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The String of Holiday Lights & Property Taxes

Have you ever put up outdoor holiday lights during the holiday season? Ever had them NOT get tangled? Property taxes are a lot like those strands of holiday lights. It only takes one small mistake to set off a string of events that will consume more time and money than you care to imagine.

BY MATT MCFARLAND

Have you ever put up outdoor holiday lights during the holiday season? Ever had them NOT get tangled? I swear little gremlins must live in my attic where I store my lights because every season my lights are a tangled mess that I could not make worse if I tried. And after I get them untangled, I always find that one of the 4,580 tiny light bulbs is burned out and none of the other 4,579 lights will work until I find and replace that one tiny bulb.

Property taxes are a lot like those strands of holiday lights. It only takes one small mistake to set off a string of events that will consume more time and money than you care to imagine.

I know the range of sentiments out there… "property taxes are insignificant", "I focus on the top line growth, not tax issues", "My accountant handles all the taxes". If you can relate to these thoughts please read on. The stories that follow are for you, they are true, and they happen all the time.

Property taxes related to a portfolio of leased assets present challenges that few industries face. For example: consolidated tax bills for multiple lessees, appropriate tax allocation for lessee reimbursement, assets being moved without notice from one taxing jurisdiction to another, assets rolling off lease in the middle of a tax year, and the list goes on.

Lessors are saddled with mountains of paperwork and varying compliance requirements from approximately 80,000 taxing jurisdictions. Many of these jurisdictions have their own forms, deadlines, and methodologies for determining taxes. As these states, counties and cities face hard economic times with sales tax revenues falling to record low levels, they must look to other sources of revenue to maintain their already anemic budgets. The current trend is to bolster the property tax revenue. However you choose to handle property taxes, you must acknowledge and accept the LAW of Property Tax Administration: The cost of performing the property tax function "marginally" WILL cost you thousands of dollars annually… PERIOD!

To minimize your taxes and insure your lessee reimburses you for their appropriate share of property taxes, you must commit the proper resources. Long gone are the days that lessors could "have the accountants handle property taxes". Property tax administration requires specialized knowledge of each taxing jurisdiction where your lessees are located. Today, assessing jurisdictions are ever vigilant in their discovery of taxable assets, and tax collection efforts continue to be relentless.

Tangled Mess #1:
Assets Incorrectly Classified

A lessor leases rail car loading equipment that is coded in their general ledger as rail cars. Employee #1 fails to review the asset listing detail and assumes the description is accurate (Mistake #1). Since employee #1 knows rail cars are not taxable for property tax purposes in this particular state, the rail cars are not reported (Mistake #2). After Employee #1 leaves the company for greener pastures, Employee #2 takes over the property tax administrative function the following year. Employee #2 knows to look beyond the General Ledger code when reporting assets and finds that the true asset description of these assets is rail car loading equipment, not rail cars. Since these assets are taxable, Employee #2 reports the assets. Upon receiving the asset listing from Employee #2, the taxing jurisdiction notes that the assets have been in service for 3 years but have never been reported so the assets are assessed for three prior years and the tax bill total is $400,000. When the mistake was discovered, and the tax bill was due and payable, the lease had expired and the lessor was liable for the previous year's property taxes. The lessor should have the ability to collect the tax portion from the lessee, however penalties and interest are the responsibility of the lessor. Prior to collecting any money from the lessee, the lessor had to write a check for $465,000 to the taxing authority for taxes, penalties, and interest.

Tangled Mess #2:
Assets Not Properly Reported

A lessor has many expensive assets being leased. The assets are considered "rolling stock" and as such, are typically reported by the lessee (for property tax purposes) to achieve an interstate allocation of taxes among the various states the assets have traveled. It is important to note that the lessee in this story represents a significant portion of the lessor's leasing portfolio business.

The lessor assumed that the lessee reported the assets to the taxing jurisdictions for property tax purposes (Mistake #1), and therefore the lessor did not report the assets. Further, the lessor did not obtain verification from the lessee that the assets had in fact been properly reported (Mistake #2). The fact is, the lessee did not report the assets to the taxing authorities.

When taxing authorities discovered that the assets were not being reported, a back-assessment was sent to the lessor (the owner of record). The lessor had two options: (1) Pay the resulting $300,000 tax bill plus $35,000 in penalties and interest or (2) Approach the lessee and request payment from them (remember the lessee represents a significant portion of the lessor's portfolio). This oversight created a no-win situation for the lessor that could have been avoided.

Tangled Mess #3:
Double Assessments

A lessor had vehicles titled under several DBA names to identify various leasing portfolios. For several years Employee #1 reported the assets to taxing authorities under the different DBA names. After Employee #1 decides to take a job with another company, Employee #2 is hired to administer property taxes. In order to simplify the property tax reporting function Employee #2 decides to report the vehicles under the parent company name (Mistake #1). The taxing authorities promptly assessed taxes on these "new" assets.

Since the vehicles reported in previous years under the DBA names were not reported in the current year, the taxing authority rolled over the prior year assessment and sent out current year tax bills to the various DBA's. This created a double assessment of taxes for the same assets (one assessment to the parent company and another to the DBA). Now the story gets even better (or worse if you are the lessor)… Employee #2 was not fully versed on the property tax laws in the state where this debacle occurred and failed to protest the double assessments within a two year period (Mistake #2). Since too much time had passed, appeal remedies had expired and the lessor was required to pay $80,000 in extra taxes while spending countless hours trying to correct the situation.

Tangled Mess #4:
Assets Relocated By Lessees

A lessor has a portfolio of commercial vehicles. Generally, for property tax purposes, vehicles are taxable in the jurisdiction where the vehicle is registered. When vehicles are moved from one location to another, double assessments can easily occur. In this situation the lessee failed to notify the lessor that the vehicles had been moved, and the lessor failed to ask (Mistake #1). Essentially, bad information created a double tax assessment whereby two or more different taxing authorities tax one asset. When the double assessments were discovered, the lessor had to file formal protests in 5 different states, contact each tax jurisdiction and each lessee to determine the actual location of each asset, and attend appeal hearings in 5 different states. The man-hours and travel costs alone were calculated to total $75,000 not counting the liability in taxes that remains in dispute.

Tangled Mess #5:
Asset Cost Incorrectly Reported

A lessor routinely included commissions, travel expense, training, and additional soft costs into the "Cost" of all leased assets. While this cost amount was meaningful for certain purposes, this erroneous cost was utilized as the basis for reporting assets for property tax purposes. The result was that the lessor reported costs 250% higher than the actual taxable cost and by doing so, incurred a tax liability 250% too high!

After the "glitch" was discovered, the lessor spent countless hours attempting to recover the overpayments in taxes from taxing authorities. The following year when the assets were correctly filed, and lessees received tax bills for much less than in previous years, some lessees raised questions. Ultimately the lessor had to calculate the amount of over-charges that were billed to lessees and refund monies to almost 3,000 lessees. This project encompassed almost two years and countless man-hours to correct, not to mention the negative goodwill generated with the lessees.

These stories are all true, and they happen every day. How do YOU avoid these situations? There are a number of ways to avoid the quagmire of faulty property tax administration.

- Hire a dedicated staff of experienced property tax professionals knowledgeable in multi-state property tax administration for leasing companies. Corporate property taxes are not as involved as taxes associated with a leasing portfolio.
- Dedicate the resources necessary to maintain vigilance over the property tax function. Most of the stories you just read were due to simple mistakes made by staff members trying to multi-task in property taxes as well as other functions. Keep the staff focused on property taxes all year long.
- Always insist on filing the property tax reports on behalf of your lessee to insure it is reported timely and accurately. Even on financing leases, the lessor should report to taxing authorities unless the title has been transferred to the lessee up-front.
- Just like your doctor advises, get an annual check-up. Contact a reputable property tax consulting firm to evaluate your situation and assess your systems, processes, and staff competencies. These assessments are invaluable to prevent problems or to correct any problems before they become tangled messes.
- When you are looking for property tax experts, always compare the firms you are considering against other firms in the same industry and make sure you check client references.
- Lowest price is often not the best deal. Consider value vs. price. Is a cheap ticket on the Titanic a good deal? Considering the potential exposure you face as a lessor, implement an appropriate plan to mitigate that risk.
- Find a firm that can offer you the experienced staff to keep these events from happening to you. Just because you hire a consulting firm to do this work does not guarantee that that firm maintains licensed property tax consultants knowledgeable about your situation.
- Find firms that will offer you guarantees that the work will be performed properly, and one that will indemnify you against the cost of any errors.
- If you are purchasing a portfolio, have the portfolio evaluated to make sure there are no hidden property tax liabilities you will inherit.

Property taxes represent significant liabilities that require in-depth knowledge and expertise to manage appropriately. The risk of financial loss and tarnished customer relationships is too high to minimize the importance of this component of your business.

The stories above are not extreme and oddball occurrences. They are scenarios that are happening every day. Taxing jurisdictions make big mistakes every year, and if you are not knowledgeable of the various taxing authorities rules of engagement, and if you are not monitoring the process, you can safely assume you and your lessee are overpaying property taxes. *m*

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