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5 Tips On Controlling Hotel Property Taxes

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Law360, New York (January 5, 2017, 12:19 PM EST) -- Hotels are generally recognized as one of the highest taxed real estate assets. A property's return on investment can be significantly impacted by real and personal property taxes. One recent study estimated that property taxes account for 40 percent of a hotel's cost of occupancy. Still, property taxes are not always a high priority for owners and this can be a very costly mistake. Below are five tips for controlling property taxes on a hotel.

Tip One: Do Your Due Diligence

Property taxes are a significant variable in an acquisition, and can be tricky for underwriting an asset. Thus, owners should always understand what implications the purchase will have on the hotel's future property tax liability before acquiring or investing in a hotel. It means researching historical tax rates and assessments of comparable properties in the area. It also means understanding the local assessment office's valuation methodology and reassessment cycle. For instance, how will the sales price affect the assessor's valuation of the property? With major renovations or new construction, what is the timing of supplemental assessments? Understanding the local reassessment cycle — many take place annually, while some can be every three, four or even eight years — can have a very large tax impact on a property. To accurately budget for property tax expenses, an owner must educate themselves about the property tax system in a state and how that tax system is implemented in the local jurisdiction.

Tip Two: Look for Errors and Opportunities

Local assessing authorities are charged with assessing hundreds of thousands of parcels. Inevitably, there are errors made in the county's property records. A careful review of those records is important. For instance, the assessor's records may reflect mistakes in the building's total square footage, age, hotel occupancy (limited service, full service) as well as many other key characteristics. Correcting these mistakes for a newly constructed or a recently acquired hotel may significantly reduce a property's long-term tax liability. In addition, many jurisdictions provide taxpayers specific protest avenues to correct these common mistakes that may have existed on the tax roll for years.

Tip Three: Investment Market Value Does Not Necessarily Equate to Property Tax Value

Even if an investor believes the assessor's valuation is reasonable based on their understanding of investment market value, the hotel may still be overvalued. This is because investment market value as commonly understood differs from property tax value. Appraisals completed for financing or due diligence purposes measure the value of the total assets of the hotel as an operating business. On the other hand, market value for property tax purposes is limited to just the value of the real estate. Most states prohibit taxing a hotel as a going concern, meaning intangible value attributable to a brand, licenses, trained workforce, proprietary technology such as reservation systems, hotel management and franchise agreements must be excluded from the assessor valuation. The Appraisal Institute and other authorities have long recognized the existence of

intangible value in hotels, which by some measures can account for 20 to 30 percent of a hotel's total value. To obtain a true property tax value for the real estate, the income attributable to personal property and intangible property must be excluded. For example, in a decision that has implications beyond California, the California Court of Appeals in SHC Half Moon Bay LLC v. County of San Mateo, 226 Cal.App.4th 471 (2014) recognized that the assessor's failure to exclude all the intangible value violated California law. SHC Half Moon Bay purchased the Ritz-Carlton Half Moon Bay Hotel for approximately $124 million. The purchase price included the total assets of the business. The assessor deducted the value of the personal property and reduced the value to $117 million. SHC challenged the San Mateo's assessment asserting the intangible value was $16 million. The Court of Appeals held that the assessor's valuation methodology of accounting for intangible value by deducting management and franchise fees from the cash flow was legally flawed. The assessor's method, which is typically used by assessing authorities nationwide, did not fully account for the existence of intangible assets. The lesson from SHC is not just that the assessor must identify and exclude all intangible value but also that sales price does not necessarily equate to market value for property tax purposes.

Tip Four: Real Estate Transfer Taxes

Investors acquiring a hotel should also be aware of whether a real property transfer tax applies. Currently, 35 jurisdictions levy a tax on the transfer of real property but there is little uniformity among jurisdictions. The first step is to determine whether a hotel transaction is subject to a real property transfer tax and, if so, what type of property is subject to the tax. In most states, transfer tax only applies to the transfer of real estate. Hotels, of course, involve the sale of substantial non-real estate items. Investors should consider conducting a purchase price allocation to segregate the real property, tangible personal property and intangible personal property. With careful planning transfer taxes can be minimized. It is also critical to understand the local jurisdiction's reporting requirements, audit procedures and, if necessary, the process for obtaining refunds where the property's value has been misreported.

Tip Five: Understand the Assessment Laws and Procedures in the Jurisdiction

To take advantage of the opportunities to lower property taxes, investors must understand how and when they can appeal. Every state has a process for disputing a property's valuation and filing a formal appeal. However, property tax appeal procedures vary greatly from jurisdiction to jurisdiction, can be difficult to navigate and often require perseverance. Among other things an investor needs to know are the methods used by assessors to derive the initial value, when values are annually noticed, the deadlines to appeal, where to file an appeal, what evidence is necessary to be successful on appeal, and what rights a taxpayer may have when appealing to court. Owners unfamiliar with the deadlines, procedures and understanding of the valuation methods used to arrive at their assessment can easily miss an opportunity to reduce their property's valuation. Thus it is always prudent to review a hotel's property tax value annually to maximize their chances for success.

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