International Property Tax Institute

PRESIDENT'S MESSAGE

June 2023

I have just returned from a family holiday in Mallorca (Majorca) and, as usual, looked at prices, taxes, etc., for the type of property we were renting. It is useful to know that, if you buy a property there, you need to consider the following fees and taxes: notary fees and charges of the property register; 10% VAT on the purchase of <u>new</u> properties, known as *Impuesto sobre el Valor Añadido*; a purchase tax (*Impuesto sobre Transmisiones Patrimoniales*) which applies to an <u>existing</u> property (8% to 11.5% depending on value); 1.5% stamp duty (*Actos Jurídicos Documentados*); and lawyers fees. Each year you will also need to pay the local municipal tax (*Impuesto sobre Bienes Inmuebles)* with the amount based on the official value of the property (*valor catastral*) and a tax rate of between 0.4% and 1.2%. If you are resident in Spain, you are also liable to wealth tax on your worldwide assets every year. If you are non-resident, only your Spanish assets will be assessed for this tax. Wealth tax rates in the Balearics range from 0.28% for taxable assets up to €170,472, to 3.45% for assets over €10,909,915 (as at April 2019). Both Spanish residents and non-residents receive a €700,000 personal allowance, and if you live in Spain, you receive an extra allowance of up to €300,000 for your main home. So resident couples who own a property in joint names could have a total tax-free allowance of up to €2 million. As always, the "burden" of property tax needs to be considered alongside the "basket of taxes" payable in the country concerned to get a real idea of its relative importance, but in Spain, according to the OECD (2020 data), property tax is 2.5% of GDP in comparison with the OECD average of 1.8% and amounts to 6.6% of total taxation in comparison with the OECD average of 5.5%, so it is on the high side in comparison with many other countries.

Moving on, the California Court of Appeal (Second Appellate District) published what is being described as a "landmark decision" recently that may have significant implications for the property tax assessments of qualifying California hospitality assets such as hotels. A news report stated: "In California, tax assessors often appraise commercial properties, including hospitality assets, using the "income method" (a discounted cash flow analysis), calculating the property's assessed value by taking the net present value of the expected future income stream of the property. This method requires assessors to exclude income fairly ascribed to certain intangible assets (versus real property and tangible personal property), including those "directly necessary to the productive use of the property." Hospitality assets typically derive income from clear use of the real estate (e.g., rental of rooms) and from the operation of the property as a going concern involving various components, such as intangible assets.

In *Olympic and Georgia Partners, LLC v. County of Los Angeles*, the court determined that, in appraising the value of a hotel property, the county assessor erroneously included income from the following intangible assets: (1) a rebate of transient occupancy taxes (TOT) collected by the City of Los Angeles (the City) from hotel guests; (2) a "key money" payment; and (3) certain hotel "enterprise assets" related to the operation of the hotel. Any owner of a hospitality asset in California that has been valued with these and perhaps similar intangible assets should examine whether this decision may support a property tax appeal to reduce the assessment of its asset."

The report continued: "Olympic and Georgia Partners, LLC (Hotel Owner), owns the subject property, the Ritz-Carlton and JW Marriott Hotels (collectively, the Hotel) in downtown Los Angeles. After completion of construction, the Hotel was reassessed by the Los Angeles County Assessor's Office (the County), and property taxes on the Hotel were thereafter based on the new valuation. Hotel Owner asserted that the County should have subtracted from the Hotel's assessed valuation (1) a rebate agreed to by the City of TOT, having a present value of $80 million (which the court characterized as the Tax Subsidy); (2) a one-time key money payment from Ritz-Carlton and Marriott (collectively, the Hotel Managers) to Hotel Owner (the Key Money Payment) in the amount of $36 million; and (3) other enterprise assets of the Hotel, characterized as "flag and franchise," "food and beverage," and "assembled workforce" assets, which the court called the Hotel Enterprise Assets, in the amount of $34 million. Hotel Owner did not have any success in these arguments with the County, with the Los Angeles County Assessment Appeals Board (the Board), or at the lower court level (except with respect to the Hotel Enterprise Assets).

After discussing certain precedents in California law for excluding certain intangible assets from the valuation of commercial properties for real property tax purposes, the court stated that the relevant test for determining whether to exclude the value of a particular asset from the assessed valuation of a property is (i) whether that asset is intangible; (ii) whether that intangible asset is capable of valuation; and (iii) whether that intangible asset is necessary to the productive use of the property.

Regarding the Tax Subsidy, the court focused on Hotel Owner's arguments that the City's desire to make its downtown convention center competitive in the national market prompted the City to provide the TOT rebates, payable on a monthly basis over the course of 25 years, to incentivize the development of the Hotel, which would increase the use of the nearby convention center. The court further accepted Hotel Owner's arguments that while development of the Hotel would be publicly beneficial, it would not have been economical to develop the Hotel without this rebate. Applying the test referenced above, the court held that the value of the Tax Subsidy must be deducted from the Hotel's valuation because it was (i) intangible (since it is "not something tangible you can touch"); (ii) capable of valuation (since the parties agreed it had a present value of $80 million); and (iii) necessary to the productive use of the property (since the Hotel would not have been built without it).

Regarding the Key Money Payment, the court described how in engaging the Hotel Managers to serve as the managers of the Hotel, Hotel Owner agreed to pay a hotel management fee calculated as a percentage of the Hotel's gross revenue. As part of that agreement, the Hotel Managers agreed to make the Key Money Payment to Hotel Owner. The court viewed the Key Money Payment as a "discount" of the management fees that Hotel Owner was obligated to pay the Hotel Managers over the term of the 50-year hotel management agreement, bestowed by the Hotel Managers to secure their arrangement with Hotel Owner. The court further reasoned that since "discounts" (such as when getting a price break in buying a car) are not "income," the $36 million Key Money Payment should not have been counted as income of the property for purposes of assessment (and therefore should be excluded from the Hotel's valuation).

Finally, regarding the Hotel Enterprise Assets, in response to the Board's argument that the flag and franchise and workforce were the property of Ritz Carlton and Marriott (and not Hotel Owner), the court stated that no California law allows an assessor to require a taxpayer to pay property taxes on intangibles so long as the taxpayer does not own the intangibles. Further, the court stated that the Board improperly failed to address Hotel Owner's extensive expert analysis of the valuation of the Hotel Enterprise Assets.

The court did not accept the County's argument that its assessment "identified and completely removed" the value of the Hotel Managers' franchises and workforces by simply deducting the franchise fees from the valuation, stating that if a franchise fee were so high as to account completely for all intangible benefits to a hotel owner, the owner would have no reason to agree to the franchise. The court remanded the question of the valuation of the Hotel Enterprise Assets to the Board and held that such valuation must be deducted from the Hotel's valuation."

However, the report continues with details of a dissenting judgement from the court. It stated: "A dissent from the majority's holding criticized the majority's opinion, especially in characterizing the TOT rebate as a "monthly subsidy to build" the Hotel and the "key money" payment as a "discount." The arguments and analysis provided by the dissent may be instructive in future appeals of this case or in similar cases. The dissent argued that TOT rebates are income generated by the use of the taxable property (the Hotel), not by an intangible asset (i.e., the value of the Tax Subsidy derives directly from Hotel Owner's use of the Hotel, similar to lease payments being derived from the use of a property, not just from the lease agreement itself). The dissent further asserted that as part of the calculation of the overall return on investment for Hotel Owner, the rebate of TOT should be included as taxable income for purposes of property tax assessment.

The dissent also rejected the characterization of the Key Money Payment as a "discount" and instead likened it to prepaid rent under a commercial lease. The dissent reasoned that since the key money was paid in exchange for the right to use and control the Hotel over an agreed amount of time (similar to rent under a lease) and must be returned upon an early termination of the hotel management agreement by Hotel Owner, the Key Money Payment also should be counted as taxable income for purposes of property tax assessment." The report concludes: "Given this decision, owners of hospitality assets in California would be wise to examine whether the assessed valuations of their hospitality assets may include values ascribed to the types of intangible assets described above (and perhaps other similar intangible assets) and consider whether an appeal to reduce the assessment of any such hospitality assets may be available." From IPTI's perspective, it is worth mentioning that the issues raised in this case have been debated by valuers for many years and have been included in many of our conferences and other events.

Moving on to IPTI activities, we are currently involved in a number of interesting and varied property tax projects and I am pleased to report that we have just been successful in being awarded a contract for a new project which we are looking forward to starting shortly. It is good to be busy!

As usual, we also have a full programme of events extending to the end of the year full details of which can be found on our website: www.ipti.org

In terms of recent events, in May we delivered another in our series of online mass appraisal workshops, this one being titled "MAV 201 Mass Appraisal Valuation - Direct Comparison Approach". Our two expert presenters provided a hands-on model building skills session guiding attendees through a DCA model building process from start to finish. The 3-hour workshop included mass appraisal model building, ratio studies and model performance review. That event was followed by another 3-hour online workshop later in the month titled "MAV 202 Mass Appraisal Valuation - Cost Approach". This workshop involved three experts providing a hands-on model building session guiding attendees through the cost model building process from start to finish. The scope included the building of a land model with market derived depreciation and a land model with residuals. The workshop also covered ratio studies and model performance reviews. Both workshops were well-received by attendees.

Also in May we held IPTI's Annual Corporate Property Tax Workshop for representatives of large corporations. The title of this one-day, in-person event was "Challenges in Managing Property Tax Portfolios in Current Economic Environment". Corporate property tax managers are dealing with difficult business conditions including rising inflation and higher interest rates which may have a negative impact on their company's performance. The COVID pandemic created additional challenges which also included changing consumer behavior. Some of the challenges include the inability to easily analyse property assessments based on current market conditions. This workshop, hosted by IPTI's Corporate Advisory Committee, provided an opportunity for experience sharing and interactive discussion. The discussions were lively and interesting, and participants covered a wide range of relevant topics.

Looking forward, in June we are holding our annual Mass Appraisal Valuation Symposium (MAVS). The MAVS, with the theme "Valuing Properties in Uncertain Times", will be a two-day online event held on 21-22 June. We have a great line-up of speakers and topics and will be delivering the event in partnership with the International Association of Assessing Officers (IAAO). If you have not already registered, I would urge you to do so as the event is one not to be missed.

Looking a little further ahead, I would like to draw your attention to our annual Caribbean conference. This in-person event is being held in Barbados on 9-10 November. This will be our 10th Annual Caribbean conference and, as usual, will be delivered in partnership with the Royal Institution of Chartered Surveyors (RICS). The theme is "Advancements in Real Estate - Recent Trends Impacting Valuation and Construction". The conference agenda is available on our website and you will see it covers a wide range of topics of interest to those involved in property valuation and construction.

Now it's time for a quick look at what is making headlines concerning property taxes in selected jurisdictions and countries around the world. For more information, and links to the original news articles, please refer to IPTI Xtracts which can be found on our website: https://www.ipti.org/

A recent news headline stated: "Singapore's 60% Property Tax for Non-Citizens Is Now the Highest in the World." It continued by pointing out that the city-state doubled its Additional Buyer's Stamp Duty so foreign home buyers will have to pay a 60 percent duty, the highest property-tax rate in the world. The article pointed out that if a foreigner were to buy a $5 million property in Singapore, they'd have to pay 65 percent in taxes, or about $3.25 million. In other major international hubs, the taxes would be much less: Foreigners in Vancouver and Hong Kong have a tax rate of 30 percent, while London, Melbourne, and Sydney are all in the 14 percent range. New York, in comparison, has a pretty low tax rate of just 4.3 percent. It was suggested that this change may mean that foreigners are more likely to purchase property in nearby Hong Kong. Those from mainland China, in particular, may see the region as much more appealing when compared with Singapore. Hong Kong currently charges a still-high 30 percent stamp duty on property purchases by foreigners, but if a homeowner becomes a permanent resident later on, most of that can be refunded, thanks to Hong Kong's efforts to attract talent. Singapore's housing market has been doing well lately, with an influx of money and interest in the real-estate sector. However, that's led to concerns about Singapore becoming less affordable for locals, a trend that the tax-rate increase is designed to combat. It will be noted that similar concerns exist in many other cities around the world.

Property tax exemptions continue to attract criticism. In Pennsylvania (USA) the Commonwealth Court recently issued four related but distinct opinions (the "Tower Cases") which it is reasonable to expect may be used by local taxing authorities to attempt to challenge the property tax-exempt status of certain Pennsylvania non-profit hospitals. The Tower Cases support the notion that the courts are going to scrutinize the real estate tax exemption of Pennsylvania non-profit hospitals, notwithstanding that they may have an open admissions policy, accept Medicare and Medicaid payments, and/or be money-losing operations. The Tower Cases, at the very least, put Pennsylvania non-profit hospitals on notice of the importance of continuously re-evaluating management fees, executive compensation, and financial assistance policies to ensure compliance with property tax exemption requirements. As hospitals and hospital systems continue to grow, the Pennsylvania courts continue to scrutinize what qualifies for real estate tax exemption. Professional commentators say that in order to be best positioned to withstand such scrutiny, hospitals should take the teachings of the Tower Cases into account in making decisions for their own operations. In IPTI's view, it is helpful to review all property tax exemptions regularly.

More controversy about property tax exemptions, this time from Massachusetts (USA) where a news headline reads "Amid economic downturn, state program slashes elite golf clubs' property taxes". It continues, some of the state's most exclusive country clubs use a state program to eliminate hundreds of thousands in local property taxes each year. Private country clubs in Massachusetts enjoy a generous tax break from a decades-old state program intended to help preserve open land and recreational space. The article states that the benefit lopped off about $600,000 from one club's payments to the city of Newton this year at a time when the city faced soaring costs to fund schools and its public services, and leaders asked residents to increase their own taxes by more than $9 million in March. Some officials in the city apparently questioned why three clubs for wealthy members should continue to enjoy a combined tax break of $1.75 million at the expense of Newton residents. Amid economic uncertainty and high inflation, the struggles of even well-to-do communities such as Newton have sparked a re-evaluation of the state program, called Chapter 61B, that reduces property taxes on eligible land used for open space or recreation by as much as 75 percent. The Mayor of Newton said she is encouraging the state "to re-examine the financial benefits" provided to recreational properties like golf courses. She acknowledged that communities can benefit from the open space and opportunity to purchase land under the program, but added, “the level of abatement that state law currently allows deserves a second look.” Across the state, the newspaper identified at least 100 golf courses that participated in the program this year. While the bulk of the clubs reported taking property tax cuts of less than $60,000, the paper found 10 courses that received breaks of about $100,000 or more, according to public property and tax documents gathered in response to records requests.

In Ireland it is reported that while most people in the Republic support the introduction of a vacant homes tax, many believe the proposed rate is too low. That’s according to a survey by consumer group Taxback.com which tested public sentiment around the new measure. The 0.3 per cent tax, introduced as part of Budget 2023, will be payable from January next year under a self-assessment system. Taxback’s survey indicated that just over 50 per cent of respondents supported the Government’s vacant homes tax but that 70 per cent of these believed the rate “should be at least almost five times more than the 0.3 per cent it is currently set at”. Almost three in 10 (28 per cent) said they were not in favour of the tax because of its implications for choice and autonomy, “with this cohort believing that property owners should be allowed to do as they wish with their homes”, Taxback said. Almost one in five (17 per cent) were against it because they did not believe it would solve anything. About a quarter of those in favour of the tax said they believed it should be set at a rate of 5 per cent, one in five believed the rate should be 10 per cent, while one in seven said it should be 20 per cent. Ten per cent would like it to be more than 20 per cent.

And finally, some of you may recall that, in a recent newsletter, I referred to what appeared to be a “travesty of justice” involving the seizure of residential property by a municipality to enforce payment of the owner’s outstanding property taxes. Nothing wrong with that process in principle but, in this case, the municipality retained the entire proceeds of sale, not just the amount of money owed. Perhaps surprisingly, this retention of the entire sale proceeds was held to be legal by a number of courts until it reached the US Supreme Court who, thankfully, issued their decision in favour of the owner on 25 May. Part of that decision stated: “Hennepin County, Minnesota, sold Geraldine Tyler’s home for $40,000 to satisfy a $15,000 tax bill. Instead of returning the remaining $25,000, the County kept it for itself. The question presented is whether this constituted a taking of property without just compensation, in violation of the Fifth Amendment.” And later, the decision states: “The principle that a government may not take more from a taxpayer than she owes can trace its origins at least as far back as Runnymeade in 1215, where King John swore in the Magna Carta that when his sheriff or bailiff came to collect any debts owed him from a dead man, they could remove property “until the debt which is evident shall be fully paid to us; and the residue shall be left to the executors to fulfil the will of the deceased.” It continued: “This principle made its way across the Atlantic. In collecting taxes, the new Government of the United States could seize and sell only “so much of [a] tract of land . . . as may be necessary to satisfy the taxes due thereon.” In conclusion, the judgement states: “The Takings Clause was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole … A taxpayer who loses her $40,000 house to the State to fulfill a $15,000 tax debt has made a far greater contribution to the public fisc than she owed. The taxpayer must render unto Caesar what is Caesar’s, but no more.” In my opinion, a good outcome in which justice prevailed!

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