billion and the percentage growth would be reduced by less than 9/100 of a percent.

In Mr. Bancroft's noted that the State of Idaho did not claim any fiscal impact when passing similar legislation early in 1998 regarding intangibles.

Continuing with his report, Mr. Bancroft said that 22 companies with an intangible problem were identified. To ascertain how that problem was allocated among the counties in which they did business, the Department of Taxation Bulletin No. 180 was used. This bulletin showed how each centrally assessed company's value is allocated among the various counties. A chart has been provided summarizing the allocation by county (Exhibit D). For example, the assessed value of property in Carson City for tax year 1998-1999 is approximately \$883 million. The assessed value

associated with the intangibles issue is approximately \$85,000. This is less than 1/100 of a percent of Carson City's tax base. More importantly, a loss of \$85,000 in the assessed valuation is more than offset by the county growth, which has been experienced in the past year. Over the past year, the tax base in Carson City has grown by more than \$53 million.

Responding to Assemblyman Neighbors, Mr. Bancroft said the fiscal impact to Lincoln County was about 3 percent of its property value. The growth of the centrally assessed tax base in Lincoln County has increased by over \$9 million during the past year. This increase, to some degree, offset a reduction in property tax values at the local level. Over the past year, Lincoln County's overall tax value has decreased, which is due to locally assessed property taxpayers.

Marvin Leavitt

Mr. Leavitt said that it must be decided whether or not to tax intangible property. Addressing Mr. Bancroft, he said: *In your assumptions, you have assumed that the way to bring them [the centrally/locally assessed] into reconciliation is to eliminate the taxation of intangibles on utilities.* Questioning Mr. Bancroft, he asked how other states were handling this matter.

In reply, Mr. Bancroft said that Nationwide the movement is away from the taxation of intangibles, which has already happened in California and Idaho at the centrally assessed level. In California, the constitution specifically exempts intangibles and they are now taking the steps necessary to recognize that in the central assessment process. In Nevada, the issue is the constitutional requirement that all taxpayers must be treated in a uniform and equal manner.

Mr. Bancroft indicated that if it was decided to tax all intangibles, it would place the local government assessment process into an upheaval, causing problems for the staff of the assessors office in terms of the number of property tax appeals, and taxpayer satisfaction with the overall process. He said that the proposal submitted by him on behalf of the utility companies would be easy to implement and have minimal fiscal impact.

Mr. Bancroft advised the committee that during the Fall of 1997, the Tax Commission conducted a series of telecommunication workshops that focused on valuation of principles, and, as a result of the workshops, the Commission and the Department moved to a capitalization rate based on a yield methodology. By moving to a yield methodology, it increased the capitalization rate, reducing the overall income indicator of value. That step took half the intangible value out of the centrally assessed telecommunication companies. He assured the committee that the main goal is to make this tax change with little or no fiscal impact.

Responding to Linda Ritter, City Manager of Elko County, Mr. Bancroft said that the assessed value by county for 1998-1999 shown in Exhibit D was produced by the Department of Taxation, and the amount listed includes net proceeds.

Mary Walker

Ms. Walker questioned if the decrease is due to the capitalization rate being applied to everyone next year.

In reply, Mr. Bancroft said that the two elements involved are: 1) the move to a yield capitalization rate; and 2) applying that rate to most of the telecommunications companies, two electric companies, and one gas company.

Ms. Walker asked if the capitalization rate was only applied to those companies that protested.

Responding, Mr. Bancroft said that as a result of the telecommunications workshops held last fall, the tax commission opened the regulations which govern how the value for central assessments purposes are calculated; and the yield capitalization rate is now in the proposed regulation, as well as a second step, which is that the regulations also allow the Department to consider a market based capital structure when determining the capitalization rate.

Ms. Walker asked Ms. Rubald what her opinion was of the proposal offered by the industry, which was presented by Mr. Bancroft.

Replying, Ms. Rubald said that she had several concerns, including:

- The deletion of franchise — There is considerable legal debate as to the definition of the word "franchise" and the Department has a large amount of information from the Office of the Attorney General, indicating that franchise means intangible values.
- The amendment proposing to delete the stock and debt indicator — Although the Department does not always rely on the stock and debt indicator because of difficulties verifying the numbers, it can be used as an outside reference point to double check the income and cost approaches.

Mr. Rubald added that as explained previous by Mr. Pitlock, NRS 361.260 determines that locally assessed public utilities have intangible values that should be accounted for; and similar properties such as public utilities valued at the local level should be treated the same as public utilities at the state level.

Speaking to Ms. Rubald, Mr. Hobbs specified that the inference was made by Mr. Bancroft to shift to a cost based system and that several of the taxpayers referred to are currently assessed less than cost because of their income. He questioned if those taxpayers would be negatively affected if the shift was made to a cost based system. Mr. Hobbs also added that the proposal offered by the industry provides an income approach for those where income does not exceed cost, but not going above cost where income would exceed cost. Mr. Hobbs noted that with this type of structure, differential treatment would still exist for taxpayers.

Responding, Ms. Rubald said that the proposal recommended by the industry would offer "the best of both worlds" and she also noted that the industry's position was not clear to her on this issue. She questioned if the industry's position was to exclude intangibles, then why would the income approach be used in one regard?

Responding, Mr. Bancroft concurred that Ms. Rubald and Mr. Hobbs were correct in their summary of the industry's proposal. He explained that basically the proposal offered by the industry is the present methodology used by local assessment. *Nevada Revised Statutes* 361.227 governs the methodology employed by the local county assessors and as indicated in the illustration presented in Exhibit D, the county assessor builds the value of property based on its fair market value of land, and replacement cost of improvements and personal property. In Mr. Bancroft's opinion, the local government's present methodology is a favorable approach to valuing property.

Ms. Rubald explained that when the income approach is used, the capacity of the assets to produce an income is estimated. She explained that if the Department is constrained to estimating the cost to reproduce a property and the property is not earning the income estimated, one approach the Department can take is to reduce the value according to what the income indicator reports. She noted that there may also be companies in which the capacity to produce exceeds the actual cost of the assets. Therefore, the income indicator should not only be applied to reduce property value, but should also be applied to increase property value.

Mark Scofield

Mr. Schofield, Clark County Assessor, addressed Mr. Hobbs' question. He said that the statute contemplated using income for one purpose, which was to test whether or not the taxable value exceeded full cash value. If Mr. Bancroft's proposed legislation were to pass, those current centrally assessed utilities that are experiencing a loss of income would still be able to enjoy the privilege of having their income's capitalized, and subsequently, the taxable value reduced.

Regarding the intangible/franchise elements, Mr. Scofield said that section of the statute was added in the late 1960s, prior to the tax shift. Until the tax shift, local assessors were using a market driven system — "the simple market value." He explained that to arrive at a market value, comparable sales are used or, if it is an income producing enterprise, the income is capitalized. The tax shift resulted in a tremendous reduction of the property tax burden, primarily enjoyed by commercial properties. The following property tax reductions occurred as a result of the tax shift:

- Residential property - 26 percent.
- Commercial property - 56 percent.

According to Mr. Scofield, the State of Nevada is no longer using a market driven system, but has implemented a

replacement cost system; and intangible/franchise elements, are dealt with in a market system. What is occurring is an inequity as it relates to the assessment of two similar types of property and according to Article 10 of the *Nevada Constitution*, all taxpayers should be treated equally.

In reply to Chairman O'Connell regarding whether or not this was the basis of the AT&T law suit, Mr. Scofield said the concern raised in the AT&T law suit involved the discrepancy between local and central assessment, and the taxation of intangible property held by one taxpayer, while not taxing it when it is held by another taxpayer.

Ms. Walker commented that the taxpayer inequity problem regarding utilities must be resolved at some point and the tax to utilities should be based upon the local assessed value; or all taxpayers should be assessed using central assessment. Outlining a third alternative — to have all general taxpayers (i.e., hotels, residences) remain under local assessment, and utilities, whether centrally or locally assessed, to include intangibles, Ms. Walker asked if this could be an option.

Mr. Scofield said that if this option were to be enacted, a tremendous learning would be necessary by several of the smaller assessors offices; and as indicated by Mr. Bancroft, a substantial augmentation of staff will be needed throughout the state.

Mr. Bancroft also reminded the committee that the constitutional requirement would have to be changed since it does not create a separate class for utilities.

Replying to Ms. Walker, Mr. Bancroft clarified that this is in the statute now without a constitutional amendment because there is a history of it being in the statutes during a time when Nevada was on a fair market value system. In 1981, the property tax shift was enacted and it was implemented for local county assessors, but the tax system for the Department of Taxation remained the same. As a quasi-monopolistic companies, utilities were able to recover any cost passed on to them through their rate base. As previously indicated, this has changed for numerous industries that are centrally assessed, and it also will be changing in the future for electric companies.

Michael Pitlock

Regarding the legal issues, it is Mr. Pitlock's assessment that attorneys disagree on many issues. The Department of Taxation and the State Board of Equalization are represented by the Office of the Attorney General on several different law suits that are pending in court. He agreed with Mr. Bancroft about the difficulty defining who should be considered a utility.

Continuing, Mr. Pitlock said that the information provided by Mr. Bancroft on the fiscal impact of the intangible issue, is from one tax year. He explained that the calculation of the intangibles is sensitive to the profitability of the industry during that particular tax year because the income indicator could bring the reconciled value above cost; and as entities become more profitable, relative to the cost of their property, the fiscal impact of the intangible issue could also change dramatically. Particularly, this change may be seen with industries that rely heavily on high-tech property, where the cost decreases, but the profitability increases.

As indicated by Ms. Rubald, the State of Nevada is actually moving further away from taxing value. As an overall tax policy, the state will have to deal with the issue that intangible assets have value; and that is the reason companies are purchased for significantly higher prices than the actual replacement cost. Mr. Pitlock explained that land is also impacted by intangibles and is the one item where market value is utilized; although, market value of land can vary because of the intangible aspects of the land. For example, a lot with a view of Lake Tahoe will sell for a higher price than the same size lot behind the mountain with no views.

Regarding the Attorney General's opinion mentioned by Mr. Scofield, which was distributed at the April 23, 1998, meeting, Mr. Pitlock concurred with the Deputy Attorney's General that are working on the litigation for the Department. They had serious questions about the applicability of that particular opinion from 1984 as it relates to the issues being discussed today.

Michael Alastuey

As pointed out by Mr. Pitlock, to discard a certain kind of value that we are just becoming to appreciate is hasty. Mr. Alastuey informed the committee that at the point of production of a property, the value includes intangibles; but at the point of exchange in the retail market, the property becomes less tangible.

He explained that equity, in terms of a definable point of value where a product is less intangible, is a better point to tax as opposed to the capital of those that generate commerce. Finally, as a matter of a larger economic development policy, there are certain areas of entrepreneurship that the state may not want to exempt.

Mr. Alastuey suggested that in the future, the committee may want to review: 1) how taxation affects the economy of the state, 2) how to attract certain businesses to the state while maintaining a stability in its revenue base, and 3) respond to the constitutional issue.

Assemblywoman Lambert asked at what point do intangibles become more tangible.

Responding, Mr. Alastuey gave an example of if the State of Nevada was growing from an agricultural state to a tourist and entertainment state, would its current terms of doing public policy accommodate the relocation of a company like Microsoft to Winnemucca or even Reno. He questioned if the state had the capability to place value on this type of business.

Providing an additional scenario, Ms. Rubald said that there is a telecommunications company called Worldcom that has been growing tremendously. In the Fall of 1997, it made an offer to merge with MCI, which will probably be approved. Although Worldcom has little investment in copper wire, it is paying a great deal of money to acquire companies like MCI and the difference is being booked as goodwill, which is considered an intangible. The vast majority of Worldcom is turning from a physical asset of copper wire into a facility that generates a great deal of income because it is driving the value by combining its name and ability to manage the network; the difference being intangible value.

Chairman O'Connell clarified if goodwill that an entity is paying for is favorable, it is recognized in the profitability of the company. She added that after carrying a franchise operation herself for over 3 years in Las Vegas, the franchise did not achieve what it promised. During that time period, the expansion and new concepts of the hotels being built on the Las Vegas Strip, came into place. In the Chairman's opinion, to tax this type of intangible because it should be providing a profit is not correct.

Mr. Scofield added that what is happening in the marketplace is a higher level of competition, which limits income for each entity. That is what has happened in the telecommunications industry and what may happen in the electric and gas distribution industries. One of the reasons the state enjoys such diversification of industry is because of its tax structure. Regarding property tax, Nevada is the 17th lowest state in the country. The overall tax structure is the 3rd lowest in the country.

On behalf of all the assessors, Mr. Scofield advised the committee that they would adamantly oppose any attempt to change the methodology of the local tax structure. If the intangibles were taxed on the locally assessed utilities, the state will be "opening the door" to treating other industries in the same manner.

Ms. Rubald clarified that a questionnaire survey of the 392 telecommunications companies doing business in the state revealed the vast majority do not own property here.

Assuring Mr. Scofield that the members of the Technical Advisory Committee are sensitive to any property tax impact, Mr. Hobbs said that it would be helpful to the committee to have figures as to what the fiscal impact would be on the prior five years if Mr. Bancroft's proposal were accepted.

Mr. Pitlock informed the committee that the Department has the capability to calculate those figures for the last five years and offered to compile the information applying the more current tax rates to them.

Responding to Assemblyman Price, Mr. Scofield said that the largest property taxpayer in Clark County is Mirage Resorts; and the largest taxpayer in the State of Nevada is Nevada Power/Sierra Pacific Power Company.

Chairman O'Connell added that, the state owns property on which there are transmission lines that deal with telecommunications.

PUBLIC COMMENT

Carole Vilardo

Ms. Vilardo, Nevada Taxpayers Association, stated that in today's environment, the tax structure that was used in the past does not work well. She suggested that the committee evaluate some of "Adam Smith's Principles." Regarding intangibles, Adam Smith noted that "it is necessary to look at compliance, the ease of being able to comply, the ease of administration, the issue of equity, maintaining revenue neutrality."

Regarding the issue of expanding the taxation of intangibles to other companies, Ms. Vilardo suggested that the committee take into consideration how this would be administered, and what the compliance levels would be. She stressed that this is not just a revenue issue and nobody can predict what new technology will bring in the future. The reason this issue came about is because utilities are no longer monopolistic. Telecommunications has become a major issue since the United States Congress deregulated it.

In Ms. Vilardo's opinion, most of the people representing telecommunications and electric companies would rather be regulated because in a rate based environment they could pass tax increases on to their customers. In a deregulated society, these companies are experiencing more competition and telecommunications companies have been competing on an unequal playing field.

Ms. Vilardo recommended that the committee look at some type of transition. She also explained that goodwill is booked when a company is being sold. An example would be: *If I owned a private company and have been fortuitous to grow, I would not have goodwill on my books.*

In closing, Ms. Vilardo urged the committee to pay more attention to Adam Smith's Principles when evaluating changes to the property and fuel taxes.

Assemblywoman Lambert stated that during the 1997 Session, the Legislature discussed deregulation and it was her understanding that federal requirements would be placed on utilities to split up into generation distribution and transmission companies. The unitary valuation discussed earlier regarding centrally assessed may have little meaning if a company is owned by a corporation working out of the state.

Regarding electric restructuring, Mr. Pitlock explained that Assembly Bill 366 (Chapter 482, *Statutes of Nevada 1997*) requires "if two or more companies join together to provide electric service, those two companies would be centrally assessed." For example: an electric utility that placed its transmission, distribution, and generating plants into three separate companies. He explained that whether or not the principle presently written into law will survive as restructuring expands is difficult to foresee, and this is a topic that will require further research.

Mr. Pitlock explained that it may be possible to preserve the central assessment of a company within Nevada, but, for example, if Sierra Pacific Power Company decided to purchase its power from an out-of-state company who had no property in the State of Nevada, it is questionable how that transaction would be taxed. He noted that some states have looked at eliminating property taxes on utilities and instead, placing an excise tax on the service provided by the utility. If this was accomplished, it would not matter where the electricity came from because it would be an excise tax on the service, rather than a tax on the hard assets providing the service.

Continuing, Mr. Pitlock said in the past, monopolies existed because a tremendous capital investment was required to provide a utility service. The cost to build a power plant to provide electricity could be in excess of \$300 million, therefore, monopolies were set up to provide protection to the investors of these large plants.

Mr. Pitlock commented that driven by technology, telephone companies no longer require large sums of capital to establish a company. Presently, this can be accomplished by filing an application with the Public Service Commission

(PSC) and purchasing several computers. The value of a company is no longer in its hard assets, but is in the accumulated work force, the customer base, and many other intangibles.

In closing, Mr. Pitlock said in the near future, it will have to be decided how value is taxed on industries that are based on technology and ideas. He explained that value is presently derived from hard assets which will diminish over time as the state becomes more high tech.

Chairman O'Connell noted that she is a member of the Legislative Commission's Utility Oversight Committee, which is reviewing deregulation of the electrical industry. She advised the committee and members of the public that it will be meeting tomorrow, Thursday, June 4, 1998, in Room 4100 of the Legislative Building at 8 a.m. She noted that the Oversight Committee has been discussing some of the same issues as this committee.

Mr. Pitlock informed the committee that he will be speaking at the Oversight Committee at tomorrow's meeting.

Robert A. Ostrovsky

Mr. Ostrovsky, representing Prime Cable and Nextlink of Clark County, conveyed his support of the proposed legislation presented by Mr. Bancroft. The companies he is representing are both locally assessed companies and do not provide service outside of Clark County. Prime Cable and Nextlink view themselves as being classed as a utility, subject to either central assessment or the Department of Taxation indicating to local assessors that they are to use intangible value for those companies. He noted that this would have a substantial tax impact on both of the companies he represents. He suggested that the committee determine the amount of revenue needed to run the state before a tax increase is imposed.

Regarding economic development, Mr. Ostrovsky recommended that whatever tax policy is established for the state through this committee, it must be diverse. Lincoln, White Pine, and the other small counties are struggling with tax base and tax rate issues. If these counties could attract some high tech industry, it would bring in additional property tax, sales tax, and new growth to the tax base.

Assemblywoman Freeman asked if Congress provided federal guidelines for the states to follow when the deregulation statute passed.

Responding, the Chairman said that no guidelines were issued to the states. Because each state will handle deregulation differently, the Federal Government did not set any regulations; and to day, the Public Service Commission has not established new rules.

Adding, Mr. Pitlock explained that Federal Government did not provide guidelines to the states because each state's tax policy varies tremendously. Some states may rely on corporate income tax, while others may not have an income tax, but depend on property tax.

Mr. Leavitt commented that the committee is trying to establish a tax policy that is neutral to the state. He explained that the committee is not seeking a new revenue source, but the state needs to develop a new tax policy to accommodate deregulation of utilities. In Mr. Leavitt's opinion, it is a difficult task to try to set a new tax policy to accommodate everyone's needs.

Mr. Bancroft concurred that development of a sound tax policy is a difficult task. Balancing the needs of local government for a steady revenue source, and also take into consideration the concerns of industry to be treated in a uniform and equal manner will be difficult to achieve.

Mr. Alastuey added that the suggestions and remarks of Messrs. Bancroft and Ostrovsky have been a great help.

Mary Walker noted that according to the comments made by Mr. Leavitt, if higher assessed valuation was placed on intangibles for other locally assessed utilities there would be additional funds coming into the local governments because of a higher assessed valuation. A local government could then lower the tax rate to all taxpayers in its jurisdiction. She questioned if the utilities were to see an increase in profits, will it pass it on to its customers by

lowering their rates.

Mr. Pitlock said that each industry would have different circumstances of the various stages of deregulation. For example, an electric entity that is subject to full rate base regulation would be in a different situation from the 392 telecommunications companies that may not have any regulatory constraints.

Questioning Ms. Walker's comments, Ms. Vilardo said that *when speaking of the rates and saying the local government would have to reduce its rate on a windfall that would only occur if the local government were receiving more than 106 percent of the maximum allowed revenue. Clark County has at least five towns that could take the windfall and Washoe County is only at 5 percent against the maximum allowed revenue. I do not know the current budget, but I think that needs to be clarified. I think there are local governments that could have a windfall, but the school districts do not have the same restrictions as the cities, counties, and towns. Therefore, it would depend solely on if they were at the maximum allowed rate and would not include school districts.*

Mr. Leavitt added that the local governments have agreed, as part of the process, to require a rate reduction if they become aware of a windfall.

Hal Holmquist

Mr. Holmquist, Sprint Communications, Kansas City, Missouri, addressed the issue of rate reductions. He informed the committee that a rate reduction is not the only alternative to return dollars to customers. He explained that businesses, just like individuals, have a certain amount of budget to spend on capital expenditures, payroll, etc. If expenses are lowered through a property tax shift, sometimes a rate reduction back to the rate payer is not the best thing to do. Another solution would be to reinvest into the community in terms of new technology, which could bring about increased services that would become available to the customer. This would improve the standard of living and increase profits, which could allow a company to expand, thus increasing the property tax base in the future.

Chairman O'Connell mentioned that increased earnings might even show up in a bond rating, which reduces the cost of capital. She further noted that those who reside in southern Nevada should be aware of this because of the problems incurred by Nevada Power, whose bonding rate is now at a "B," which is costing them a tremendous amount of interest and has only been impacted by the tremendous growth.

The Chairman noted that the committee would recess for its Technical Advisory Committee meeting.

REPORTS FROM TECHNICAL ADVISORY COMMITTEE

ISSUE DEVELOPMENT

Following the study group's hearing of the Technical Advisory Committee of the Legislative Committee to Study the Distribution Among Local Governments of Revenue from State and Local Taxes (S.B. 253), Chairman O'Connell excused the facilitators for Item VI of the Agenda "Reports from the Technical Advisory Committee — Issue Development" from making their presentations to the full committee because of the late time of day and travel commitments.

Testimony of the conclusions of the technical advisory committee were submitted to LCB staff following the meeting and have been attached for the record as Exhibits E, F, and G.

Chairman O'Connell called Mr. Les Dunn forward to submit his report to the committee. For the record, the Chairman requested that Mr. Dunn speak about his work with the University of Nevada, Las Vegas (UNLV).

REPORT FROM THE SUBCOMMITTEE TO CONDUCT STUDY OF COST OF

MAINTAINING HIGHWAYS, ROADS, AND STREETS

Les Dunn

Mr. Dunn noted that his work with UNLV is related to the road study. He is responsible for gathering the information in order to put together a comprehensive cost study for road maintenance. This road study was originally formed by S.C.R. 40 under the gas tax redistribution.

The UNLV had three tasks, including:

- Task A - Research is being conducted on Nevada's surrounding states to ascertain how they are handling redistribution of gas tax money and other funding they have for road maintenance.
- Task B is comprised of meeting with the city/county entities and collecting information through a survey. The survey actually defines some of the road maintenance that is presently being worked on. Approximately 1/4 of this task will be completed by June 5, 1998, and Northern Nevada should be complete by the end of June 1998. At that time UNLV will compile reports from the information collected. Included in these reports will be some basic

costs for the road maintenance.

Responding to Chairman O'Connell, Mr. Dunn said that his work for UNLV is on schedule with the contract, but he was not aware of how far along UNLV was with compiling the data.

Walter C. Vodrazka, Jr.

Mr. Vodrazka, Transportation System Analyst, Transportation Research Center, UNLV, informed the committee that UNLV is slightly behind schedule regarding the data collection. He explained that completion of the data collection will be complete by the July 31, 1998, contract deadline.

Responding to the Chairman, Mr. Vodrazka noted that of the 36 surveys, 20 will be complete by June 5, 1998. The surveys are being completed during the site visits to each city and county.

ADJOURNMENT

There being no further business before the committee, Chairman O'Connell adjourned the meeting at 4:30 p.m.

Respectfully submitted,

Jeanne Peyton

Secretary

APPROVED:

Senator Ann O'Connell, Chairman

Date