"WHY ARE MY PROPERTY BILLS GOING UP WHEN PROPERTY VALUES ARE GOING DOWN?"

{ ANSWERING VEXING CLIENT QUESTIONS ABOUT NEVADA'S PROPERTY TAX ABATEMENT SCHEME }

BY WILLIAM MCKEAN, ESQ. & JENNIFER DIMARZIO, ESQ.

During these trying economic times, the last thing Nevada home and business owners need is a surprise when they receive their property tax bills. Yet that is exactly the scenario many are facing. What do you tell a client who asks why their property tax bill has increased when the value of their property has plummeted, or if the property they are thinking of buying will retain tax cap protection following the purchase? This article provides a brief overview of these and other vexing client questions about Nevada's property tax abatement scheme.

Nevada's Property Tax Abatement Statute

Enacted in 2005, the property tax abatement statutory scheme was intended to address the problem of skyrocketing property taxes during the housing boom.[1] The statutory scheme caps increases in property taxes by abating any amounts that exceed certain statutory thresholds. For owner-occupied primary residences and rental properties charging rates at, or below, the Department of Housing and Urban Development (HUD) fair market rents, the threshold (or "tax cap") is 3 percent per year. For all other property, the tax cap is 8 percent (or lower, if that percentage exceeds twice the annual increase in the Consumer Price Index based upon the growth rate in a particular county). Although

taxable values for properties may increase more quickly, the cap is intended to ensure that property tax bills increase at a rate no greater than the 3 or 8 percent cap.

This abatement scheme breaks the historical correlation between property values and tax bills. This has been confusing to many taxpayers and has raised a host of novel issues.

Question 1:
Why are my property tax bills going up when property values are going down?

The answer to this question lies in the fact that Nevada's abatement scheme caps increases in a property's tax bill; it does not limit increases in a property's taxable or assessed value. Local county assessors continue to perform their annual valuations, as required by Nevada law (in counties where assessors do not perform annual appraisals, changes in value may be based upon factors set by the Nevada Tax Commission).

Each county assessor appraises the real property situated within his or her county (property that extends over a county border, such as power or telephone lines owned by a public utility, is generally assessed on a central basis by the Nevada Department of Taxation), using separate valuation methodologies for the land and improvement components. The taxable value of land is generally based on the use to which any improvements are being put; vacant land is valued by considering the use to which it may be lawfully put. Improvements (i.e., buildings) are valued at present replacement cost, less depreciation (1.5 percent per year to 50 years).[2] Property is then assessed at 35 percent of its taxable value.[3]

Prior to the tax cap, the amount of the final property tax bill was the result of the assessed value multiplied by the applicable tax rate. Take, for example, a commercial property valued at $800,000. The assessed value of that property would be $280,000 ($800,000 X .35). At a tax rate of 3 percent, the tax bill would be $8,400 ($280,000 X .03).

Even after the tax cap, this same calculation is performed. However, the tax bill for this commercial property may not be increased by more than 8 percent from the prior year. If, for example, the prior year's tax bill for this property was $5,000, then absent certain exceptions discussed below, the new year's tax bill is capped at $5,400 ($5,000 X 1.08). The difference between these two amounts, or $3,000, is the abated tax.

Depending on the extent to which a property's value has increased since the tax cap became effective, a decline in taxable value may not result in a reduced tax bill. Rather, a property's tax bill can continue to increase by the applicable tax cap limit until the tax bill catches up with taxable values.

For example, given the current abated tax of $3,000 for our hypothetical commercial property, the taxable value of the property would need to decrease from $800,000 to less than $514,285 for the decrease in value to cause a reduction in the current year's tax bill (a taxable value of $514,285 equates to an assessed value of $180,000 ($514,285 X .35), which results in a tax of $5,400 ($180,000 X .03 = $5,400)).

CONTINUED ON PAGE 16 ▶

NEVADA'S PROPERTY TAX ABATEMENT

CONTINUED FROM PAGE 15

If the taxable value of the property decreased by an amount that was not this extreme – say to $700,000 – the property could see an increased tax bill.

Question 2:
Is the tax cap lost on a sale of property?

This question usually stems from confusion given Nevada's proximity to California, where the sale of property can trigger loss of California's property tax cap. Enacted in 1978, California's tax cap – commonly referred to as "Proposition 13" – freezes property taxes to no more than a 2 percent increase per year, so long as the property is not sold. Once sold, a property is reassessed at 1 percent of the sale price, and the 2 percent cap becomes applicable to future tax years.[4]

In Nevada, however, a sale of property does not, by itself, trigger a loss of the tax cap. Instead, the most common exceptions to the tax cap are:

1) when there has been "any improvement to or change in the actual use" of property, or;
2) where a newly created parcel (*e.g.*, as a result of a new subdivision map or reparceling) is not considered a "remainder" parcel. (*See* Questions 4 and 5 below for an explanation of these exceptions.)

Although the sale of a property does not by itself trigger loss of the cap in Nevada, there are situations where a sale may be accompanied by another event that *will* cause a property to lose the protection of the cap, in whole or in part. An example of this is where a sale is coupled with a change in use of the property – such as from residential to commercial use.[5]

A prospective purchaser, therefore, may be well advised to evaluate the abatement status of property prior to closing. For example, a purchaser may want to determine whether there have been any recent changes to the property that might trigger a future loss or change to the existing tax abatement amount. One such common circumstance is where a property that has been used as a primary residence is purchased for use as a rental property at above HUD fair market rent. Although the abatement is not lost, the cap limit percentage will be increased from the 3 percent residential rate to 8 percent.

Question 3:
Why is my property tax bill higher than an identical neighboring property?

The advent of the tax cap has introduced a myriad of reasons why tax bills for seemingly identical properties may differ. One reason can be that there are different tax cap limits for each of the identical properties. Because the 3 percent cap applies only to a primary residence, and all other properties are capped at 8 percent, it is possible for "identical" properties, such as condominiums, to have different cap amounts and, accordingly, different tax bills.

Consider, for example, two identical condominiums, each of which is valued the same and had a property tax of $1,000 in the base year of 2004-05. One of the units is a primary residence while the other is a vacation home. Now also imagine that the

value of these properties increased each year so that, without a cap, their property taxes would have increased more than 8 percent each year. In this scenario, in 2005-06, the primary residential unit's taxes would have been capped at $1,030 ($1,000 x 1.03) while the vacation unit could have increased to $1,080 ($1,000 x 1.08). In 2006-07, this difference could have increased to $1,061 versus $1,080, and so on, until you have a potential tax difference of $1,159 versus $1,469 for tax year 2008-09.

Another common example of seemingly identical properties having widely divergent property taxes is where two similar homes were built in different years. Consider, for example, where one home in a subdivision was built prior to 2004-05, and a second, identical home was completed in 2006, when land values were at their height. Because the newer home would have an initial "base" value that is much higher, its property taxes may be substantially higher than the comparable property.

Question 4:
Will subdividing or reparceling my property affect my tax bill?

The answer to this question is maybe. The tax cap generally applies to property for which an "assessed valuation was separately established for the immediately preceding fiscal year." A county assessor establishes a separate assessed value for each parcel or other taxable unit based upon a parceling system approved by the Department of Taxation.[6] In cases where a previously assessed parcel is reconfigured as a result of subdividing or reparceling land, it will be assigned a new identification number or "assessor parcel number" (APN). This can occur, for example, in cases involving subdivision mapping, a commercial parcel map, parcel consolidations, lot line adjustments, or apartment-to-condominium conversions. Whenever a parcel is assigned a new APN, the assessor must determine whether the parcel is a new parcel that has undergone a change in use from the immediately preceding fiscal year, which is not entitled to the benefit of the tax cap, or is a remainder parcel the use of which has not changed from the prior year, which is entitled to the benefit of the tax cap.[7]

The remainder status of a new parcel is determined on the basis of whether there has been a change in use of the property; i.e., that the use of the property as of the commencement of the current fiscal year is different from the use of the property as of the commencement of the prior fiscal year.[8] The use of property is defined as the principal purpose of the property for one of the following:

(i) agricultural;
(ii) open-space;
(iii) residential;
(iv) commercial or industrial;
(v) institutional;
(vi) recreational; or
(vii) use as vacant land held for development. If the use of the property has not changed from the previous year, the parcel is a remainder parcel.

CONTINUED ON PAGE 18 ▶

NEVADA'S PROPERTY TAX ABATEMENT

CONTINUED FROM PAGE 17

In the case of vacant land, a new parcel only loses the cap if it is created by the "recording of a subdivision map creating individual lots for residential development" (i.e., a final residential subdivision map) or "new construction on the parcel," establishing a new and different use. Land with an established use only experiences a change in use when the use of the property as of the commencement of the current fiscal year is *categorically* different than the use of the property as of the commencement of the prior fiscal year (e.g., agricultural use to residential use, or residential use to commercial use).

Calculation of the amount of the tax cap limit for a remainder parcel is based upon an allocation of the amount of net property taxes for a particular land area. The amount of net property taxes attributable to the land area of, and any improvements to, a remainder parcel for the prior year must be determined by:

(i) identifying each of the parcels that contain the land area of the remainder parcel in the prior year;
(ii) determining the pro rata percentage that the remainder parcel's land and improvements contributed to the assessed value of each of the parcels identified;
(iii) multiplying this percentage for each of the parcels identified by the total amount of taxes levied, or which would have been levied but for any exemptions from taxation in the prior year on that parcel, and adding those products together.

Question 5:

The improvements on my property were demolished; why did my tax bill increase?

In some cases, a parcel of land may be worth more vacant than it is with its improvements. This is because, as previously mentioned, the taxable value of vacant land is determined by considering the use to which it may be lawfully put (i.e., a "highest and best use" value); whereas the taxable value of improved land is determined by considering the use to which the improvements are being put (i.e., an "in-use" value).

Take, for example, an older single-family home located in an area that, over the years, has become a bustling commercial zone. That parcel's highest and best use would likely be commercial. So long as the improvements exist, however, it must be valued based upon its use as an older residential parcel. Once those improvements are removed (or intentionally or accidently destroyed), the parcel's taxable value can be based upon its higher commercial value.

The tax cap does not necessarily protect against these types of tax increases. In fact, in some cases the tax cap can actually exacerbate the problem. This is because new tax amounts attributable to increases in property value as a result of any "improvement to or change in

CONTINUED ON PAGE 20 ▶

NEVADA'S PROPERTY TAX ABATEMENT

CONTINUED FROM PAGE 18

the actual or authorized use of" the property are levied outside of the tax cap.[9] In the years following the base year (2004-05), the values of many properties increased significantly. Accordingly, a parcel that was revalued from a residential in-use value to a commercial highest and best use value may have faced a significantly greater increase in 2006-07 than it would have in the 2004-05 base year. In such cases the addition of incremental new taxes in a current tax year can cause a "slingshot" effect – depriving a property of the accrued benefit of the tax cap relative to other similar parcels.

Fortunately, new regulations have recently been adopted that both narrow the circumstances that can constitute an improvement to or change in actual or authorized use, as well as the amount of incremental taxes that can be added outside the tax cap. A finding of "any improvement" to property must be based upon an "appurtenance erected upon" or "on-site improvement" made to (and located on) the property.[10] A change in actual use requires a finding of a categorical change – from residential use to commercial use, or from commercial use to vacant use."[11] The regulation mitigates the "slingshot" effect through a two-step methodology: both a "current year calculation" and a "base year calculation" will be separately performed. The lower of the two tax amounts is used as the incremental increase in taxes to be added outside the cap for the current tax year.

CONCLUSION

With property values expected to continue to decline in 2009, Nevada lawyers can expect to hear many of the same taxpayer questions repeated next year. With this overview, you can have answers for at least of some of the most vexing of these questions. NL

WILLIAM MCKEAN is a shareholder in Lionel Sawyer & Collins' gaming and regulatory law department, where his practice focuses on regulatory matters before local, state and federal government agencies. He has represented clients in appeals and rulemaking proceedings before the Nevada Tax Commission, the State Board of Equalization and local county boards of equalization. Prior to joining the firm, McKean served as in-house counsel for AT&T Nevada (formerly Nevada Bell).

Lionel Sawyer & Collins associate JENNIFER DIMARZIO assists clients in obtaining Nevada state and local business licensing and represents clients before various professional boards and state and local tax authorities. Prior to joining Lionel Sawyer & Collins, Jennifer was a law clerk for the FCC, the National Telecommunications and Information Administration, NPR and the National Association of Broadcasters, all in Washington, D.C.

1 Assembly Bill (AB) 489 (2005) and Senate Bill (SB) 509 (2005), codified at NRS 361.471 to 361.4735, inclusive.
2 NRS 361.227.
3 NRS 361.225.
4 See *Nordlinger v. Hahn*, 505 U.S. 1 (1992).
5 See LCB File No. R109-08.
6 NRS 361.305.
7 NRS 361.4722(6)(b).
8 Nev. Admin. Code § 361.61034.
9 NRS 361.4722.
10 See LCB File No. R109-08, Sections 16(1) and 9(1).
11 See LCB File No. R109-08, Section 17(1).