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Are You Paying Too Much in Property Taxes?

Understanding the Assessment Process

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Property taxes are paid on the value of property regardless of whether a business is in a loss position on its financials, and the rules regulating them differ from jurisdiction to jurisdiction. It is therefore important to understand what property is taxable and how its value is assessed. Further, tax professionals with local knowledge may be able to identify exemptions and other opportunities to lower your burden.

General Overview of Property Taxation

While the general laws that impose property taxes are state laws, it is usually local jurisdictions (e.g., counties, townships, special taxing districts) that are responsible for assessing and collecting the taxes.

What Property is Taxable

Real property is taxed in every state and is generally defined to include land and the improvements erected on or affixed to the land, such as buildings, structures, and fixtures. Personal property is taxed in most states and is generally defined as all property other than real property. Some states only tax tangible personal property, such as portable machinery or office furniture, while other states also tax intangible property. A lesser number of states include business inventory as a type of taxable personal property. In addition to real and personal property, some states tax possessory interests, which are private interests in publicly owned lands, such as boat slips at public marinas.

Where Property is Taxed

In general, real property and possessory interests are taxable in the county where

they are located. Tangible personal property is generally taxable where it has established "permanent situs." If the property is moveable, determining permanent situs is usually dependent on a number of factors including the type of property, where the property is typically used, and the property owner's residence.

Property Tax Exemptions

While all states have some form of property tax, most states have laws which provide for full or partial tax exemption for certain property. Some common types of property excluded fully or partially from taxation are personal effects (e.g., household furniture, clothing) and property owned or used by nonprofit organizations. Some states also offer preferential exemptions for new construction, manufacturing machinery and equipment, etc. to encourage economic activity.

The Assessment Process

In general, assessments are determined annually, as of a specific date (the "lien date"), which is January 1 in most states. The assessor must go through a series of

steps — the assessment process — in order to be able to prepare the assessment. This process involves the assessor identifying all taxable property in the jurisdiction and obtaining an accurate description of the property, determining the property's legal situs, classifying the property according to type, and collecting and analyzing economic data in order to value the property. Rules for reporting information to the assessor vary — a few states do not require disclosure of real property purchase information, and some states do not currently impose a penalty for failing to report personal property.

Using the data obtained in the initial steps of the assessment process, the assessor will apply generally accepted methods of valuation to estimate the property's taxable value. The valuation becomes the basis for the assessment. When the assessment is complete, the assessor provides notification of value to property owners in a manner prescribed by law (typically via U.S. mail).

In addition to the assessment process, several jurisdictions perform property audits periodically. The audit cycle is every four years in California, but the timing varies by jurisdiction. Many states in the Eastern and Southeastern United States use third party auditors, who are very aggressive in attempting to collect more property taxes. It is especially important in these situations to employ local tax professionals who are familiar and experienced with the rules and procedures of the auditing jurisdiction.

Valuation Issues

Property tax is an ad valorem tax,

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meaning it is a tax imposed on the basis of value. There are three generally accepted methods of valuation, used to estimate a property's fair market value: the cost approach, the comparative sales approach, and the income approach. Most jurisdictions require the assessor to analyze all the available data regarding a specific property and utilize the approach most appropriate for that property.

Approaches to Value

With the **cost approach**, the value of improved real property is estimated by adding the value of the land to the estimated cost to construct a reproduction or replacement of the existing structure and improvements less accrued depreciation. (Note, however, that differences between reproduction and replacement cost can be significant.) The cost approach can also be used to estimate the value of personal property, whose fair market value is generally based on the property's original cost less an annual depreciation allowance. The cost approach is the most universally applied approach to value for property tax purposes; it is the preferred approach when reliable sales and income data are not available.

The **comparative sales approach**, also called the market approach, is based on the premise that a property's fair market value is closely and directly related to the sales prices of comparable properties. Thus, under this approach, the property being valued is compared to similar properties that have sold recently.

With the **income approach**, capitalization techniques are used to convert an expected future income stream into a present value estimate, which would indicate the property's current fair market value. This approach is

used when the property being valued is the type of property typically purchased as an income-producing investment.

Depreciation and Adjustments for Changes in Market Conditions

A property's value may change due to market factors, many of which are beyond the taxpayer's control. There are three forms of depreciation that cause a property to lose value: physical deterioration, functional obsolescence, and external obsolescence. Sometimes the depreciation is considered curable (i.e., if the cost to cure the deficiency does not outweigh the resulting benefit), but often the deficiency gets overlooked by the assessor, especially when it involves environmental contamination.

Physical deterioration may result from wear and tear either from use or due to the forces of nature.

Functional obsolescence is the loss of value caused by the design of the property itself. When a property's capacity to perform its intended function declines, functional obsolescence begins. Functional obsolescence may be attributable to such things as changes of taste in the marketplace, poor initial design, or advances in technology.

External obsolescence, also called economic obsolescence, occurs when adverse external factors cause a loss in value. Increased building vacancy due to economic downturns and underutilization of property caused by decreasing demand are examples of external obsolescence.

Because there are so many factors that can cause a property's value to decrease, it is important that the assessor take such market factors into account in order to correctly estimate the property's fair market value. If the assessor fails to recognize

losses in value due to depreciation or changes in market conditions, or if the appropriate approach to value is not applied, such an error provides an opportunity for appeal. Thus, taxpayers should check the assessor's records specifically for two things: (1) to make sure that all of the assessor's data regarding your property is accurate; and (2) to see how the assessor determined the value for your property (i.e., which approach to value was applied). If you disagree with the values, you may appeal your assessment.

The Appeals Process

Most states have laws providing taxpayers with a right to appeal should they disagree with their property tax assessments. However, the deadline for filing an appeal can vary greatly from jurisdiction to jurisdiction, and many jurisdictions have short deadlines. Thus it is very important for you to make sure that the assessor's records contain your correct mailing address. Likewise, because of the many differences between jurisdictions, it is important to enlist local tax professionals in order to protect your rights as a taxpayer and to help ensure that your property is being taxed correctly by that jurisdiction.

Finally, keep in mind that property taxes are the only taxes that are determined or directly affected by someone's opinion. If that person uses faulty information or incorrect procedures in formulating an opinion of value, that opinion will be faulty or incorrect as well.

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