INTERNATIONAL TAXATION

The challenging and changing world of property taxes in the USA

By Scott D. Davis

Over the last decade, the amount of funds made available by the Federal Government and distributed to the State Government has continued to dwindle. As these Federal funds dried up further, less money has been made available to the individual states and therefore less to local towns and cities. This ongoing trend has been forcing towns and cities to come up with alternative ways to obtain the funds that the state used to provide which are required to pay for the local public services. As costs at local level rise further and the deficit of these state funds increases, locally assessed property taxes have been and continue to be used as the major way to fund these revenue deficits in local budgets each year.

Unlike many countries around the world, property taxes in the USA are a locally assessed tax. The Federal Government has no power or role in the assessment and collection of these funds. The individual states play a small role in the governing of the property tax function, and although it is listed in all State Statutes, administration is left to the cities and towns. The application of the statutes is therefore subjective in many cases and determined by how the statue is interpreted by one town assessor (the individual in charge with the administering of the property tax function at the town or city level). There is usually a very different interpretation of how a statute is administered from town-to-town and city-to-city in a given state.

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Property taxes have become a very large expense item for not just corporations, but homeowners as well. The average U.S. property tax rate is 3% of owned property on a national basis. Until recently, many businesses and individuals received their bill and basically paid it without reviewing it. As property taxes have risen and become more expensive, a greater number of taxpayers started to review their bill more closely. In the USA, owners of property have the right to appeal their property values if they feel it is unfair. If the owner is successful they can recover some of their overpaid taxes. However, it is sometimes a long and arduous process, which can also be quite costly.

There are two general types of property in the USA subject to local property taxation, real and personal property. Every state in the USA taxes real estate. There are 31 states which tax personal business property. Below is a very brief definition of each property and some comments concerning each.

Real property

This is defined as land and any structure which is permanently affixed to the ground and would include a building or a house. The concept of taxing real property dates back a very long way. In England during the middle ages, the estate was a source of tax revenue for the King, while in Ancient Rome, the tax on estates of the rich was a source of revenue for the Empire and the Emperor. Similar taxes can be traced to the Far East as well.

In general, real property taxes are assessed or valued every year on a specific annual date, known as a lien date. In most cases this date is 1 January. That property value is considered fair market value at that lien date. In some states, the value does not change. However, in other cases the value will change by a predetermined increase every year. This increase is a way to cap values from rising out of control. For example, in the state of California there is a rule known as Proposition 13, which limits an annual increase of 2%, the state of Massachusetts has Proposition 2 and a half, which limits the increase to 2.5% and New Jersey also has a similar rule.

A way many towns and cities have bolstered their depressed revenues, particularly in times when properties values have fallen, is to carry out town-wide or city-wide revaluations, through which all commercial and residential properties in an area are revalued in order to raise the total property values in a given town and therefore have a higher property base to tax. In the year of a revaluation, tax rates may drop and some taxpayers appeal and get reductions in their property values, but in the long run the towns will begin raising their tax rates and still have a higher property value base so they obtain more funds to pay their bills. In the USA, many states have enshrined mandatory revaluations in their Constitution. Many require them every five years and North Carolina requires one every eight years.

Personal property

As mentioned above, 31 states in the USA tax business personal properties, which is property used in the operating of a single business. A chart has been provided at the end of this article identifying the 31 states. The definition of "personal property" is any property which can be removed without demising the real property. These types of properties are office, computer and manufacturing equipment. One will file an annual return in the town where the property is located similar to an annual tax return with the local town assessor. Some industries, like public utilities and telecommunications companies, will file an annual return at the state level. The state will assess these special properties but then allow the cities and towns to assess their tax.

All states have exemptions for personal property which vary by state. One needs to research the state their property is located in to verify the exemptions available. It is critical to remember that all exemptions are assertive in nature and that it is the taxpayer's responsibility to take advantage of the exemptions available and that this will not be provided by the assessor.

There are heavy penalties imposed for those who have property in a given jurisdiction, if that jurisdiction resides in a state which requires the filing of personal property and the taxpayer does not file a timely return. The assessor will assess a 25% assessed value penalty along with penalties and interest from the date the return was originally due. As a note, in the USA penalties can be abated but not the interest because it is statutory. It is therefore imperative to review the local rules in any state where one intends to conduct business.

There is only one state in the USA that audits personal property tax returns statutorily. That state is California, which performs audits once every four years. That rule has been relaxed in recent years due to manpower shortages at the local level. California has a diminimus rule, where if the assets are less than a specified amount they will not audit as it is not material enough. However, to keep revenues up many local jurisdictions are hiring third parties to audit on their behalf. These third parties are being paid on a value-added basis not a fixed fee, so they are very aggressive in what they obtain. These audits are done electronically and usually the taxpayer finds out the results of the audit by either a letter or email and then has a statutory period to respond before the assessment becomes final.

Appeal process

A taxpayer has the right to challenge their real or personal property tax assessments on an annual basis. Usually there is a stipulated period in which to appeal. Failing to act during that stipulated period means the assessment becomes final. If taxpayers do wish to appeal, they should do their homework and come in with proper documentation to support their position. Without the right documentation, the likelihood of a reduction is remote. It is also essential to get to know the local assessor as that relationship is important. As an assessor once told me: "I wish taxpayers would come in and talk to the assessor before they appeal, as a lot of appeals could be avoided that way".

Conclusion

The property tax area is a very complex process in the USA. Each state has its own way of administering it. The assessors are in a very tough position. They must be fair, but they also need to protect the revenue provided by property taxes in light of the diminishing revenue base a town or city is operating with. A taxpayer should only pay their fair share of taxes. It is a delicate balance. Anyone starting to do business in the USA from a foreign country should pay attention to this area. It is usually the one tax that creates a heavy burden that is often forgotten.

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Auditing & Accounting, Tax, Advisory, Corporate Finance, Fiduciary & Estate Planning
Basking Ridge (NJ), Long Island (NY), Los Angeles (CA), New York (NY), White Plains (NY), USA
Scott D. Davis
E: sdavis@pragermetis.com
W: www.pragermetis.com