# PROPERTY TAXES – GENERAL CONCEPTS AND OPPORTUNITIES

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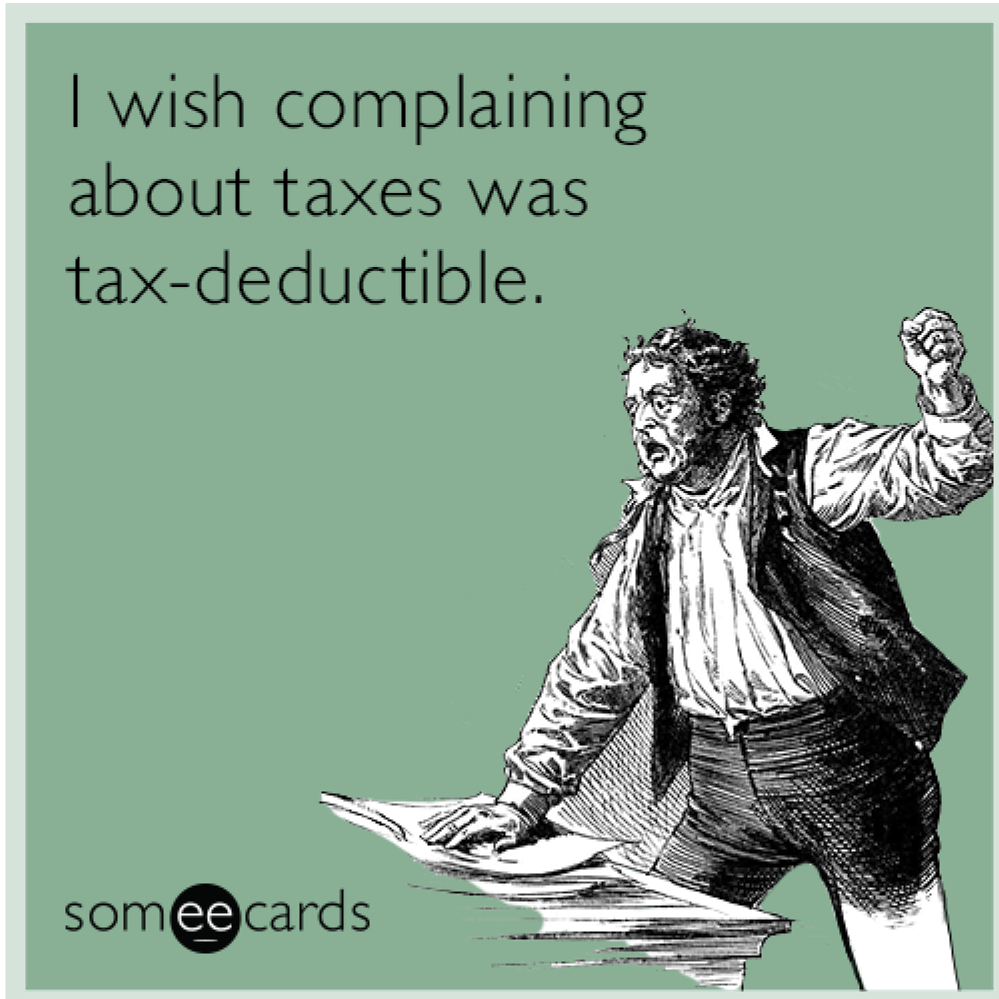
I wish complaining
about taxes was
tax-deductible.
someecards

# AGENDA

- Explain – what is property tax, definition, likenesses/differences to other taxes
- Types of property tax and definition of terms
- Assessed vs Appraised Values, rates/ratios
- Where property tax imposed and on what
- Exemption from property tax and benefits/downsides of property tax versus other taxes
- Who imposes property taxes and what do property taxes fund
- Approaches to Valuation
- Missouri specific property taxes
- Illinois specific property taxes
- Assessment timing/cycles
- Property Tax appeal process, reasons/when to appeal
- Property Tax incentives
- Examples/Stories
- Best Practices
- Discussion/Questions

# WHAT IS PROPERTY TAX

- Property Tax is an ad valorem “according to value” tax which means a tax based upon the value of an item. This is different from a transaction tax which is normally imposed upon the selling price of an item

- Property Tax is an above-the-line expense

- Property taxes equal the mill rate multiplied by the assessed value

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# ABOUT PROPERTY TAX

- Property tax is primarily levied on immovable property like land and buildings, as well as on tangible personal property (tpp) that is movable, like vehicles and equipment.

- Property taxes are the single largest source of state and local revenue in the U.S.

- Property taxes account for over 30 percent of total state and local tax collections and over 70 percent of total local collections.

- The US relies on property taxes more than many other developed countries who rely more on consumption taxes.

# WHAT IS PROPERTY TAX IMPOSED ON

Property Tax is a tax imposed on real property in every state and imposed on business personal property in all but 9 states.  11 states tax inventory.

What is Real Property?

**Real Property**

- Land, Buildings, Land improvements, Building Improvements
- Improvements – intended permanently attached additions to land
- Fixtures – varies in how categorized
  - Real Property valuation mostly based upon sales of like property
  - There is no automatic depreciation of real property
  - To the contrary, real property generally increases in value

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# WHAT IS PROPERTY TAX IMPOSED ON (CONTINUED)

What is Personal Property?

**Personal Property**

- Tangible items that are not real property such as vehicles, machinery, and F&F
- Personal Property valuation mostly based upon original cost less depreciation
- Most jurisdictions have automatic depreciation based upon age
- Jurisdiction depreciation tables can vary significantly

So, property taxes are imposed on most land, buildings, land/building improvements, personal property fixed assets, and various other personal property such as supplies and inventory depending upon the state.

# HOW IS PROPERTY TAX DETERMINED

What is Appraised Value?

**Appraised Value**

Estimate of the fair market value between a willing buyer and willing seller not under duress

What is an Assessed Value?

**Assessed Value**

The value or ratio of the appraised value (estimated FMV) on which property taxes are based

# HOW IS PROPERTY TAX DETERMINED

**Assessed Value (Missouri – in example)**

The portion of the appraised value (estimated FMV) on which property tax is based

| MO Assessment Ratios | |
|---|---|
| **Personal Property** | 33.3% |
| **Real Property** | |
| • Residential | 19.0% |
| • Agricultural | 12.0% |
| • Commercial | 32.0% |

Assessment ratios can vary by state and are sometimes 100%.

# TRIVIA QUESTION #1

## What does “ad valorem” mean?

a. Type of ads politicians blow up my phone with before an election

b. What a good soldier has in battle

c. A type of tax meaning “according to value”.

# COMMON PROPERTY TAX EXEMPTIONS

- Property Tax is not imposed on intangibles, software, residential personal property except motor vehicles and other licensed personal property in certain states.
- Freeport Exemptions – goods shipped outside the state
- Enterprises Zones
- Other exemptions vary by state
  - Such as:  Market value concerns

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# BENEFITS / DOWNSIDES OF PROPERTY TAX VS OTHER TAXES

**Benefits**

- Theoretically tax goes down as value decreases (personal property)
- Rates are generally low compared to other taxes
- Property taxes provide for vital services such as schools and fire protection
- Not as complex as income taxes

**Downsides**

- Tax imposed every year
- In some cases, vital to have an expert witness for valuation/appeals
- Some jurisdictions are understaffed and lack technical knowledge

**Benefits of personal property vs real property**

- Real property generally appreciates so the taxable value continually increases.
- Personal property depreciates and therefore the value goes down over time.
- Generally, personal property taxes have a floor of anywhere from 10-20% of the depreciated value.

# AT WHAT GOVERNMENT LEVEL ARE PROPERTY TAXES IMPOSED

Property taxes are allowed in states based upon state statutes. However, they are imposed at the local level (Counties, Cities, Parishes, etc.)

**What do property taxes fund**

Generally, Property Taxes fund Schools, (Education), and County/City services such as Ambulance, Fire, and Police.

| **Property taxes are used for funding various public services and infrastructure including:** | |
|---|---|
| • Schools | • Water and sewer departments |
| • Police and fire departments | • Parks and recreation |
| • Road construction and repair | • Garbage collection |
| • Libraries | • Hospitals |

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# THE THREE APPROACHES TO VALUATION

| • Cost | • Sales Comparison | • Income |
|---|---|---|

Property valuations may be performed semi-annually, annually or less often depending on the jurisdiction. The assessor determines market value using one or more of the three methods that include:

- **Cost Method:** The assessor determines property value based on how much it would cost to replace it. Assessors consider the depreciation of the property and the costs of building materials and labor.
- **Sales/Market Method:** The assessor values the property using comparable sales including criteria such as location, condition, improvements, and market conditions.
- **Income Method:** This method is based on how much rental income the property can generate. The assessor considers maintenance and management costs, insurance, and taxes when using the income method.

# COST APPROACH

- The cost approach can be used to appraise all types of improved property.
- The cost approach provides a value indication that is the sum of the estimated land value, plus the depreciated cost of the building and other improvements.
- The total cost of constructing a new building today frequently sets the upper limit of value, assuming the building is the highest and best use for the land.
- The cost approach produces a reliable indication of market value when a sound building replacement or reproduction cost estimate is coupled with appropriate accrued depreciation estimates.

# COST APPROACH (CONTINUED)

- Replacement cost is the cost of constructing, using current construction methods and materials, a substitute structure equal to the existing structure in quality and utility. It provides expediency and a reliable indication of the cost for most structures. The replacement cost includes, but is not limited to, direct and indirect costs and entrepreneurial profit.

- Reproduction cost is the cost of constructing, as closely as possible, an exact replica of the existing structure.

# SALES COMPARISON APPROACH

- In the sales comparison, or market approach, value is estimated by comparing the subject property to similar properties that have sold.
- The sales comparison approach often produces the most reliable evidence of FMV because sales are based on the actions of buyers and sellers in the marketplace.
- This approach assumes the typical buyer will compare sales and asking prices to make the best possible purchases.
- Like the cost approach, the sales comparison approach is based on the principle of substitution. This principle presumes that a prudent buyer will pay no more for a property than the purchase price of a similar and equally desirable property.

# INCOME APPROACH

- Income-producing properties are appraised using all three approaches to value. However, since income property is usually bought and sold on its ability to generate and maintain an income stream, more weight is typically placed on the income approach.

- One basic principle in estimating the value of income property is the anticipation of future benefits.

- The income approach, also called income capitalization, converts future benefits of property ownership into an indication of present worth (market value).

- Present worth, which is the result of capitalizing net income, is the amount a prudent investor would be willing to pay now for the right to receive the future income stream.

# THE THREE APPROACHES TO VALUATION (CONTINUED)

| | |
|---|---|
| **Steps in the Income Approach to Value** | |
| **The steps used to value property by the income approach are:** | |
| • Estimate potential gross income | • Deduct vacancy and collection loss |
| • Add miscellaneous income to arrive at effective gross income (EGI) | • Estimate expenses before discount, recapture, and taxes |
| • Deduct expenses from EGI to determine the new operating income (NOI) | • Select the proper capitalization rate |
| • Determine the appropriate capitalization procedure to be used | • Capitalize the net income into an indication of present value |
| | |
| | |
| | |

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# TRIVIA QUESTION #2

## What is the difference between assessed value and appraised value?

a. A real estate term that is too hard to understand

b. Fair market value vs. taxable value

c. Fair market value less the county assessment ratio applied for an asset

d. What Lance said

e. All of the above

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"Our property tax has doubled. How many birdhouses did you put in the backyard?!"

# MISSOURI SPECIFIC PROPERTY TAX INFORMATION

| | | |
|---|---|---|
| **Property Tax Classes (Missouri ratios)** | | |
| • Real | • Personal Property (33% assessment ratio – not sure if for all subclasses) | • Intangible (nontaxable) |
| **Real Property Subclasses** | | |
| • Residential (19% assessment ratio) | • Agricultural (12% assessment ratio) | • Industrial/Commercial (32% assessment ratio) |
| **Personal Property Subclasses** | | |
| • Agricultural Crops | • Livestock | • Farm Machinery |
| • Vehicles | • Manufactured Homes | • Motor Vehicles – Historic |
| • All Other Personal Property | | |
| **Exempt from MO property tax** | | |
| • Freight | • Taxes | • Installation |
| • Software | • No Value Added – rework, redo | |

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# ILLINOIS SPECIFIC PROPERTY TAX INFORMATION

Property Tax cycle extends two years where payments are made in the subsequent year except for Cook County (Chicago area)

- Illinois has an assessment ratio of 33.3% (excluding farmland and buildings).
- IL does not impose tax on personal property
- IL is generally in the top 5 in terms of the highest real property tax effective tax rates
- Reassessment every 4 years except every 3 years in Cook County
- Can appeal to the County Board of Review, except Cook County can file with the County Assessor. Next, appeal to the IL Property Tax Appeal Board or Circuit Court.
- Green energy systems, pollution control facilities, historic buildings, farmland, State of IL, and charitable property exempt

# PROPERTY TAX ASSESSMENT PROCESS

**Process of taxing property**

**Real Property**

- Assessors appraise the value
- Once all values are determined, rates are set
- Bills are sent near the end of the year and due 12/31 (can vary and some states spread payments out in 3-4 payments throughout the year – initially being estimates)
- Real Property appraised value can be appealed

**Personal Property**

- For personal property, taxpayers must declare/render their personal property by Mar 1 (in MO, can vary in other states)
- Assessors appraise the value
- Once all values are determined, rates are set (generally statutory limits on rates)
- Bills are sent near the end of the year and due 12/31 in MO (again can vary by state)
- Personal Property appraised values can be appealed

# TRIVIA QUESTION #3

## What is the principle of substitution?

a. The act of replacing one President for the next one

b. The Arizona Cardinals replacing one Cardinal player for another

c. A presumption that a prudent buyer will pay no more for a property than the purchase price of a similar and equally desirable property

d. All of the above

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# PROPERTY TAX APPEAL PROCESS

**Property Tax Appeals Process**

- Most States: Assessor, Board of Assessment Appeals, Tax Commission/Court

*NOTE: Most appeals are part of the public record so open to the public. Exceptions with certain proprietary data that can be "sealed".*

**Reasons for value appeals**

- Classified incorrectly – i.e., assessed as real property and should be personal property

  Appraised Value incorrect due to:
  - Deterioration
  - Obsolescence – functional/economic
  - Extraordinary Depreciation

**Tax recoveries**

If the facts support an appeal, generally expect a minimum reduction of at least 10%. This is a good general rule in determining the cost/benefit of appealing (also consider potential appraisal). Generally, appraisals will be in the range of $3-10k.

# PROPERTY TAX APPEAL PROCESS (CONTINUED)

**Property Tax Appeals Process**

The basic mass appraisal methods used by counties to value real property may create inflated valuations resulting in higher taxes. They rarely consider inefficiencies or obsolescence. Assessors value personal property at cost less set depreciation rates. Unique factors and/or no-value additions are not analyzed.

# HOW DO WE IDENTIFY SAVINGS OPPORTUNITIES?

Common mistakes made by companies as it relates to Business Property Tax:

- Inaccurate fixed asset listings
- Assets miss-classified in the wrong category on the Property Tax form
- Paying tax on assets the company no longer has in their possession (ghost assets)
- Reporting no-value added assets/additions (scheduled overhauls, etc.)
- No knowledge of the jurisdiction’s exemptions (i.e., MO – freight, taxes, installation)
- Lack of resources/time/knowledge on how to challenge an assessment
- Failure to fully review/consider property taxes and valuations for M&A transactions

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# PROPERTY TAX INCENTIVES

- Abatements (Chapter 100 in MO)
- PILOTs
- Rebates
- Refunds
- Beneficial Assessment Ratios
- Enterprise Zones

# EXAMPLES/STORIES

Robert's St. Charles County Appeal

- Error/assumption on Assessor's part – did not know all the facts

STL City Appeals

- appraisal, MTC appeal, negotiation, settlement – City had very old cost figures, never considered market for buildings if owner moved out. Who had the size to buy it?

LA County Appeals

- County used the reproduction cost approach but did not consider extraordinary deterioration/depreciation

Harris County Late Payment

- Provision in the statute that allowed an extra week to pay, paid within a week and filed for a refund, offered to settle – would have agreed to pay a smaller penalty and already had paid the interest and did not appeal it. Case went to County level, District level, State Appeals level and appealed to Texas SC.

# BEST PRACTICES

- Prior to purchasing large assets (real or personal), consider potential property tax incentives
- Break out exempt portions of fixed assets such as software, freight, sales tax, installation (specific to MO, states vary)
- When preparing annual personal property renditions/declaration, do not merely copy/paste fixed asset/depreciation schedules. Watch for capitalized repairs, replacements, scheduled maintenance, etc.
- Check for asset additions in new jurisdictions (do not forget about assets leased to others)
- Be sure to remove retired assets (especially related to replacements)
- Review real and personal property assessments annually (unusual increases in real property value, accuracy of personal property assessment to rendition/declaration)
- Estimate total amount due based upon last years rates and compare to current year's tax bill
- Prepare a tax calendar for renditions/declarations, tax due dates, and appeal deadlines

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# WHAT CAN LEA FIRMS ASSIST WITH?

- Large asset addition property tax planning
- Incentives – Tax Reduction/Abatement Projects
- Savings Reviews
- Renditions/Declarations
- Appeals

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# TRIVIA QUESTION #4

**What are ways to reduce your property tax on this year's assessment?**

a. Appeal based on Deterioration, Extraordinary depreciation, or Obsolescence of assets

b. Keep divested assets on the asset schedule

c. DON'T DO THIS! Move my assets to a jurisdiction that has no property tax on December 31st, then move them back on January 2nd

d. Sell my business before March 1st.

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EVERYTHING IS BIGGER IN TEXAS...
PROPERTY TAX BILL
GRUNT

# QUESTIONS???

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# THANK YOU!

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