Jim Hitchner's
Valuation Products and Services

DO YOU KNOW?

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A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do you know…

… the valuation of goodwill is an important aspect in the property tax assessment of many industrial and commercial companies?

State and local taxation (SALT) authorities appraise the taxable property of most industrial and commercial taxpayers based on what is called the *summation principle* of valuation. The assessment authority values each component of real estate (RE) and tangible personal property (TPP) in the warehouse, factory, store, or office building and then "sums" these individual property values to conclude the taxpayer's total property tax assessment. Most often (and typically based on state statute or regulation), the SALT assessor applies the cost approach to value the taxpayer's individual RE and TPP assets.

In contrast, tax assessors apply what is called the *unit principle* of valuation to appraise the taxable property of many types of industrial and commercial taxpayers. Applying this principle, all of the taxpayer's property is valued in the aggregate as a single "unit" or bundle of operating assets. Most often, the SALT assessor applies the income approach and/or the market approach to value this "unit" of property. In the income approach, the income considered is business operating income and the discount or capitalization rate is derived form capital market data. In the market approach, again the income considered is business operating income and the pricing multiples are extracted from either guideline company stock market multiples or guideline merger and acquisition transaction pricing multiple.

If a unit principle property valuation sounds a lot like a business valuation, that's because it is a lot like a business valuation.

The types of taxpayers that are subject to unit principle valuation include:

- Companies that cross jurisdictional boundaries (railroads, airlines, telecom companies, electric companies, pipelines)
- Companies with properties that are physically, functionally, and economically integrated (refineries, cable TV systems, racetracks, hospitals)
- Companies where the business is location-dependent (mines, marinas, sports stadiums).

In many taxing jurisdictions, only RE and TPP are subject to property tax. That means that goodwill and other intangible assets are not subject to property tax. In just about all taxing jurisdictions, only "property" is subject to property tax. And, only property that is in place (i.e., that exists) on the assessment date is subject to property tax.

In many jurisdictions, while goodwill is an asset for accounting purposes, goodwill is not "property" for legal purposes. This is because goodwill may not meet all of the legal requirements to be considered property.

There are many definitions of goodwill. A common accounting definition is the residual business value (if any) that is left over after appropriate values have been assigned to all of the entity's tangible assets and identifiable intangible assets. A more valuation-related definition for goodwill is the present value of future income from future assets. A very common definition of goodwill is capitalized excess earnings, where excess earnings are calculated as the residual earnings after a fair return has been provided for all of the entity's tangible assets and identifiable intangible assets.

Accordingly, regardless of the goodwill definition applied, the taxpayer entity's goodwill should not be subject to property tax. And, it is up to the taxpayer to (1) identify its goodwill, (2) value its goodwill, and (3) extract (meaning deduct) the goodwill value from the total unit value—in order to conclude the value of the remaining unit of property that is subject to property taxation.

For taxpayers subject to the unit principle of valuation, valuation analysts can provide a valuable tax planning, compliance, and litigation service. That service is to value the taxpayer's goodwill and to remove that goodwill from the total unit value in order to calculate the residual value of the taxable RE and TPP.

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A more fulsome description of property tax valuation principles and procedures is presented in ***Best Practices—Thought Leadership in Valuation, Damages, and Transfer Price Analysis*** by Robert Reilly and Robert Schweihs. A more detailed description of the generally accepted goodwill valuation approaches, methods, and procedures is also presented, as well as discussions on topics that address business valuation, damages, and transfer price analysis.

BEST PRACTICES

Thought Leadership in Valuation, Damages, and Transfer Price Analysis

by Robert E. Reilly and Robert P. Schweihs

An anthology of related discussions not found in most textbooks, ***Best Practices*** is nearly 1,200 pages of thought leadership, with chapter discussions including:

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