

## Are You Keeping an Eye on Your Tax Pro-ration?

*While many firms ignore the area of tax pro ration review as an operating expense reduction opportunity our business in this area has continued to grow over the last several years as a direct result of the savings potential. Landlords generally don't think about how many of their tenants have accruals for unbilled or under billed property tax liabilities. Conversely, many tenants never check whether or not the amount of taxes their landlord is billing them is correct. Because erroneous pro rations can go on for years before being discovered, the size of the recoveries can be significant. As most of our clients that use our pro ration service are tenants, the article is slanted that way. However, the issues discussed certainly concern Landlords and their approach to a lease pro ration as well.*

### Lease Provisions

A tenant's liability for property taxes starts with the signing of a net lease but initial control begins in the lease negotiation phase. Assuming it is the lessees' desire to pay its fair and equitable share of taxes, it's imperative to be familiar with the taxable property and make sure the tax pro ration clause in the lease allows for the equitable pro ration of taxes. Critical factors to be concerned with include a precise definition of the total premises and the leased premises.

With multi-tenant properties, lessees need to know the productive components of the property and avoid paying taxes on any excess land or future expansion sites. If the landlord is unwilling to exclude these, work toward limiting your exposure by establishing controls that will limit liability if the excess property is not developed in a reasonable amount of time.

You should discount leases where the denominator of your pro rata share is based on the total leased and occupied square footage of the property.

This is an inequitable trend that is growing in parts of the county. A landlord will eliminate his tax liability on untenanted space. This unfairly increases a tenant's share of the property taxes. It also diminishes the urgency with which the landlord will attempt to rent out the untenanted space to reduce its carrying costs.

Small tenants are typically better off paying property taxes based on their prorated share of square footage i.e. their square footage divided by total square footage. However, if you are a large tenant or an anchor in a shopping center or office building, negotiating your pro rata share based on the

value of the premises as part of the whole may be to your advantage. Typically, anchors pay lower rent per square foot, which translates, to a lower value per square foot. The valuation as established by the assessor or an independent third party may be utilized to establish the tenant's pro ration procedure in this instance.

Other key issues that should be addressed in the lease provision include:

1. Control—who gets the property tax bill? Who pays the tax? Does the tenant get a copy of the bill and proof of the amount and payment/refund?
2. Payable Period—While it is readily assumed the tenant will pay the taxes during the period of occupancy, is it clear whether the taxes will be billed based on the fiscal or calendar year of the tax bill? Will the payment be made in advance or in arrears i.e. made monthly based on an estimated amount adjusted when the bill is issued or just paid when the tax bill is due? Also, if there is a change in the assessment (+/-), when will the estimated payment be adjusted, any excess or deficiency in reserve be refunded or collected? And what prevents landlord from establishing excessive estimated monthly tax accruals? Is interest payable on the excess when refunded?
3. Tenants Rights—Who had the right to audit the tax pro ration? Is the tenant free to recover any excess tax collected or taxes that are refunded? Are there limits on the period of time to audit and subsequent recovery? Lessees may want to investigate limiting potential large increased in their tax liability that could result from the sale of the property. Do these rights survive termination of the lease? In some jurisdictions tax litigation is settled years after taxes are paid and subsequent refunds never show up on tax bills. What are the tenant's rights in these cases? With increased RE tax litigation, it is advisable to determine if any RE tax litigation is pending before a termination agreement is executed. Preserve your right, as a tenant, to refund after termination. It is not

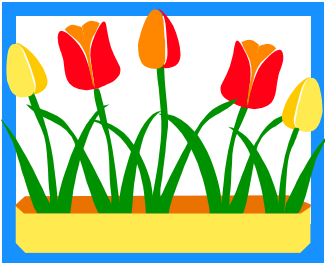
*Don't forget to mention E&A to any of your business associates or friends.*

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uncommon for litigated refunds to never get back to the tenants.

4. Appeal Rights—Who has the right to appeal? If the landlord does not appeal, can the tenant file? Must the landlord cooperate? In most cases, without the landlord's cooperation it may be impossible for a tenant to win an appeal. If there are other tenants, will they share in a recovery and the expense to contest? In a majority of multi tenant appeals the owner usually takes action and then passes the cost and hopefully the benefit to each tenant via their common area expense invoices. Are there limits on contesting fees? If the building is on the market, it is recommended that any buyer join in the appeal action and share the expenses and cost of the appeal as they will ultimately benefit from the action.

#### Administration



Once the lease is negotiated, procedures must be put in place to review the assessment and pro ration. The frequency of reviews needs to be established on a case-by-case basis. You may only want to conduct a review with the

Think Spring

assessment or pro ration factor changes.

However, this won't let you know when there is an increase in the size of the property's total square footage, which should decrease your pro ration. An advisable way to conduct reviews is to look at a percent of them each year, with the cycle taking 4 or 5 years.

Key to any review is a copy of the tax bill, property size and value, and information on appeals and tax refunds.

If the review process is a task you believe can't be handled effectively by in-house staff, call us. In no event should you ignore it as an expense reduction opportunity.

### Personal Property Rate Drops in Oklahoma

Oklahoma City County Assessor Leon Sullivan announced his intention to lower the PP assessment rate in 2006 to 13.75 from the 2005 rate of 14%. This will save businesses and others about 1.4 million.

"During these economic times, it's important to do what we can to help our businesses." says Sullivan.

## Congress Gets Involved

In an earlier issue of Taxfacts we reported that the Supreme Court was going to hear arguments in DaimlerChrysler Corp. v. Cuno. : Wilkins v. Cuno. case You'll remember this is the case where DaimlerChrysler, some local and Michigan state taxpayers and one business that had to relocate filed suit to stop the state from offering tax incentives to foster development in depressed areas.

The respondents argued that this tax incentive scheme is unconstitutional under the dormant Commerce Clause, which prohibits state taxes from discriminating against interstate commerce.

Ennes & Associates President, Terry Ennes, was recently appointed to the Village of Arlington Heights Plan Commission. In his role on the commission he will review and approve all projects proposed for the Village that require any exceptions from the established zoning and building codes.

The Court faces major issues in the case: Whether Ohio's investment tax credit, which seeks to encourage economic development by providing a credit to taxpayers who install new manufacturing machinery and equipment in the State, violates the Commerce Clause of the United States Constitution, Whether the dormant Commerce Clause allows a State to attempt to attract new business investment in the State by offering credits against the State's general corporate franchise or income tax, where the amount of the credit is based on the amount of a business's new investment in the State and Whether the Respondents have standing to challenge Ohio's investment tax credit.

Now Congress has been drawn into the fray. A subcommittee of the Senate's tax writing panel on March 16, 2006 listened to arguments for and against the practice. Subcommittee Chair Craig Thomas, R-Wyo, said that while he was hesitant to address an issue on litigation, he felt that many of the matters involved, from international competitiveness to charges of states discriminating against interstate commerce, justified a congressional "look-see".

Support for any legislation was not universal among those addressing the panel. Dr. Peter Fusher, a professor of Graduate studies in Urban and Regional Planning at the University of Iowa, called such incentives "counter productive" to states' economic interest. We've seen an inordinate amount of State Governors proposing property tax relief this year. Maryland Governor Robert L. Ehrlich Jr., included a 15% reduction in state property tax in his FY2007 budget, Vermont Governor James H Douglas proposed to cap education property tax growth at no more than the rate of inflation each year and repeal property taxes on working farms and Florida Governor Jeb Bush proposed the biggest tax cut package in state history including a \$500 million property tax reduction. And these are just to name a few.

What's fueling this reform frenzy? Some say election year, others say a growing economy. Still others say it will end up being a tax swap with increased sales and income taxes. The jury is still out on whether the cuts take place or the final outcome to the state coffers. In any case, businesses want to be wary that the cuts to homeowners don't place an additional burden on business.