

MGA Review Discussion Paper

Machinery and Equipment Property Assessment and Taxation

This technical document is part of a series of draft discussion papers created by Municipal Affairs staff and stakeholders to prepare for the Municipal Government Act Review. It does not reflect existing or potential Government of Alberta policy directions. This document is the result of a careful review of what is currently included in the Municipal Government Act (MGA) and regulations, definitions of terms and processes, changes requested by stakeholders over the last 18 years, some highlights from other jurisdictions, and identification of potential topics for discussion during the MGA Review. This information will be used to prepare consultation materials as the MGA Review proceeds.

These discussion papers have been reviewed and approved by the MGA Stakeholder Advisory Committee, comprised of representatives from major stakeholder organizations: Alberta Association of Municipal and Counties, Alberta Association of Urban Municipalities, Alberta Rural Municipal Administrators Association, Alberta Chambers of Commerce, City of Calgary, City of Edmonton, and Local Government Association of Alberta.

The Government of Alberta is asking all Albertans to directly contribute to the MGA Review during online consultation in late 2013 and consultation sessions throughout Alberta in early 2014. This technical document is not intended for gathering stakeholder feedback, but to generate thought and discussion to prepare for the upcoming consultation. Public engagement materials will be available in early 2014. To learn more about how you can join the discussion on how we can build better communities, please visit mqareview.alberta.ca/get-involved.

Preamble

The *Municipal Government Act (MGA)* provides the legislative framework to guide the operations of municipalities in Alberta. The current *MGA* empowers municipalities with the authority and flexibility to provide services in the best interests of the community. The *MGA* Review will proceed along three major themes: *governance and administration*; *assessment and taxation*; and *planning and development*.

This paper is one of 12 discussion papers exploring aspects related to the *assessment and taxation* theme. Property tax valuation systems should be designed to maximize equity among property taxpayers and visibility or openness, while minimizing administrative complexity and confusion¹. Alberta's property assessment and taxation framework must be considered with the following principles in mind:

- Clarity
- Fairness
- Efficiency
- Predictability
- Stability
- Transparency

This paper focuses on market value assessment and administration as outlined in the *MGA* and its attendant regulations. Below is a list of the 12 papers that relate to the *assessment and taxation* theme.

- Market Value Assessment and Administration
- Linear Property Assessment
- Machinery and Equipment Assessment
- Farm Property Assessment
- Railway Property Assessment
- Airport Property Assessment
- Supplementary and Progressive Assessment
- Equalized Assessment
- Taxation
- Exemptions and Other Special Tax Treatment
- Assessment Complaints and Appeals
- Municipal Revenue Sources

¹ International Association of Assessing Officers (IAAO). *Standard on Property Tax Policy*. Kansas City: IAAO, 2010.

Machinery and Equipment Property Assessment



The *MGA* sets out two methods, or standards, for the assessment of property in Alberta: the market value based standard (a methodology based on the market value of a property) and the regulated procedure based standard (a methodology that uses assessment rates and procedures as prescribed under regulation to calculate the assessed value of a property).

Machinery and equipment (M&E) property is one property type that is assessed under the regulated procedure based standard.² M&E are the components or equipment within commercial and industrial properties where manufacturing or processing occurs. These properties include, but are not limited to, refineries, chemical plants, pulp and paper plants, upgraders, food processing facilities, grain and fertilizer handling facilities, bakeries and butcher shops. Within these sites, the M&E property includes such things as storage tanks, separators, fuel gas scrubbers, compressors, chemical injectors, metering and analysis equipment, ovens, mixers, grinders, and other equipment and components.

This paper explores what we have heard from stakeholders on the current valuation procedure for M&E property, existing definitions and the delineation of M&E property from other property types, depreciation rates and practices, and assessment and taxation incentives that are applied to M&E property. The table on the following page is an example of the taxes payable by M&E properties compared to residential and non-residential properties when all assessment incentives are applied to an M&E property.

² Other regulated property assessment categories (i.e., linear, farmland, and railway property assessment) are addressed in separate *MGA Review* discussion papers.

Table 1: Comparison of Taxes Payable for Residential, Non-residential and Machinery and Equipment Properties

	Residential	Commercial	Machinery and Equipment
Value*	\$1,000,000	\$1,000,000	\$1,000,000
Minister's Guidelines including the Cost Construction Reporting Guide (CCRG)**	N/A	N/A	\$600,000
77% Statutory Level	N/A	N/A	\$462,000
Final Assessment	\$1,000,000	\$1,000,000	\$462,000
Municipal Tax Rate	0.008	0.016	0.016
Education Tax Rate	0.004	0.008	0.00%
Total Annual Municipal Taxes	\$8,000	\$16,000	\$7,392
Total Annual Education Taxes	\$4,000	\$8,000	\$0
Total Annual Taxes	\$12,000	\$24,000	\$7,392

*Value for each property type as newly completed. For residential and commercial property, value is assumed to be the market value. For machinery and equipment, value is the total project cost as calculated using the regulated assessment formula in the Minister's Guidelines and does not include land and buildings.

**Once the CCRG and the Minister's Guidelines have been applied.

Discussion Points

Below are some discussion topics and questions identified through a review of requested amendments, cross-jurisdictional research and issues raised by stakeholders.

1. Assessing Machinery and Equipment Property

Background

M&E property is assessed using a regulated procedure based model. This model includes rates, procedures and depreciation tables as set out in the Machinery and Equipment Minister's Guidelines, and is applied to M&E property through a standardized process.

Industry stakeholders have suggested that this standard process is not reflective of current and real time "market value" and does not accurately account for a property's depreciation. However, market value is difficult to estimate for M&E property since the value of the business, which is not subject to assessment, is not easily separated from the value of the property's physical components which are subject to assessment, and the use of a market value model may not maintain a consistent, predictable assessment base.

Cross-jurisdictional Research

- In British Columbia, M&E properties are assessed as "major industrial" or "light industrial" property, using regulated rates set by the Province.
- In Saskatchewan, M&E properties are assessed as "industrial" using regulated rates.
- Ontario also uses a regulated procedure based model for industrial properties.

Stakeholder and Legislative Amendment Requests

- Some industry stakeholders have requested an assessment process for M&E property that is similar to a market value standard.
- Some industry and municipal stakeholders have suggested that major industrial M&E properties such as upgraders and refineries should be assessed by the Province (as are linear properties), given the complexity of these properties.

2. Definitions

2a) Definition Overlaps

Background

In some respects, the current definition of M&E property overlaps with the definition of linear property. This can present some challenges, particularly considering that there are several distinctions in legislation and procedure when it comes to the assessment of "linear property", "machinery and equipment", "buildings and structures", "buildings", "structure" and "land".

This sometimes causes confusion in appropriately describing and assessing these types of properties. For example, a petroleum tank farm is likely to contain both linear property and machinery and equipment property – with distinct procedures/rates applying to each type of

property. This separation of the overall property site into smaller types of property for assessment purposes can be difficult for the property owner to understand, particularly if the site produces a single product. It may also result in challenges for the municipal assessor if he or she is not certain whether a particular component of a facility is linear property (which the ministry assesses) or machinery and equipment (which the municipality assesses). It's possible that the same type of tank farm might be assessed somewhat differently by another assessor in another municipality.

Similar challenges can arise with electric power generation facilities. In general, municipal assessors are responsible for assessing M&E property. However, some M&E components qualify as linear property and are assessed by the ministry, such as certain components of electric power generation facilities.

Additional challenges exist in commercial properties such as a bakery or butcher shop that is composed, for the most part, of land, buildings and structures, and is assessed primarily through the market value approach – but its ovens, mixers, grinders, etc., are assessed through the regulated approach for M&E property. Industrial facilities are usually composed of a greater component of M&E and are assessed primarily through the regulated approach – however, land, buildings and structures that are not directly involved in the processing or manufacturing are assessed at market value.

Cross-jurisdictional Research

- In British Columbia, there are nine classes of property that clearly differentiate between property types. B.C. also has a major industry class that assesses major industrial facilities as one property type.
- Ontario has 13 classes of property including industrial, large industrial, and pipelines. These classes categorize the properties into one property type (e.g., refineries and manufacturing facilities).

Stakeholder and Legislative Amendment Requests

- Municipal and industry stakeholders have requested that definitions be modified to provide for the assessment of linear, market value and machinery and equipment properties within the same facility as a single property.

2b) Definition Updates

Background

Current definitions for M&E property were created in the 1980s and reviewed in the early 1990s with the drafting of the *MGA*. As time passes, industries develop and component labels and technology change. In order for a property assessor to properly value and apply the legislation, M&E property definitions should be clear, relevant and up-to-date. Although industrial technologies are constantly evolving, M&E property definitions have remained relatively static under the *MGA*.

Stakeholder and Legislative Amendment Requests

- Municipal associations and individual municipalities have requested that the Province update definitions to reflect current and emerging technologies used in M&E properties.
- A municipal association has requested the Province add Trucks and Shovels used in oil sands excavation to the definition of M&E.

3. Special assessment and taxation treatment of M&E Property

3a) Statutory Assessment Levels

Background

The *MGA* prescribes a reduced statutory level of 77 per cent for the assessment of M&E property. In other words, once the assessment is calculated for M&E property, the value is reduced by 23 per cent to determine the final taxable assessment. The original intent of this policy was to support investment in industry in Alberta.

Stakeholder and Legislative Amendment Requests

- Municipal stakeholders and municipal associations request that the Province review this provision and ultimately remove it from legislation.
- Industry stakeholders believe this incentive is still required to maintain Alberta's competitiveness, given market uncertainty in the current economic climate.

3b) Depreciation

Background

Depreciation in assessment is the loss of property value due to any cause. For properties such as M&E that are assessed using a regulated model, applicable levels of depreciation are set out under the Minister's Guidelines. Currently, M&E properties receive immediate depreciation of 25% and can receive up to 60 per cent additional depreciation based on the age of the property, resulting in significantly less in municipal tax payable. These depreciation methodologies were originally implemented to encourage new plant construction and replacement of old plant M&E. Conversely, market value properties and other regulated properties (e.g., linear property) do not receive the same level of treatment.

Stakeholder and Legislative Amendment Requests

- Some municipal stakeholders have suggested that this maximum level of depreciation is no longer relevant given the durability of modern machinery and equipment, and that depreciation rates require updating.
- Industry stakeholders maintain that this level of depreciation is still necessary to account for the volatility of the current economic environment.

3c) Education Tax Rate of Zero

Background

In the early 1990s, the Province initiated a phase out of the education tax on M&E as an incentive to promote industrial competitiveness in Alberta. Currently, M&E has a zero education tax rate.

Cross-jurisdictional Research

- In British Columbia, education taxes are levied on M&E.
- Saskatchewan also levies education taxes on M&E.

Stakeholder and Legislative Amendment Requests

- Municipal stakeholders and owners of different property types have asserted that the education tax burden is not shared by M&E owners.
- M&E owners maintain that this incentive is necessary for the ongoing development of industrial facilities in Alberta.

4. Progressive Assessments³ on Machinery and Equipment

Background

Progressive assessments allow a municipality to capture the assessment value for properties that are partially complete when the annual assessment is prepared. Unlike residential and commercial properties, an assessment cannot be prepared for M&E if it is only partially completed by December 31 (physical condition date). If the municipality has a supplementary tax bylaw, a supplementary assessment may be prepared for M&E. Therefore it becomes taxable in the month that it is operational.

Stakeholder and Legislative Amendment Requests

- Municipalities are concerned about missing tax revenue for municipal services for up to a year and would like the legislation amended to allow them to tax partially completed M&E.
- Industry stakeholders maintain that they should not be taxed on property that is not operational, as the property is not generating revenue until it is complete.

³ Progressive assessments are discussed in more detail in the Supplementary and Progressive Assessment Discussion Paper.

Discussion Questions



1. Is the assessment and taxation process for machinery and equipment property fair and equitable for municipalities and property owners? Why or why not?
 - a. Is a regulated procedure based model a reasonable method to assess machinery and equipment property? Why or why not?
 - b. What aspects, if any, of the regulated procedure based model could be improved?
 - c. Who should have the responsibility for assessing major industrial M&E properties: municipal assessors, or the Province? Why?
2. Are there instances where existing M&E property definitions in the *MGA* are unclear? (e.g., linear property overlap, electric power generation, new technologies, etc.)? If so, which definitions?
 - a. Should different property types within the same facility be assessed as a single property? Why or why not?
3. Are current assessment and tax policies for M&E still relevant?
 - a. Is the reduced statutory assessment level of 77 percent for M&E property relevant? Why or why not?
 - b. Are the current depreciation methodologies for M&E properties still relevant? Why or why not?
 - c. Is the 0% education tax rate for M&E still relevant? Why or why not?
4. Should municipalities have the ability to prepare progressive assessments on partially complete machinery and equipment? Why or why not?