

In re: Signal Mountain Cement Company:

Board of Equalization Administrative Law Judge Rejects Use of “Value in Use” Standard of Valuation for Tangible Personal Property Tax

November 2011

Taxpayers subject to Tennessee ad valorem taxation should take note of the recent Initial Decision and Order by the Tennessee Board of Equalization in *In re: Signal Mountain Cement Company* (Hamilton County, Tax Years 2008-2011). The Administrative Law Judge (ALJ) rejected both the “value in use” methodology as well as the use of federal capitalization principles in valuing tangible personal property. The ALJ held that such property should be valued at “fair market value,” which excludes intangible costs incurred for shipping, engineering, configuration, installation and sales tax.

Signal Mountain manufactures cement at a facility located in Hamilton County, Tennessee. The Hamilton County Property Assessor back assessed tangible personal property tax against Signal Mountain for the 2008 and 2009 tax years. Applying a “value in use” method of valuation, the Assessor added intangible costs for items such as freight, installation, engineering and sales tax attributable to Signal Mountain’s machinery and equipment to the “original cost” of such items. Original cost constitutes the starting point for standard valuation on Tennessee tangible personal property reports. In order to utilize “value in use,” the Assessor relied upon capitalization principles that are applied in the federal income tax code (the Code) for cost-recovery purposes. Under the Code, intangible costs associated with a tangible asset must be capitalized. The inclusion of these intangible values significantly increased Signal Mountain’s personal property tax liability.

The ALJ, however, rejected the Assessor’s utilization of a “value in use” methodology. The ALJ held that Tenn. Code Ann. § 67-5-601(a) prescribes a fair market value standard of valuation for property subject to ad valorem taxation in Tennessee. The section specifically states that “[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values.” The ALJ further found that the capitalization and depreciation of combined tangible and intangible expenses related to acquiring and placing an asset into service for federal income tax purposes merely constituted a method of allocation similar to that permitted under Generally Accepted Accounting Principles (GAAP). This allocation method requires taxpayers to deduct such tangible and intangible expenses from taxable income over the useful life of the asset to which they relate, and is not a method of valuation. Applying these findings, the ALJ held that, consistent with the accounting and appraisal expert testimony presented, while values for installation, engineering, freight, or transactional taxes may be properly capitalized on a taxpayer’s books for Code purposes or properly considered in making a “value in use” determination, it is not appropriate to include such intangible values when

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determining fair market value. The ALJ additionally noted that excluding intangible values from the determination of fair market value for items of tangible personal property is consistent with Tenn. Code Ann. 67-5-501(12), which defines “tangible personal property” as including “machinery and equipment separate and apart from any real property and the value of which is intrinsic to the article itself.” See also Tenn. Comp. R. & Regs. § 0600-5-.01(12) (setting for substantially the same definition). When read in context with the rule in Tenn. Code Ann. § 67-5-601(a) that tangible personal property must be valued at fair market value (i.e., the price that a willing buyer would pay a willing seller in an arm’s-length transaction on the open market), the ALJ concluded it is clear that tangible personal property must be valued separately from intangible costs incurred to ship, configure or install it, as well as from transactional sales and use taxes incurred upon such purchase.

On November 10, 2011, the ALJ denied the Assessor’s Petition for Reconsideration, though it is anticipated that the Assessor will seek to appeal the Initial Decision and Order to the Assessment Appeals Commission. Dependent upon the outcome of this matter, taxpayers who reported capitalized book values calculated for federal income tax purposes as the “original cost” of tangible personal property for purposes of standard valuation on Tennessee’s tangible personal property report should consider filing amended returns for 2011 segregating out intangible costs such as engineering, freight, installation and sales tax from the “original cost” of such items. The deadline to file amended 2011 tangible personal property reports is September 1, 2012, and the Assessor of Property with whom it is filed has sixty (60) days in order to make a determination, after which taxpayers may appeal.

For additional information, please contact **Leigh Griffith, Charlie Trost, Michael Yopp, Chris Wilson** or any member of the Waller Lansden Tax practice at **800-487-6380**.

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