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A Once in a Lifetime Opportunity to Reduce a Property's Taxes: A Supplemental Notice of Value

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In the next few weeks, county assessors throughout Arizona will issue supplemental notices of value for the 2018 tax year. Supplemental notices are issued when there is new construction or additions, parcel splits or consolidations, or changes to a property's use that have occurred since October of the previous year. Since the tax cap on property valuations went into effect with Proposition 117 in 2014, many Arizona taxpayers have grown complacent in monitoring their property's valuation. If they fail to carefully review a supplemental notice, taxpayers may miss an opportunity—possibly a once in a lifetime opportunity—to reduce a property's tax liability. The reason: the supplemental notice triggers a "Rule B" valuation.

To understand the effect of a "Rule B" valuation, let's take a simple example of a newly constructed commercial building. Suppose construction of your new building was completed in July 2017. The county assessor set a full cash value of $4 million to the property. In Arizona, the full cash value ("FCV") is typically synonymous with market value. This is the easy part.

Just to make things more complicated, Arizona has a second value known as the limited property value ("LPV"). The LPV is the value that is most important to taxpayers because property taxes are calculated only from the LPV. The FCV varies from year to year depending on market conditions. By contrast, the LPV is determined by a statutory formula based on a property's LPV from the prior tax year and it is limited to annual increases of no more than 5 percent. When a supplemental notice is issued, Arizona law considers this to be a first-time valuation of a property so there is no prior year valuation to determine the LPV. So how does a county assessor determine the LPV for our new commercial building?

The LPV is established by what is called a "Rule B" ratio. The "Rule B" ratio is the ratio of the average LPV to the average FCV for similar properties in the same classification throughout the county. Rule B ratios vary by county, by class of property, and by tax year. For example, the "Rule B" ratios in Maricopa County for the 2018 tax year are: for vacant land 62%; for commercial property 79%; and for residential 74%. This means, for instance, that in Maricopa County the average LPV for commercial property is currently 79% of the average FCV.

Based on Maricopa County's "Rule B" ratio for our new commercial building, the LPV would be established at 79% of the full cash value of $4 million or $3,160,000. The property's tax liability will be calculated solely on the LPV of $3,160,000.

Now that we understand how the FCV and LPV are determined when a "Rule B" valuation occurs, the question remains why it represents a once in a lifetime opportunity to reduce a property's taxes. The reason is a successful appeal that reduces the FCV will also reduce the LPV in proportion to the Rule B ratio. For example, if our owner appeals the supplemental notice and successfully reduces the FCV to $3.5 million, the LPV will be set at 79% of the full cash value or $2,765,000.

Now let's see what happens if the owner of our newly constructed building misses the deadline to appeal the 2018 supplemental notice. The owner waits until next February 2018 and appeals the 2019 tax year notice. The FCV is again set at $4,000,000 and the LPV will be set at $3,318,000 (2018 tax year LPV of $3,160,000 x 1.05). The owner appeals the 2019 valuation and prevails by reducing the FCV to the same $3.5 million value mentioned above. In this case, however, there are no tax savings. The reason is that the appeal did not reduce the LPV. Why? A reduction in FCV will not, by itself, reduce the LPV. There was no "Rule B" valuation because the LPV was set in the prior tax year. Unless there is a reduction in FCV below the current LPV, there will be no reduction in the LPV and in the property tax paid. This is why a Rule B valuation represents a once in a lifetime opportunity to reduce a property's taxes not only for the current tax year, but for many tax years to come.

Owners that receive a supplemental notice should not be complacent about challenging their valuation. For taxpayers who want to appeal their valuation, they have twenty-five days from the mailing date of the supplemental notice to file an administrative appeal. All hope is not lost if a taxpayer misses the twenty-five day window, as a taxpayer may initiate a lawsuit in tax court by December 15.

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