# Property Taxes




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## Background

Some taxes are based on a proportion of the value of the property being taxes. These are known as "ad valorem" taxes. To arrive at an accurate amount of tax, an APPRAISAL of the taxable subject matter's value needs to be done periodically. When the property owner's property value changes, so does their assessed or appraised value. Most property taxes are this AD VALOREM variety. Ad valorem property taxes are based on ownership of the property. Property owners must pay these taxes whether they actually use the property or not or whether it generates income for them or not.

There are many types of property subject to property tax although the tax is most commonly based on the value of real property (land). Municipal governments use property taxes to collect revenue probably more than any other taxing authority. Municipalities gain their authority to levy property taxes from state law. Property taxes are used to help finance local government services. These include public schools, fire and police protection, roads, parks, streets, sewer and/or water treatment systems, garbage removal, public libraries, and many other local services.

Taxing land and buildings is one of the oldest forms of TAXATION in the United States. Before income and sales taxes, local governments used property-based taxes to finance most of their activities. Property taxes remain a major source of revenue for local governments. Most local governments collect taxes on both real and PERSONAL PROPERTY, but they have been moving away from taxing intangible property such as bank accounts and CORPORATE stocks and BONDS.

Both state and local government agencies are authorized to levy taxes, but the way they conduct assessments, collection, and compliance can differ widely. In some states, a single state agency has primary responsibility for obtaining all appraisals, making assessments, and collecting taxes. In most states, certain agencies assess some or all railroads and utilities properties.

Generally, responsibility for the three phases of property tax—levy, appraisal, and collection—rests almost exclusively on the taxing authorities within local governments. A taxing authority like a county, city, town, hospital, refuse collection, school, or other special district, is a legal entity of the government with elected or appointed officers who serve a distinct geographic area.

## Types of Property

There are two basic categories of property: real and personal. The ASSESSMENT procedures and the tax rate will vary between these two categories. Real property, in general, is land and anything permanently affixed to land (e.g. wells or buildings). Structures such as homes, apartments, offices, and commercial buildings (and the land to which they are attached) are typical examples of real property.

Basically, personal property is any property that is not real property. Personal property is not permanently attached to land. In most cases, it is moveable and does not last as long as real property. It comprises nearly everything that is perceptible to the senses. Personal property includes vehicles, farm equipment, jewelry, household goods, stocks, and bonds.

Personal property is divided into "tangible" and "intangible" forms. **T**ANGIBLE personal property is just that: it has a physical form. It can be seen, touched, and moved. Examples of tangible personal property include clothing, books, and computers. On the other hand, the notion of intangible personal property is an abstraction. They do not have physical forms. These include assets such as PATENTS, TRADEMARKS, stocks, and bonds.

In addition to the basic types of property, property is grouped into various classes and subclasses for purposes of tax assessment. These classes are based on the use of the property. These schedules of classes vary considerably from state to state. For example, a state may have the following classes of property:

- Class 1: Agriculture, grazing, livestock, notes, bonds, stocks, accounts receivable
- Class 2: Commercial properties
- Class 3: Motor vehicles
- Class 4: Personal property, except motor vehicles
- Class 5: Residential, farm homes
- Class 6: Swamp and waste

Property classification according to various uses or types serves as a basis for adjusting the rate of tax.

## Determining Tax Rates

Tax dollars help support the functions and services of specific local organizations. The local taxing authority (e.g. the county or municipal government) uses one of two methods to calculate the tax rate:

1. In the first method, the taxing authority estimates its total expenditures over a given time period. Then, it divides that figure by the taxable or assessed value of all property within its JURISDICTION. The result is the tax rate. This rate is sometimes expressed using mills or percentages; sometimes it is expressed as a dollar amount ($1 per $100).
2. In the second method, the taxing authority estimates the amount of taxes available from property tax levied at a specific rate. The taxing authority will either increase or decrease its budget based on increases or decreases in the total value of the property's taxable or assessed value.

State constitutions or statutes commonly impose rate limitations. Many states set a maximum rate for each class of government (e.g., school, city, or county). Because real property can be located in overlapping tax districts (e.g. schools and towns), the total tax rates will vary from one neighborhood to another. This results in more than one local taxing authority calculating tax rates for the property. Many jurisdictions aggregate these rates, resulting in a single tax levy called a consolidated, overall, or composite levy.

## Exemptions

Basically, all real and personal property is subject to tax unless specifically exempted. Exemptions come in many forms. These exemptions include its use, such as for religious or charitable purposes, and the form of its ownership, such as household goods. Exemptions are used by state and local governments to help attract new businesses or to encourage certain types of development, such as low-income housing or reclamation of historic sites.

Exemptions range from full to partial tax relief. One town may provide a full exemption for personal or business property, whereas another town may provide only a partial exemption for these types of property. The limitations can be expressed in terms of dollar amounts or by a percentage of value. Homeowners' exemptions are an example of this kind of partial exemption. Other forms of exemptions exist for the following:

- Certain municipal levies
- County city, town and school purposes
- Government property (these are required by state law)
- Persons over age 65
- Veterans

An important issue in property tax law deals with the location of property or its "situs" for tax purposes. If a taxpayer owns property in more than one area, or if the taxpayer owns property that is moveable, like a car or a trailer, it can be difficult to determine the most appropriate location from which to determine the property tax on those items. Because the law can be so variable from one place to the next, this issue is often in dispute.

The general rule states that land will be taxed according to the laws of the county where the land is located, regardless of where the owner resides. On the other hand, moveable property is generally taxable according to the laws of the county where the taxpayer resides. These are general rules. For information specific to a person's own situation, the person should check with an accountant, tax advisor, or lawyer.

## Tax Assessments

An assessment is basically an estimate of what a piece of property is worth. This valuation of the property helps decide what part of the local property tax levy will be billed to the property. Once this has been determined, the value is multiplied by the tax rates, sometimes known as the "mill rate," to determine how much tax the owner must pay on that piece of property. Many states use full MARKET VALUE (or a fraction of it) as a basis for their assessments.

Assessors "value" property for tax appraisal purposes. "Value" is also known as the following:

- Actual value
- Appraisal value

- Fair and reasonable market value
- Fair cash value
- Full and fair value
- Full value
- Just value
- Market value
- True value

Despite these similar terms, most states focus on "market value." Market value is the amount of money a typical, knowledgeable, buyer (unrelated to the seller) would pay for a given parcel of property. To calculate the market value of a piece of property, an assessor will determine if there have been changes in the real estate market where the property is situated. The assessor will examine what different types of property are selling for, local construction costs, normal operating expenses like utilities, nearby rental rates, and inflation. Changes in these factors may change the assessed value of the property.

## Assessing Personal Property

To make assessments of most personal property, appraisers use information contained on personal property statements filed by the property owner. If the property owner does not provide information about the value of his or her personal property, the assessor estimates the property's value using acceptable appraisal data and techniques, taking into consideration factors such as the age, cost, and type of property. Depending on the state or locality, tax rates for personal property may be the same as that for real property or may differ.

## Assessing Real Property

There are three principal methods for assessing the value of real property. These differ based on the kind of property being assessed.

1. The cost (or replacement) method. This method is used for assessing buildings or other structures. Assessors estimate how much it would cost, using current rates for material and labor, to replace a given structure. An assessor will deduct the reasonable DEPRECIATION of the property but add the value of the land. This approach is most appropriate when the assessment is of a new and unique or specialized property. It is also useful when there are no meaningful sales of comparable properties.
2. The income method. Under this method, assessors estimate the amount of income from a piece of property if the property is used to produce an income. This method is used for apartments, stores, warehouses, shopping centers, and office buildings. To arrive at an assessment, the assessor considers the business taxes, the amount of income the property may generate, insurance costs, rates of vacancy, operating expenses, maintenance costs, and the current interest rate charged for borrowing money for making improvements or repairs on such a property.
3. The market or sales comparison method. Here, sales of similar properties are compared to each other and adjusted for differences. Most residential real estate is appraised by using the market or sales comparison method. This approach is similar to the method banks employ to value property when they consider issuing a MORTGAGE.

Most states appraise various classes or types of real estate using other approaches to value. For example, farmland or timberland may be appraised on its use or level of productivity. Business inventories may be assessed on the basis of the business's records, as well as the state of its machinery and equipment. And assessors may even combine approaches to arrive at a fair appraisal of a piece of property.

Taxpayers have a right to fair appraisals. Furthermore, no class of property should be over–or under– valued in relation to similar properties within a given area. Even so, it is up to individual property owners to monitor their assessments. To find out which appraisal method was used in a situation owners should contact their local assessor's office.

## Changing Property Values

Individuals may pay more in property tax if the tax rate increases, or if the value of their property increases. Their property tax rate can increase because their taxing district needs to raise revenue in order to provide services. The tax rate may also rise as a result of voter-approved bonds and override levies. If their district's budget increases while the assessed value of all property remains the same, in most cases the tax rate will rise and they will pay higher taxes.

Even if the tax rate remains the same, individuals' taxes may rise if their property value increases. Some other factors that will adjust the value upward include the following:

- Adding a new bathroom
- Adding a fireplace
- Adding a terrace
- Adding an extra room
- Expanding or adding a garage
- Finishing the basement

Besides reflecting added features to the home, the property's value is a part of the economy of the area. Thus, a development of upscale homes nearby can make their property more valuable. If individuals live in a community with rapid growth, and the demand for housing increases, their property's value will most likely go up.

The opposite is true as well. If the owner's property is in poor repair or becomes damaged by a fire, earthquake, or flood, or if a major structural problem develops or their neighborhood deteriorates, the assessed value of their home would probably decrease as well. A poor local economy, slow growth, and low demand for homes in their area will probably depress their property's value.

## Payment

The due date for property tax is due depends on location. The deadlines vary considerably. Some property taxes are paid annually, and some are paid in two, three, or four installments. Some jurisdictions allow for monthly tax payments. The collection office nearest the property owner will have more information on payment options. A few of these are:

- Credit card payments
- Discounts for early payment
- **E**SCROW agreements
- Extensions
- Partial payments
- Split payments

In some areas, homeowners pay their property tax through escrow accounts. The tax bill is incorporated with the mortgage payment. Thus, the mortgage-holder pays the tax bill out of these combined funds.

## Challenging the Valuation of One's Property

Because the effects of an assessment can be quite expensive to property owners, challenges to the valuations of properties are quite common. In most cases, owners are free to meet with the assessor to present their cases. Owners need to keep in mind that any changes must be based on EVIDENCE. Mere complaints that the owners think their taxes are too high will not lead to a reduction.

Property owners will need all the records pertinent to the valuation of their property in order to make a successful argument for changing the valuation. Make sure they scrutinize the accuracy of the assessor's information for obvious errors. If the assessor accidentally added an extra bedroom or bath in his assessment of the property, or figured the tax using the wrong taxing authority are mistakes that can make an enormous difference in the owner's property tax. Owners should also request copies of the comparable sales information the assessor used to value their property. Examine these documents and closely compare their property's assessed value and those of nearby properties.

An appeal may be successful if the appraisal overlooked hidden conditions such as a pest infestation, a cracked foundation, or other undesirable environmental conditions. These factorss could adversely lower the property's value, and hence adjust the owner's appraisal downward. Additionally, certain exemptions in the property may negatively impact its value. These include veterans', POW, and homeowner exemptions.

In most cases, the best evidence of property value are comparisons of recent property sales within the same neighborhood. Because this is public information, it is not difficult to obtain; however, analyzing it and applying it to the owner's particular situation can be difficult. For example, the motivations of buyers and sellers can influence sales prices, but this information is very difficult to obtain. If there are no recent property sales within the property owner's neighborhood from which the owner can make comparisons, the next best alternative is to check for areas of comparison between the owner's property and property that is reasonably similar to sit. Consider factors like location, style, age, and physical factors like square footage, lot size, number of rooms, and so forth.

Every state provides formal and informal methods to challenge tax bills. In both, adherence to procedure and time limitations are critical. Note that in most jurisdictions, they must pay the assessed taxes even while their appeal is pending. If they do not, the taxing authority (municipal or county government, in most cases) may charge the owner interest and penalties on the unpaid balance.

The laws and procedures for disputing a tax bill vary considerably from state to state, although there are some common mechanisms for appeals. For example, most states have between two and four steps for appeals. The level of appeal after a complaint to the local assessor usually occurs at an administrative agency (e.g., county review board, county commissioner). Here, property owners may present evidence that supports their contrary opinion of an assessment or of a tax bill. Should they not convince the authorities at that level, there are usually additional procedures at a higher state level, or even recourse to courts. If LITIGATION is the owner's next step, it is wise to hire an attorney whose specialty is representing property owners in these types of disputes.

If property owners feel that they cannot afford the taxes assessed on their property, they have little recourse. Personal hardships, such as living on a fixed income or inability to pay are not considered in the assessment of taxes. The property's worth is the only criterion for assessing taxes on that property. Property taxes are not based on earnings, the original price of a piece of property (except in California), disposable income, or one's ability to pay. If property owners receive a large tax bill that strains their ability to pay the tax, about the only recourse they have is to apply for a hardship exemption or a tax deferral. Not all states have these procedures. If they cannot pay their taxes, they may check with their local collection office for the options that are available to them.

## Additional Resources

"2001 State Tax Forms" Federation of Tax Administrators, 2002. Available at http://www.taxadmin.org/fta/link/link.html.

"The IRS" Department of the Treasury, 2002. Available at http://www.irs.gov/.

*State and Local Taxation and Finance in a Nutshell, 2nd Edition.* 2nd, M. David Gelfand, M. David, and Peter W Salsich, Jr., West Publishing, 2000.

"Tax and Accounting Sites Directory: State and Local Tax" Schmidt Enterprises, LLC, 2002. Available at http://www.taxsites.com/state.html.

*Taxes for Dummies 2002.* Eric Tyson, Eric, and David J. Silverman., Hungry Minds, Inc., 2001.

## Organizations

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