



**CPAs & Business Advisors**

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## Minimizing the bite of property taxes

Commercial real estate professionals know all too well how property taxes can get out of hand. And, with many states and municipalities coming up against budget shortfalls, real estate owners and investors will likely see property tax hikes in the near future.

So how can you minimize the pain when the property tax man knocks on your door? The answer is threefold: Watch out for double dipping, understand how cap rates affect your property tax assessments, and take available tax credits.

### Double dipping can be costly

In states where assets are taxed as both real and personal property, property can be taxed twice if an owner isn't vigilant. Here's why: Real property, which includes land and land improvements such as buildings, constitutes the major portion of an assessment. Then, any business personal property that's permanently attached to a building — in effect becoming part of the real property — is added to the assessment.

Property that can be removed and used in a different location is usually considered business personal property, with taxes on these assets based on a list of personal assets, to which depreciation is applied. But all too often, thanks to a municipality's confusing classification, the value of personal property is added to an assessment and taxed as real property.

If your property is in a state that taxes business personal property, be sure you understand how your assessment will be affected. And if it appears personal property has been classified incorrectly, challenge your assessment.

### Cap rates can complicate matters

Municipalities nationwide often employ a formula involving the capitalization, or cap, rate to calculate property tax assessments. Cap rate is determined by dividing a property's net operating income by its sales value. Although this equation involves only straightforward math, the variables going into net operating income and sales figures can make applying the formula a challenge.

To calculate a property's value, the assessor must choose several properties that seem comparable to yours and then, using those properties' net operating income and sales price, calculate a typical cap rate for the property type in your market.



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Of course, no two properties are exactly alike. They carry unique financing (or none at all), have a different mix of tenants, and generate different expenses. There can also be differences in the accounting method used. And the sales price may, or may not, have included business value.

Moreover, when the property being valued is retail, industrial or office, the complexity of calculating net operating expenses increases dramatically. In addition to having more complex lease terms, commercial tenants build out their spaces individually. An upscale shopping mall and a low-income housing project may both generate rental income, but they entail different business risks.

So it's important to evaluate whether your assessor got your cap rate right when calculating property values for your tax assessment. Again, if it appears to be off-base, don't hesitate to challenge it.

### **Credits can help you clean up**

Successfully challenging your assessment isn't the only way you can reduce your property tax bill. You may find that there are significant tax benefits to locating in an economically depressed or environmentally damaged area.

Many cities and towns offer special property tax reductions to boost economic development, while others extend reduced tax assessments to companies that undertake environmental cleanup, especially when cleanup costs can be quantified. Some municipalities also offer credits or abatements to companies that install environmentally friendly equipment, such as energy-efficient heating and air conditioning devices.

Take some time to research the possible tax credits offered in your community, and make sure you're taking advantage of all the credits for which you're eligible. It can pay off handsomely.

### **Property taxes can be managed**

Managing your property taxes requires vigilance and a keen eye for details. Fortunately, your financial advisor is there to help you minimize your tax bill.