

property

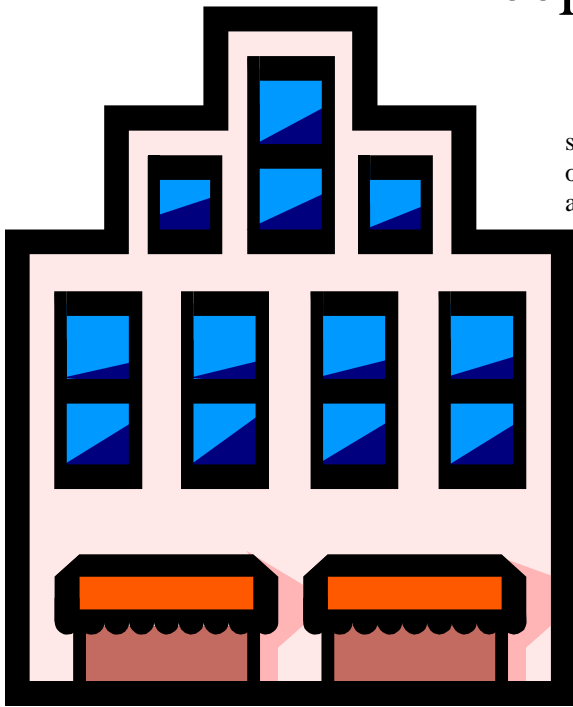
# Taxfacts

News and Views

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## Keeping an Eye on Your Building's Highest and Best Use



Real estate is generally constructed or purchased with a specific purpose in mind. When used for that purpose the property is valued at its "highest and best use". But, once determined, it doesn't necessarily follow that that use always stays the "highest and best use" for that property. Population shifts, zoning changes, supply and demand, and an area's economic climate are all factors that can affect a "highest and best use" determination. When valuing your property for property tax purposes we always take these factors into consideration.

Downtown Chicago is a prime example of this type of "highest and best use" shift. Many an old warehouse in the city center was languishing as more and more industries moved out into the suburbs. Values for these warehouses plummeted. We were able to use these low values to procure property tax

savings for our clients. Almost overnight the demographics changed as young professionals began moving back into the city. Zoning changes allowed these old warehouses to be redeveloped as condos and loft apartment buildings. The buildings' "highest and best use" changed dramatically. So did their value. Today the owners of these buildings are protesting the astronomical increases in their assessments as a result of the changes in value.

On the opposite end of that spectrum we have seen homes that were built in an area that, at the time, was mainly residential but has since been taken over by commercial interests. This change in "highest and best use" might increase the value of the land but certainly would render the residence obsolete.

When we measure the value of such properties during the conversion process we look at not only the physical make up of the land and

existing improvements, we also consider the cost to convert. These building costs may be a viable deduction from value until the transition is complete. Then, depending on the type of conversion, the value of the property would be measured based on similar type properties. This doesn't always mean the value would go up. Sometimes we see transitions that are not beneficial and therefore decrease the value of the property.

Property owners can also use the concept of "highest and best use" to make decisions when marketing their properties. For example, an owner might be able to secure zoning changes that will allow for a more viable use of a property thus bolstering its value on the market. A developer might be coerced into converting a building into a mall if the demographics fit. Markets are in a constant state of change. It is important to do a periodic reappraisal of the "highest and best use" of a property. E&A can help.

### Happy Anniversary to us! Happy Anniversary to us!

Ennes & Associates passed a milestone this July when we turned 15 years old! Some of you have been with us since the beginning in 1989. Others have joined us along the way along with 4 new staff members, 1000 additional square feet of office and about 75 new clients.

*We truly appreciate your support and your business.  
We couldn't have made it without you! **Thanks!!***

# Conflicting Interests

“It shall be “unlawful” for a registered public accounting firm to provide any non-audit service to an issuer contemporaneously with the audit...” (Sarbanes Oxley sect. 201) with these words the Security and Exchange Commission brought into focus one of the most important issues of the recent rulings...can an outside audit firm protect its independence and credibility in the audit function while providing expert opinions and legal representation on other non-audit related issues? The SEC thought not.

However, the same could be asked about a outside tax consultant or attorney who might be hired to pursue lower real estate assessments for clients. Does any conflict of interest exist? Does the consultant or the attorney have only the client’s best interests in mind? The Sarbanes-Oxley Act of 2002 puts the onus on the issuer to perform appropriate due

diligence to determine that no such conflict exists.

Conflicts can exist not only when a consultant or attorney represents clients at cross-purposes but also when they represent issues that might be diametrically opposed. The former is much easier to discern than the latter.

That is why a taxpayer must perform due diligence when hiring someone to represent them in the property tax appeal arena. But where do you start? Doing some homework on the considered firm is a good place.

There are associations that monitor the performance of property tax firms. Two of the leading ones are The National Council of Property Tax Consultants (of which our Terry Ennes is a Vice President) and the Institute for Professionals in Taxation. Find out if the firm is a member.

Interviewing the firm and asking some pointed questions is also helpful. You want to know what industries they are working with. What other property tax related issues are they presently working on? Are they in conflict with any that may come up within your industry? What does their firm stand for? What other types of work do they do? Do they represent any taxing jurisdiction? If so, what for? All of these questions will help give you a better picture of how well the tax consultant or attorney will be able to act as your advocate.

Ennes & Associates works strictly in the Ad Valorem tax arena. While some may argue that this limits our effectiveness we like to think it helps give us the single-minded purpose necessary to serve as the best advocate for our clients as possible. We have one goal in mind when working with our clients...the client’s.

## Is there a “GAAP” here?

“A tax penalty on business” is the way the personal property tax on inventory is often described. The way it is valued is just as nefarious. GAAP standards, while used for accounting purposes don’t always fit for property tax purposes. What is a company, in one of the 15 states that tax inventory to do? Tread carefully we say.

Most tax jurisdictions assess inventory on December 31 each year. Because audited financial statements are often based upon the same date, the assessor will usually expect the inventory value rendered on the personal property return to equal the value as shown on the financial statements. After all, GAAP requires inventory to be stated at lower of cost or market and could anything possibly be lower than “lower of cost or market”? Most people would probably say no. However, because a different definition of market value is used for tax assessment purposes than for accounting purposes, this may not be the case.

Most taxing jurisdictions provide a market value definition that assumes a willing buyer and willing seller, both knowledgeable, neither under duress, and a reasonable time period for market exposure. However, in the GAAP definition, “lower of cost or market” cost is measured by historic cost. The most common inventory cost methods include FIFO, LIFO, weighted average, and specific identification. The market side of “lower of cost or market” is based on replacement cost. Replacement cost answers the question: What is today’s cost of buying that inventory. If replacement cost of the inventory is less than the capitalized cost a write-down may be taken. Replacement cost under GAAP is based upon accounting principles

Therefore, given the going concern concept, consistency of accounting practice and lack of materiality of and inventory write-down to the financial statements overall, *a retail inventory’s accounting value will often exceed it’s market value*. This same situation may also exist for manufacturing inventories. This generally is recognized as a result of slow-moving or obsolete inventory items or segments.



In conclusion, caution should be exercised when using inventory values derived under GAAP to value inventory for tax assessment purposes. GAAP is a language and basis that provides commonality and a means of conveying established methodologies that are used to report financial results and do not necessarily reflect market value as extracted from the market place for property tax purposes. To confuse the issue further most accounting programs use an original acquisition cost basis for pricing inventory.

So how do you report the cost of your inventory for property tax purposes? We say...Let E&A do it!!

## Tax Credit Challenge

The 6<sup>th</sup> U.S. Circuit Court of Appeals recently ruled a tax credit Ohio granted Daimler Chrysler AG to build a new plant unconstitutional because it grants preferential treatment to companies to expand within the state rather than elsewhere. This ruling may call into question similar programs in 35 of the 45 states with corporate investment tax credits. The appeals court left standing the 10-year local property tax exemption. More on this ruling and future appeals in the next issue.