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PERSONAL PROPERTY TAXES: VALUATION OF INVENTORY

The taxpayer, an out of state manufacturer, had inventory in the City of Milwaukee in a company warehouse and in stores owned and operated by it. In May, 1959, the assessor of the city of Milwaukee included in his assessment of the personal property in the warehouse a mark-up equivalent to a manufacturer's mark-up when selling to an individual distributor. Similarly the assessor valued the goods in the company stores at a figure which included a mark-up based on the profit that a distributor would realize in selling to an independent retailer. The taxpayer objected to this method of assessment, contending that the manufacturer's cost should be the basis of the assessment of goods in both the warehouse and the retail stores. The Board of Review of the City of Milwaukee approved the assessor's action but on certiorari to the circuit court, the principle used in the assessment was expressly approved but the particular application of the principle in the present case was struck down for the reason that other manufacturers' inventories in the city were not assessed according to the same principle.¹

The decision in this case presents the interesting problem of whether or not an anticipated profit is a proper element for consideration in assessing a manufacturer's inventory under the relevant Wisconsin statute requiring that personal property shall be assessed at true cash value.²

As a matter of standard business practice, the primary rule followed in valuing inventories for accounting purposes is cost or market value, whichever is lower.³ This rule is carried over into valuing inventories for taxation purposes under federal income tax law,⁴ and is permissible under Wisconsin income tax law.⁵ The income tax inventory made by merchants and manufacturers is utilized by property tax assessors.⁶

This rule used for business and income tax accounting presents a special problem for personal property tax assessment. Under a market value test, which market is to be considered: the market on which the

¹ State of Wisconsin *ex rel.* the Goodyear Tire and Rubber Company v. the Board of Review of the City of Milwaukee, 2 C.C.H. Wis. Tax Cases ¶200-073, (Cir. Ct. Milw. Co. 1962). An examination of the file of this in the office of the clerk of court revealed that the taxpayer and the city had compromised on an assessment and had stipulated that the decision of the court could be vacated on the motion of either party.

² WIS. STAT. §70.34 (1961). "All articles of personal property shall, as far as practicable, be valued by the assessor upon actual view at their true cash value; . . ."

³ ACCOUNTANT'S HANDBOOK 560 (3d ed. Paton 1947). The accountants' use of the word "market" connotes the market on which the owner of goods could replace them at the time of inventory. The assessor's use of the word market in the instant case is the market on which the goods could be sold.

⁴ 2 MERTENS, LAW OF FEDERAL INCOME TAXATION §16.14 (rev. ed. 1961).

⁵ WIS STAT. §71.11 (9) (1961).

⁶ WISCONSIN DEPARTMENT OF TAXATION, ASSESSORS' MANUAL 160-161 (1952).

inventory holder buys or the market on which he sells? The decision in the case under discussion answered this problem by using the selling market as the one to be considered in valuing a manufacturer's inventory.

The court relied on the decision in *State ex rel. I.B.M. Corp. v. Board of Review of the City of Fond du Lac*.⁷ That case involved the assessment of business machines being rented by the taxpayer. The assessor, in valuing this personal property, ascertained the gross annual income from rental, subtracted service costs, and capitalized the resulting amount at twenty per cent. The court held the assessment improper, stressing that all elements affecting the value should be considered. The selling price of the property was stated as the test required under our assessment statute. The court went further and offered, as an aid to the lower court in reconsidering the case, a suggested formula for ascertaining the selling price of the property:

Clearly, in our opinion, the cash value of the machines at Fond du Lac is not their actual manufacturing cost to plaintiff nor their replacement value new, which is the same as actual cost, plus cost of transportation and installation. The selling price of personal property manufactured and sold on the market obviously includes, in addition to actual manufacturing cost, sales expense, transportation, installation expenses,—in some cases cost of operation instruction,—and over and above all of these a substantial profit.⁸ (Emphasis added.)

This clear statement of the permissibility—if not the necessity—of including the profit to be derived from property as an element of assessment is re-enforced when the court concludes its opinion by stating, with reference to the above quoted language:

Under the statute as it now exists, we conclude that the method suggested would result in a fair and just assessment and one which could not be successfully challenged in this state.⁹

However the holding of the *I.B.M.* case has not been without criticism. It has been pointed out that the inclusion of profit as an element of valuation was not before the court and the facts did not involve a manufacturer's inventory of goods held for sale.¹⁰

In view of the strong language used by the court in the *I.B.M.* case, it is interesting to note the administrative procedure followed by the Wisconsin Department of Taxation.

In assessing a merchant's inventory, the department has stated that although the goods in the inventory will be sold individually at retail,

⁷ 231 Wis. 303, 285 N.W. 784 (1939).

⁸ *Id.* at 315, 285 N.W. at 789.

⁹ *Id.* at 316, 285 N.W. at 789.

¹⁰ Note, *Taxation—Inconsistent Assessment of Merchant Inventories in Wisconsin*, 1956 Wis. L. Rev. 171.

the sum of such prices is not the true cash value of the inventory. Instead the "price at which such property would ordinarily sell for *on the market as a whole*," the market being free from inflationary and depressive factors, is the true cash value.¹¹ (Emphasis by the department.) The department, realizing that bulk sales of this kind are rare, declares that the ordinary method of arriving at the value of an inventory is to find out the replacement cost to the taxpayer of a similar inventory.¹²

The manual in discussing manufacturer's inventories makes this curious statement:

As in the case of merchants' stocks, determining what such a stock would *cost*, in the hands of the manufacturer and in its condition of May first, seems the most practical method of arriving at the *selling* price of manufacturers' stock. In Wisconsin, the cost or market of such inventories which have been furnished for income tax purposes are available to the assessor. . . .¹³ (Emphasis by the department.)

Thus, on comparison, the procedure detailed by the Department of Taxation and the statement made by the supreme court in the *I.B.M.* case that a substantial profit should be included as an assessment element (assuming the rule of the case is applicable to inventories) appear to be at odds with one another. Under the department's recommended method it is difficult to see how the true cash value can be determined. In Wisconsin the definition of true cash value is the "value at which a willing buyer and a willing seller would deal."¹⁴ The profit element would seem to be an inherent characteristic under such a definition.

The apparent discrepancy between the statutory standard of true cash value and the method of assessment currently employed is highlighted by the provisions of a bill introduced in the Wisconsin Assembly in 1955, a year after the profit mark-up in inventory assessment was a topic of controversy in Madison.¹⁵ The bill sought to amend section 70.34 so that personal property was to be valued at "adjusted cost," defined for personal property generally as the lower of original cost to the owner or the replacement cost. The "adjusted cost" of a manufacturer's inventory was defined as the cost of material components plus direct labor costs incurred in manufacture.¹⁶ Under the provisions of the bill the profit element would not be a proper element for consideration. However, the proposed amendment did not receive legislative approval.

¹¹ Wisconsin Department of Taxation, *supra* note 6, at 37.

¹² *Ibid.*

¹³ *Id.* at 38.

¹⁴ *Satte ex. rel. Baker Manufacturing Co. v. City of Evansville*, 261 Wis. 599, 608, 53 N.W.2d 795, 822 (1952).

¹⁵ *Supra* note 10, at 178.

¹⁶ Bill 438, A (1955).

The practical impact of the inclusion of the profit element in valuing inventories must be briefly considered. As far as the taxpayer is concerned, the value of his assessment will be increased and there will be a corresponding increment in the amount of taxes to be paid on the property. This would result in inventory owners seeking to move their holdings to a more profitable territory with a resultant loss of revenue to the taxing authority.¹⁷ The inclusion of a mark-up would increase the personal property tax burden borne by owners of merchants' and manufacturers' inventories. The present system of taxing inventories has been condemned as "uneconomic, unscientific, unsound, undemocratic and unequal."¹⁸ The practical impact on the taxing authority would be that revenue derived from the personal property tax would be increased and with the increase in the assessed value of property within the district, the debt limitation for the taxing authority would be extended.¹⁹

Relief has recently been granted to the owners of merchants' and manufacturers' inventories in the form of a fifty per cent tax offset granted by new statutory provisions.²⁰ The practical impact as discussed above is thus modified to the extent that an increased tax burden on inventory owners will be prevented, while at the same time needed revenue for the local taxing authority will be provided. The underlying problem of the inclusion of the profit mark-up will not be affected by this statutory relief.

A discussion of the problem would not be complete without noting the manner in which some other jurisdictions handle the question of merchants' and manufacturers' inventories.

In Florida, the court has upheld an inventory assessment in which the valuation was based on the original cost or replacement cost whichever was lower and an allowance was made for depreciation. The court there expressly rejected the use of market price as a measuring standard because there is a disparity between the market price at which the owner buys and the market price at which he sells.²¹

Minnesota has held that automobiles being stored by the manufacturer in a warehouse pending shipment to dealers were properly assessed at the usual price at which the manufacturer would sell to dealers. This

¹⁷ Martel, *It's Time to Abolish the Personal Property Tax on Business Inventories*, 4 J. TAXATION 78 (1952).

¹⁸ *Ibid.*

¹⁹ WIS. CONST. art. 81, §3; WIS. STAT. §67.03(1) (1961).

²⁰ WIS. STAT. §77.64 (1961). The local taxing authority remits to the department of taxation a statement of the total amount of assessments of merchants' stock in trade and manufacturers' materials and finished products. This amount is then certified to the department of administration which in turn remits fifty per cent of the local levy on the assessment to the taxing authority which credits this to the tax bills of merchants and manufacturers.

²¹ Hillsborough County *et al.* v. Knight and Wall Co., 153 Fla. 346, 14 So.2d 703 (1943).

would appear to allow the inclusion of a profit as an element in assessment.²²

The Supreme Court of New Hampshire has spoken on the matter of the propriety of the assessor including an element of salability in valuing a stock in trade.²³ In answer to a question from the New Hampshire House of Representatives, the court tersely answered:

The salability of property is a factor properly to be considered in determining its (a stock in process) value. Hence our answer to this question is that the assessing authority may give, *and in fact is bound to give* such consideration as it deems just to the salability of stocks in process *or at other stages.*²⁴ (Emphasis added.)

The same court has more recently spoken on the valuation of a stock in trade. A taxpayer complained because his stock in trade was assessed at one hundred per cent of its full cash value and his land, buildings and machinery at lesser rates. The court rejected the assessment and stated that for assessment purposes, under a statute requiring property to be appraised at full and true value, a stock in trade is identical with land.²⁵ This decision suggests an interesting possibility in relation to our question of the inclusion of a mark-up in assessing an inventory. If an inventory is to be assessed uniformly with real property, is the inclusion of an anticipated profit allowable in assessing realty?

The statutory requirement with regard to the valuation of real property is that it be "valued . . . at the full value which could ordinarily be obtained therefore at a private sale."²⁶ As far as personal property is concerned the standard is that it "shall . . . be valued . . . at . . . true cash value."²⁷ It has been held that both of these standards presuppose "a value at which a willing buyer and a willing seller would deal."²⁸

The Wisconsin Constitution demands that "the rule of taxation shall be uniform. . . ."²⁹ This command has been bolstered by a legislative direction that "the assessor shall exercise particular care so that personal property as a class on the assessment rolls bears the same relation to statutory value as real property as a class."³⁰

It follows that the standard of assessment for real and personal property in Wisconsin is the same and that the standard must be uniformly applied. The command of uniformity is that there be uniformity

²² *State v. Maxwell Motor Sales Corp.*, 142 Minn. 226, 171 N.W. 566 (1919).

²³ *Opinion of the Justices*, 95 N.H. 543, 64 A.2d 325 (1949).

²⁴ *Id.* at 544, 64 A.2d 326.

²⁵ *Bemis Brothers Co. v. Claremont*, 98 N.H. 446, 122 A.2d 512 (1954).

²⁶ WIS. STAT. §70.32 (1961).

²⁷ WIS. STAT. §70.34 (1961).

²⁸ *State ex rel. Baker Manufacturing Co. v. City of Evansville*, *supra* note 14, at 608.

²⁹ WIS. CONST. art. VIII, §1.

³⁰ WIS. STAT. §70.345 (1961).

between classes not merely within a class. The Wisconsin court has made this decisively clear:

As we heard the city's oral argument and read its brief we gained the impression that it contends that there is uniformity of taxation if one fraction of true value is applied to all real property, although some other fraction thereof may be used in the case of personalty,—that the requirement of uniformity is satisfied so long as there is uniformity within the class. We do not consider this to be the law. In our view the command of sec. 1, art. VIII of the Wisconsin Constitution, requires uniformity of taxation according to the value of real and personal property without distinction.³¹

In view of the identical assessment standard which the court has approved and the command of uniformity, we can look to decisions involving real property to see if the inclusion of a profit or anticipated value is allowable there.³²

It may be generally stated that prospective value insofar as it is reflected in present value is a proper element for consideration in assessing real property.³³

In Wisconsin this principle is demonstrated in the early case, *City of Janesville v. Markoe*.³⁴ There, taxpayer's land was subdivided into lots and blocks as an addition to the city by taxpayer's predecessor in interest and the land was assessed as subdivided. The taxpayer objected to the assessment because he used the property for farming land. Our court upheld the assessment saying:

We suppose it is the duty of the assessor to list the lands at their true value, regardless of the purpose for which they were used.³⁵

A Michigan case,³⁶ decided under a statute similar to Wisconsin's section 70.32, involved a taxpayer who owned land on which there was a dam regulating the flow of water in a river on which the taxpayer owned a power plant. The physical value of the land was claimed to be two thousand dollars. The assessment was three times that figure. The court approved of the valuation and held that the proximity of the dam to the power plant was "helpful in determining its earning power—an

³¹ State *ex rel.* Baker Manufacturing Co. v. City of Evansville, *supra* note 14, at 609.

³² That the Wisconsin court may be inclined to look to real property cases can be gathered from the *I.B.M.* case where the court in approving the inclusion of profit in assessments of personal property quoted a real property case and commented on the quotation: "That was said in respect to real estate but is equally applicable to personal property." State *ex rel.* I.B.M. Corp. v. Board of Review, 231 Wis. 303, 315, 285 N.W. 784, 789 (1959).

³³ 51 A.M. JUR. *Taxation* §706 (1944).

³⁴ 18 Wis. 368 (1864).

³⁵ *Id.* at 374.

³⁶ Alpena Power Co., Limited, v. Caledonia Township, 194 Mich. 622, 161 N.W. 829 (1917).

essential element always taken into consideration in arriving at the selling price."³⁷

These two examples as to the allowability of the inclusion of prospective value when reflected in present value lend weight to the substantial profit statement of the *I.B.M.* case, especially when viewed in the light of the uniformity requirements so clearly set out in Wisconsin.

A further argument that a mark-up for profit is permissible in assessing property can be found in the rule that the sale value is the controlling consideration in real property assessments and that intrinsic value to the owner is not determinative. An example of this rule in Wisconsin is *State ex rel. Oshkosh Country Club v. Petrick*.³⁸ The assessor valued the property in question by including in his valuation the cost of converting the meadow land into a golf course. The supreme court held that since there would be no sale for a golf course the property must be assessed at the value for which it could be sold, namely, farming. The test is that the "property shall be assessed with reference to purposes for which it may be sold rather than the purposes to which it presently may be devoted."³⁹

A more forceful declaration of the rule followed two years later in *State ex rel. Northwestern Mutual Life Insurance Co. v. Weiher*,⁴⁰ where the assessor used a formula to determine the value of the land to the taxpayer and based the assessment on the resulting figure, even though in his judgment the building could only be sold at a lesser figure. The court held that the assessment was invalid and stated:

The statutory rule of assessment of real estate is to assess it at its sale value and not at its intrinsic value *if that differs from the sale value*.⁴¹ (Emphasis added.)

It is to be noted that in both of these cases intrinsic value exceeded sale value and sale value was held to be controlling. If the rule enunciated in these cases can be applied to personal property through the uniformity requirements, merchants' and manufacturers' inventories would have to be assessed with reference to their sale price and this would include, in the natural course of business, a substantial profit.

In conclusion, it appears that the inclusion of a profit mark-up as an element in valuing merchants' and manufacturers' inventories is allowable under a statutory requirement of assessment at true cash value. This conclusion is drawn from the substantial profit statement in the *I.B.M.* case, the identical statutory standards of assessment for real and personal property, the clear command of uniformity of taxation,

³⁷ *Ibid.*

³⁸ 172 Wis. 82, 178 N.W. 251 (1920).

³⁹ *Id.* at 84, 178 N.W. at 252.

⁴⁰ 177 Wis. 445, 188 N.W. 598 (1922).

⁴¹ *Id.* at 448, 188 N.W. at 598.

the permissibility of including prospective value in assessing realty, and the emphasis on sale price as the determinative factor with the profit implication inhering in a sale between a willing buyer and a willing seller.

—ROCH CARTER