Law & Policy

Owner, Beware!

When Assessors Seek Business Income Information

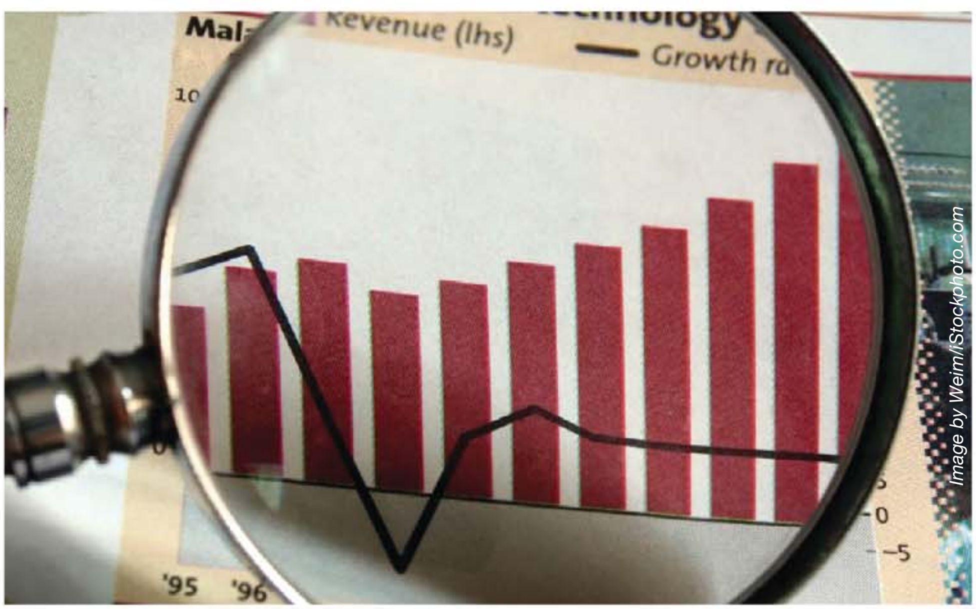
By David Suess, Esq.

Is it appropriate for a tax assessor to use income information in determining taxable value?

That question comes up frequently in property tax cases when assessors seek income information from taxpayers. The answer is that whether a request is appropriate depends on the type of property at issue and the type of income information being sought. In several recent cases involving manufacturing operations, industrial enterprises and other types of businesses, assessors have sought information on income from the business or businesses operating on the property, rather than on income from the property itself.

Often, assessors have a legitimate reason to seek certain types of income information from taxpayers. For instance, if the property type at issue is typically rented in the marketplace, as is the case with an apartment complex or an office building, it will likely be entirely reasonable for the assessor to request, and for taxpayers to use, the property's rents when evaluating its market value. Indeed, investors regularly rely on rental information to determine the price for such property.

However, some types of income data should be excluded from a property assessment. In a number of recent instances, for example, assessors attempting to value manufacturing or industrial properties have sought income and production information relating to the manufacturing process, which is unrelated to the property's income-producing capacity. Where the business is something different from the rental of property and the business income derives principally from assets other than the real estate, reliance on income information will produce misleading conclusions about the value of the real property (whether for taxation or any other purpose).



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To better understand the problem, consider a hypothetical downtown office building that houses law firms, accounting firms, travel agencies, dental offices and any number of other tenants. No reasonable assessor would consider the revenues of the tenants in determining the value of the office building.

Why not? Because that business revenue would indicate only the value of the business taking place in the building. Tenant revenues do not determine the building's rent, and no reasonable investor would value the building on the basis of such income information. In short, it is irrelevant.

The same generally goes for production and income information when it comes to manufacturing properties. A typical manufacturing process requires personnel, machinery and equipment, managerial expertise and real property. Add to that goodwill and other intangibles that allow the manufacturer to capture market share and sell its products, and it is clear the income from product sales incorporates value from a number of assets unrelated to the value contribution of the real property.

Special Purposes, Special Properties

Why, then, might assessors seek business income information, and how should taxpayers respond to such requests?

In many markets, manufacturing properties are more likely to be in owner-occupied rather than leased space, so determining the equivalent of market rents for such properties is difficult. Assessors seeking production or business income information occasionally argue that they cannot use sales data because the property is a special-purpose asset. But even if the property is special purpose, the assessor should not seek and use income information unrelated to the property and its market value.

Attorneys also hear assessors argue that the property represents a special component of, or provides a particular "synergy" to, the taxpayer's business. These assessors contend they need business income information to accurately reflect the property's true value. But such efforts to capture special value apart from the real estate itself are efforts to tax an intangible, not the property.

In some cases, it may be appropriate to consider income information to determine whether a property suffers obsolescence and is, therefore, over-assessed. For example, if the total income from all operations is insufficient even to support the real property at its current assessed value, an argument exists that the real property suffers obsolescence (relative to its assessed value). However, the fact that income shortfalls might indicate obsolescence does not make business income generally indicative of real estate value.

When assessors request business income unrelated to the property or its rent, taxpayers should consider objecting on several grounds: First, if the information is truly unrelated to the property or its rent, the taxpayer should explain that to the assessor \and try to provide only the property's rental information, if available.

Second, taxpayers should guard against the disclosure of proprietary business information. Many states have laws that protect confidential taxpayer data such as information relating to earnings, income, profits, losses and expenses; taxpayers are well advised to mark that information as confidential and take other steps to avoid public disclosure of any income information they provide to the assessor. CPE

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