

19 Real Estate Taxation

Taxing Entities
Ad Valorem Taxation
Special Assessments
Tax Lien Enforcement

TAXING ENTITIES

State government
County and local government
Tax districts

Real estate taxation refers to the taxation of real estate as property. Real estate property taxes are imposed by "taxing entities" or "taxing districts" at county and local levels of government.

There are *no federal taxes on real property*. The Constitution of the United States specifically prohibits such taxes. The federal government does, however, tax income derived from real property and gains realized on the sale of real property. The federal government can impose a tax lien against property for failure to pay any tax due the Internal Revenue Service.

State government

States may legally levy taxes on real property, but most delegate this power to counties, cities, townships and local taxing districts. Some states place limits on how local governments may levy such taxes. States may impose a tax lien against property for failure to pay any real property taxes which the state has levied or delegated to local taxing bodies.

County and local government

Counties, cities and municipalities, townships and special tax districts levy taxes on real property to raise funds for providing local services. It is common for the county to collect all real property taxes and distribute it among the other taxing bodies.

Tax districts

County and local governments establish **tax districts** to collect funds for providing specific services. The boundaries of such districts typically do not coincide with municipal boundaries. The major tax district in most areas is the school district. Other important tax districts are those for fire protection, community colleges, and parks.

A property tax bill might include tax levies from such districts as the following

- bridge and highway
- nursing home
- storm water management
- township
- fire district
- school district
- retirement fund
- health services
- historical museum
- sanitorium
- forest preserve/land management
- public library district
- park district
- community college district

In addition to generally established tax districts, a local government authority may establish a **special tax district** to pay for the cost of a specific improvement or service that benefits that area. For instance, a special tax district might be created to fund extension of municipal water service to a newly incorporated area. Unlike a permanent tax district such as the school district, a special tax district is temporary, ceasing to exist once the costs of the specific project have been paid for.

AD VALOREM TAXATION

Tax base totalling
Homestead exemption
Other exemptions
Tax rate derivation
Tax billing and collection

General property taxes are levied on an ad valorem basis, meaning that they are based on the **assessed value** of the property. Assessed value is determined according to state law, usually by a county or township assessor or appraiser. The actual tax, though based on assessed value, may be derived as a legislated percentage of the assessed value. Land and improvements may be assessed separately. Ad valorem taxes are paid annually.

Tax base totalling

The **tax base** of an area is the total of the appraised or assessed values of all real property within the area's boundaries, excluding partially or totally exempt properties:

$$\text{tax base} = \text{assessed values} - \text{exemptions}$$

Taxing entities generate the annual revenues they require by levying taxes on the tax base. The **tax rate**, or **millage rate**, determines how much of a tax levy the tax base will receive. The tax rate for each taxing entity is calculated by dividing the amount of revenue required by the tax base. This rate is then applied to the taxable value of each individual real property to determine its tax levy.

Value assessment. County or township officers, called assessors or appraisers, value the real property within their jurisdiction for purposes of levying taxes. This valuation process results in an **assessed value**. Assessment practices differ from state to state. In many states, assessed value does not reflect the market value that an appraisal for other purposes might aim to estimate. For instance, in some areas, assessors use a sales comparison approach to assess the value of land and a cost approach to value improvements.

The role of the assessor in the taxing process is limited to making the valuation and notifying the owner of the assessed value; other tax officials determine the tax rate and the tax levy.

Equalization. Some taxing bodies recognize that local assessments can lead to unfairly high or low values for properties in certain areas. Therefore the jurisdiction may establish **equalization factors** to level out the unevenness of valuations. For instance, if assessed values of properties in one county are consistently ten percent below the average for other counties, an **equalization board** may multiply each assessed value in that county by a factor of 110% to raise them to the average level for the state.

Appeals. Property owners may object to the assessed value of their property, but not to the tax rate. An owner usually has a certain period to protest after receiving notice of the assessed value. According to local law, a property owner must present evidence that the assessor made an error to a review board or appeal board. Typical evidence would include market data on comparable properties that sold recently, or evidence that neighboring properties had less appreciation or even declined in assessed value in comparison with the protestor's property. An owner who is dissatisfied with the actions of the appeals or review board can take the protest to court.

Homestead exemption

A homestead is a parcel of real property that is owned and occupied as a family home. Some states exempt a portion of the value of the homestead from judgments to protect families against eviction by creditors. States and counties may *exempt a portion of the assessed value of the principal residence from property taxation*.

A property owner generally qualifies for a homestead exemption by meeting two criteria:

- ▶ is head of a family
- ▶ resides on the property for a required length of time

Some states also allow a single person to claim the homestead exemption.

Depending on state law, home owners may have to apply every year for the exemption, or they may receive it automatically without filing.

Other exemptions

Properties. Most states exempt certain types of property from property taxes. Certain classes of property owner may also be exempted or have a reduced liability. Exempted are:

- ▶ **government-owned properties**

real properties owned by federal, state, and local governments are **immune** from real property taxation

► **properties owned by non-profit organizations**

real properties owned by churches and non-profit organizations are **exempt** from real property taxation

Owner classes. Miscellaneous exemptions may be granted to classes of property owner, such as: senior citizens, widows, and disabled individuals.

States and municipalities may also offer property tax reductions or exemptions to certain industries to encourage economic growth.

Tax rate derivation

Tax district budgeting. The derivation of a tax rate, or millage rate, begins with the taxing body determining its funding requirements to provide services for the year. This requirement is formalized in the annual budget. Then the county or district looks at its sources of revenue, such as sales taxes, business taxes, income taxes, state and federal grants, fees, and so forth. The part of the budgeted expenditures that cannot be funded from other income sources *must come from real property taxes*. This budgetary shortfall becomes the ad valorem **tax levy**. The tax levy is derived every year, since budget requirements and revenue tallies are performed on an annual cycle.

Tax rate. Each individual taxing body has its own tax rate. The tax rate is determined by dividing the taxing body's budgeted amount to be collected from real estate taxes by the tax base:

$$\frac{\text{tax requirement}}{\text{tax base}} = \text{tax rate (millage rate)}$$

If, for example, a taxing body needs \$500,000 from property taxes, and the tax base for the district is \$15,000,000, the tax rate for this body is:

$$\frac{500,000}{15,000,000} = .03$$

This tax rate of .03 or 3% may be expressed in a number of ways, depending on local practice: as **mills**, as dollars per \$100 of assessed value, or as dollars per \$1,000 of assessed value. A mill is one one-thousandth of a dollar (\$.001). A tax rate of one mill means that the owner pays one dollar for every thousand dollars of assessed value. Thus the rate of .03 above could be expressed as:

30 mills
\$3 per \$100
\$30 per \$1,000
3 percent

Tax rate limitations. Some states, counties or other taxing districts place limitations or **caps** on the absolute millage rate or the annual increase in millage for property taxes. In such situations, taxing bodies are *forced to limit their budget requirements*, unless there has been a sufficient increase in tax base to produce the required funds without raising the millage rate.

Tax billing and collection

Individual owner billings. Each property owner's tax bill is determined by multiplying the tax rate for each taxing district times the **taxable value** of the property. Taxable value is *the assessed value after all exemptions and adjustments have been taken into account*.

For example, a certain property is owned and occupied as a primary residence and qualifies for a homestead exemption. The assessed value of the property is \$240,000, and the exemption is \$75,000. The property is taxed by the school district at a rate of 5 mills, and by the county at a rate of 2 mills. The property tax bill for these items would be calculated as follows.

Exhibit 19.1 Tax Bill Calculation

I. Taxable Value

	assessed value	\$ 240,000
-	homestead exemption	\$ 75,000

	taxable value	\$ 165,000

II. Tax Calculations

	taxable value	\$ 165,000
x	5 mills—school dist.	.005

	school tax	\$ 825

	taxable value	\$ 165,000
x	2 mills—county	.002

	county tax	\$ 330

III. Totaling

	school tax	\$ 825
+	county tax	\$ 330

	total tax bill	\$ 1,155

Payment deadlines are usually set by law and differ from region to region. Different taxing bodies may have different fiscal years, and as a result may issue tax bills at different times of the year. It is more common for a county to issue a bill that consolidates the bills of all the lesser taxing bodies. The consolidated bill may be payable annually, semi-annually, quarterly, or on some other schedule as prescribed by law. In many cases where the owner has a mortgage and a required escrow account, the escrow officer will pay the tax bill. The owner will only receive notice of the assessed value and the tax statement.

SPECIAL ASSESSMENTS

A special assessment is a tax levied against specific properties that will benefit from a public improvement. Common examples are assessments for sidewalks, water service and sewers. Special assessments are based on the cost of the

improvement and apportioned on a pro rata basis among benefiting properties according to the value that each parcel will receive from the improvement.

For example, a dredging project is approved to deepen the canals for a canal-front subdivision. The project cost is \$200,000. Although there are 100 properties in the subdivision, only the 50 that are directly on the canal stand to benefit. Therefore, assuming each canal-front lot receives equal benefit, the 50 properties are each assessed \$4,000 as a special assessment tax. Note that once the work is completed and paid, the assessment is discontinued.

If a taxing entity initiates an assessment, the assessment creates an **involuntary tax lien**. If property owners initiate the assessment by requesting the local government to provide the improvement, the assessment creates a **voluntary tax lien**.

Special assessments are usually paid in installments over a number of years. However, taxpayers generally have the option of paying the tax in one lump sum or otherwise accelerating payment.

TAX LIEN ENFORCEMENT

Sale of tax certificates

Tax deed

Tax sale

If taxes remain unpaid for a period of time specified by state law, the tax collecting agency may enforce the tax lien in several ways, depending on what the law prescribes.

Sale of tax certificates

Some states sell **tax certificates**. The buyer of a tax certificate agrees to pay the taxes due. After a period of time specified by law, the holder of the tax certificate on a property may then apply for a **tax deed**.

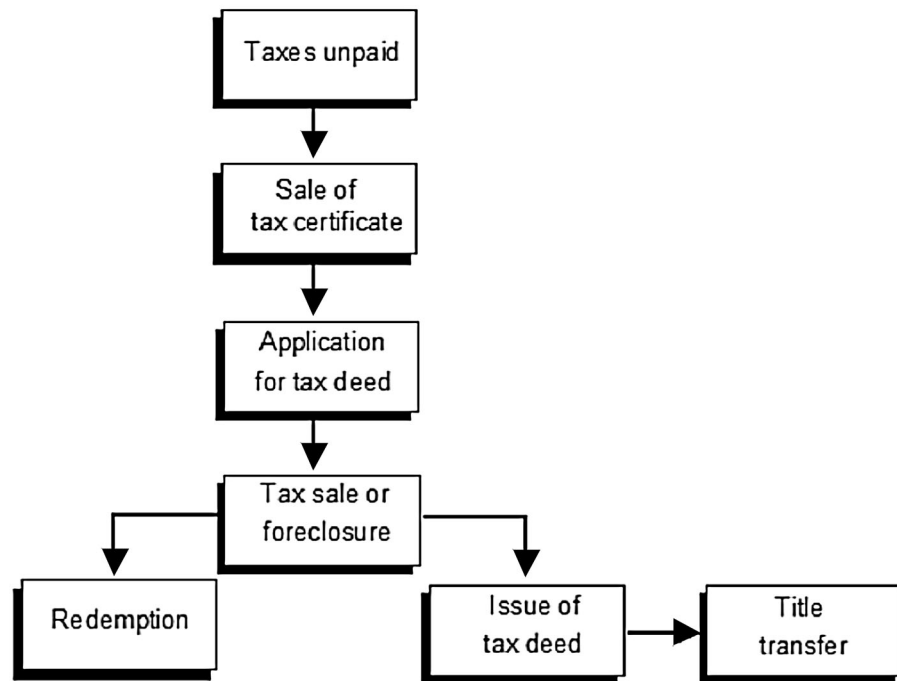
Tax deed

A tax deed is a legal instrument for conveying title when a property is sold for non-payment of taxes. The application for a tax deed causes the taxing agency to institute a **tax sale** or **tax foreclosure**.

Tax sale

A tax sale is frequently some type of auction. If the tax has not already been paid through the tax certificate process, the buyer of the property must pay the taxes due. There is usually a legally-prescribed **redemption period** during which the defaulted taxpayer has the right to buy back the property and reclaim title. If the taxpayer can redeem the property by paying the delinquent taxes and any other charges before the tax sale occurs, this right is known as an **equitable right of redemption**. If the taxpayer can redeem the property after the tax sale, this right is known as a **statutory right of redemption**. In this case, the taxpayer must pay the amount paid by the winning bidder at the tax sale, plus any charges, additional taxes, or interest that may have accumulated. If the defaulted taxpayer does not redeem the property within the allotted time, the state issues the tax deed to convey title.

Exhibit 19.2 Tax Lien Enforcement



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Real Estate Taxation Snapshot Review

TAXING ENTITIES	no federal ad valorem taxes, only federal tax on income and gain; federal government can impose a tax lien against real property
State government	states may levy property taxes but many delegate this power to county and local government; states can impose a tax lien against real property
County and local government	counties, cities, municipalities, townships and special tax districts levy taxes on real property
Tax districts	established to collect funds for providing specific services, e.g., schools, fire protection, parks, community colleges, libraries, road maintenance
AD VALOREM TAXATION	property tax levied annually on the taxable value of a property in order to help fund government and public services
Tax base totalling	tax base equals the total of assessed values of all real property within the area, excluding exemptions
Homestead exemption	a tax exemption of a portion of the assessed value of a property owned and occupied as a family home
Other exemptions	immune from tax: government-owned properties; exempt from taxes: properties owned by non-profit-organizations
Tax rate derivation	(1) taxing entity determines what budget requirements must be met by ad valorem tax; (2) divide tax requirement by the tax base
Tax billing and collection	- tax rate stated as mills (\$.001), or dollars per \$100 of assessed value, or dollars per \$1,000 of assessed value, or as a percentage of assessed value - individual tax bill: tax rate times taxable value - taxable value: assessed value minus exemptions and adjustments
SPECIAL ASSESSMENTS	tax levied against specific properties that will benefit from a public improvement; amount is based on a pro rata share of the cost of the improvement and the value each parcel will receive from the improvement
TAX LIEN ENFORCEMENT	
Sale of tax certificates	the buyer of a tax certificate agrees to pay the taxes due and after a period of time may apply for a tax deed on the property
Tax deed	conveys title in the tax sale
Tax sale	the buyer must pay the taxes due, if still unpaid; the defaulted taxpayer may be able to redeem the property and reclaim title; if not redeemed, the state issues the tax deed to convey title to the buyer