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## Nevada's property tax shaft

More egregious than the public realized

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CARSON CITY, Nev. — Last July, Nevada Department of Taxation appraiser Shannon Silva sent an e-mail to an Indiana property-tax official desperately seeking guidance on how to apply two common appraisal techniques used throughout the country.

Twenty-eight years after Nevada abandoned a market-based property-tax system and replaced it with a "taxable value" system that separately values land and improvements, Nevada still hadn't developed guidelines for the state's 17 elected assessors on how to use two appraisal techniques known as allocation and abstraction (see here for explanations of these terms).

Standard appraisal reference guides developed for market-based property-tax systems do not specifically address how to use the two techniques in Nevada's peculiar system. So, Silva turned to Indiana because it once had a property-tax system similar to Nevada's but scrapped it after the Indiana Supreme Court — in a series of decisions from 1996 to 1998 — found the system inequitable.

Nevertheless, Silva hoped Indiana could help Nevada develop a regulation so the state could comply with a 2006 Nevada Supreme Court order requiring the department to provide uniform appraisal methods to county assessors.

"I am hoping you may be able to help us," Silva wrote in the e-mail obtained under the Nevada Public Records Law. "Can you possibly provide us with any information on how you handled allocation and abstraction under your old system? And would you possibly know of any other states that used to be on a

split system? Any assistance you can provide would be greatly appreciated!!!"

Indiana sent back a link to its website and some documents from 1995. While the information appears to have been helpful, according to Silva's e-mail to superiors, the department has not yet developed a regulation to address the use of the two methods that are used to determine land values when there are insufficient vacant land sales for comparison.

The decades-long failure of Nevada to promulgate regulations for how to apply common appraisal techniques such as allocation and abstraction provides a window into the difficulty the state faces in creating a fair and equitable property-tax system that passes constitutional muster for a non-market-based system. The state department of taxation is years behind in developing a comprehensive framework of regulations to ensure the state's assessors are appraising property uniformly.

The department, for example, has had a list of 26 "proposed topics for regulatory consideration" to address appraisal issues since 2007 and none have been passed, department records show. Among these topics are basic issues such as the definition of land and clarifying the meaning of "cost of replacement." Developing clear, technically sound definitions for abstraction and allocation are also on the to-do list.

Further complicating matters is mounting evidence that state regulators are misapplying basic appraisal principles. This is resulting in higher valuations than allowed by Nevada law, a leading appraisal expert said.

The lack of timely regulations defining appraisal methodologies and the incorrect application of

appraisal principles has direct implications for taxpayers because assessors across the state are not using the same methods to determine the valuation of property, despite a 2006 Supreme Court order directing the state provide standard methodologies.

The patchwork of regulations and different valuation techniques used by different county assessors is disguised from taxpayers by a system that makes it virtually impossible for property owners to understand how their property is appraised.

"Most people who own residential property have no way of understanding the taxing system," said Barbara Smith Campbell, a former director of the state Tax Commission.

The root of the problem is the fact that Nevada is the only state in the nation that doesn't use a market-based system as the basis for developing valuations for property taxes. The entire U.S. appraisal industry and its major academic textbooks and reference guides are based on a market-based approach to appraisal.

The end result is Nevada's taxable-value system, property-tax experts said, inherently creates valuation inequities between similar properties — inequities at odds with the Nevada Constitution's requirement of "a uniform and equal rate of assessment and taxation."

"Once you go off market value, you've got issues where you are not going to be equal," said Carole Vilardo, executive director of the Nevada Taxpayers Association.

In 1981, the Nevada Legislature created a "bifurcated" property-tax system where land and improvements are valued separately and then added together. Under this "taxable value" system, land is valued at full cash value based on comparable sales. Improvements, which typically make up about 75 percent of the value of a residential property, are valued based on their replacement cost new, less 1.5 percent depreciation per year up to 50 years. The replacement cost is determined by using a manual of building costs compiled by Marshal & Swift, a company that provides building cost data.

Retired University of Nevada, Reno economist Glen Atkinson has been intimately involved with state tax issues for more than 40 years. Atkinson said the state's method of valuing improvements based on replacement costs less depreciation creates a fairness issue because two properties that have the same market value could be taxed at different levels depending on the age of the improvements.

Depreciating for the age of the improvement, he said, creates situations where an older home with the same overall taxable value before depreciation as a

newer home next door, will be taxed a lower rate depending on the age of the home.

For example, a new house with a land value of \$100,000 and improvements valued at \$100,000 will not receive any depreciation deduction, so it will have a taxable value of \$200,000. But a 20-year-old house next door with the same land value of \$100,000, and an equivalent improvement value of \$100,000 will receive 30 percent depreciation, resulting in a taxable value of only \$170,000.

"This raises an equity issue in that you are not treating all property uniformly and equally," Atkinson said.

Washoe County Assessor Josh Wilson said property of equal value should be taxed at the same level. "I truly feel that our forefathers envisioned a tax on value regardless of how old a property is or anything else," he said. "If your property is worth \$5 and my property is worth \$5, we are paying the same tax."

Suellen Fulstone, a Reno attorney representing Lake Tahoe basin taxpayers who have staged a seven-year property-tax revolt, said the state's taxable-value system is unworkable and vulnerable to a direct constitutional challenge. "It just cannot work, certainly not in the way it is presently set up," she said.

Fulstone said different counties are using different methodologies to determine taxable values of properties.

"We have a system that creates too many options" for assessors to use to determine property valuations, said Fulstone. "If you tell the assessor they can value property in one of five different ways, or any combination of the above, you absolutely cannot keep uniformity."

The tax department, meanwhile, has never determined whether the different approaches are resulting in equivalent valuations. "No one has ever done any studies to see if these different methodologies used in the different counties actually get to the same result," she said.

The problems will persist as long as the state stays on a taxable-value system, Fulstone said. "If the state would go back to a full-cash value system, a lot of this would simply go away," she said.

Richard Almy, a leading appraisal expert and former executive director of the International Association of Assessing Officers, said it is difficult to understand "what the rationale is" for Nevada's taxable-value system. He said the state could provide property-tax benefits for specific taxpayer groups — such as the elderly, so they don't get taxed out of their homes — in a market-based system.

"If you want to favor or penalize some taxpayer, you can do that with a market-based system," he said.

He also criticized the state's reliance on a costing manual developed by a private company that is used to determine the replacement cost of improvements. "It's a weak foundation for a tax system," he said. The cost manual only provides an estimate of the actual cost of replacement, added Almy.

In many cases, especially with custom-built homes, the manual underestimates the replacement cost, and so assessors shift value into the land — resulting in taxpayers paying higher taxes, he said.

Almy suggested that Nevada should seriously consider revamping its entire property-tax system. "I think I could safely recommend that it probably ought to be rethought if they really want to do it this way or not," he said.

State elected officials have ignored property-tax-equity issues for decades, despite high-profile warnings. In 1988, the Nevada Legislature commissioned a study of the fiscal affairs of state and local governments. This included an examination of the state's taxable-value system. The study found that the failure to tie the state's property-tax system to market value was a major issue that the legislature should examine for possible change.

"When the common tie between market value and assessed value is abandoned, the property tax essentially abandons its underlying theory," economist Robert D. Ebel wrote in the 1988 report *A Fiscal Agenda for Nevada*. "The tax ceases to be a tax on some objective measure of value (of accumulation of wealth) and becomes, instead, a somewhat arbitrary collection of exactions based on age and the like."

The legislature did not take action on the recommendation. Instead, as property-tax attorney Paul Bancroft notes in a 2008 article in *Institute for Professionals in Taxation*, Nevada has moved further toward an arbitrary property-tax system that is forcing the courts to intervene at an extraordinary level.

Without an "objective measure of value," Nevada's courts have repeatedly ruled over the last seven years in taxpayers' lawsuits that the state Tax Commission, in order to pass constitutional muster, must provide uniform appraisal methodologies to county assessors.

So far, the Tax Commission has failed to successfully implement detailed regulations as called for by the Supreme Court. In addition, the commission has also failed for more than a decade to publish a 350-page policies-and-procedures manual meant to provide detailed instruction to assessors — a direct violation of state law.

"No policies and procedures manual? That is not good," said Ebel last week in an e-mail.

A taxpayer revolt in the Lake Tahoe basin has uncovered reams of information related to the misapplication of state law by the Washoe County assessor's office and the state department of taxation on appraisal methodologies. Among the most egregious is an assertion by the tax department that the value of land is proportional to the value of the improvement.

In other words, according to the tax department, if three essentially identical parcels of land had progressively more-valuable houses on them, their land values would increase proportionately. In a sworn affidavit, Almy, the former executive director of the IAAO, called the department's methodology "surprising."

Other leading Nevada appraisal experts were shocked when they learned about the state's approach during an April 10, 2008 state Tax Commission advisory meeting. "This is a serious issue," Clark County Assessor Mark Schofield said during the daylong meeting of the advisory panel called the Blue Ribbon Commission. "Land values should be based on actual sales."

Nevada's taxable-value system was created by the legislature in 1981 to thwart a citizens' initiative to establish a property-tax system similar to California's controversial Proposition 13. Passed in 1978, the California measure limits property taxes to 1 percent of assessed value. It also limits annual increases in a property's assessed value to 2 percent, except when the property is sold, when the assessed value is reset to market value.

Seeking to avoid a similar measure in Nevada, the legislature abandoned its market-based property-tax system and replaced it with taxable value. The new system was supposed to shield homeowners from rising property taxes by removing improvements, which account for about 75 percent of the value of a typical residence, from sharply increasing market prices.

This bifurcated Nevada system of valuing land and improvements separately is the basis for many of the disputes between taxpayers and assessors, said Dino DiCianno, executive director of the state Department of Taxation.

"Where it gets complicated is trying to use a market-value process for the land separate from the improvements," DiCianno said. The system "can break down," he said, "if you have discrepancies with the methodologies that are used."

Such discrepancies have provided the basis for a taxpayer revolt at Lake Tahoe spearheaded by the

citizen nonprofit group Village League to Save Incline Assets, Inc.

Soon after the Village League was formed in late 2002, its attorneys zeroed in on the appraisal methods used by former Washoe County Assessor Robert McGowan, rather than protesting the actual taxable value. The Village League's legal attack on methodology confounded Washoe County, which, to this day, asserts that it has never over-valued property in Incline Village.

"The property was never over-appraised, and if anything, it was under-appraised," said McGowan. But as the courts would later determine, it doesn't matter what the value is, only whether it is computed based on methodologies approved by the Tax Commission.

McGowan also insisted that his office was using common appraisal practices — even though the Tax Commission had not approved some of the methods. His use of subjective appraisal methods that included increasing the value of a property based on its view of Lake Tahoe or the number and type of rocks on beaches of lake-front homes created deep and bitter animosity among taxpayers.

The struggle culminated with the Village League filing a civil action seeking criminal charges against McGowan. The case was dropped in April 2006, but the political damage had been done. McGowan retired as assessor in late 2006, ending his 24-year tenure.

Soon after, McGowan's protestation that Incline Village property was undervalued was rendered meaningless when a Village League lawsuit challenging McGowan's appraisal methodologies finally reached the Nevada Supreme Court in 2006. The lawsuit was filed by 17 property owners in 2003 and challenged four methodologies used by McGowan's appraisers.

In *Bakst vs. State Board of Equalization*, the Supreme Court ruled in December 2006 that since the four methods used by Washoe County had not first been approved by the state Tax Commission, they could not be used and were illegal.

Two years later, in *State Board of Equalization vs. Barta*, the Supreme Court reaffirmed its *Bakst* ruling in a case where taxpayers challenged the assessor's methods used to adjust property values in a year when the county assessor did not appraise properties, but used an estimate called "factoring" to determine taxable values.

In both cases, the court ordered that the Incline Village plaintiffs' property taxes be rolled back to 2002-03 levels.

In a major shift, the two Supreme Court rulings established that a taxpayer could challenge the methodology used to determine taxable value, regardless of whether that taxable value was greater than or less than market value of the property.

This fundamentally altered the state's tax-appeal system that has long relied on the premise that if a county assessor's taxable value didn't exceed market value, there was no justification for a taxpayer to appeal the assessor's valuation.

"A taxpayer does not need to present evidence of a value; the taxpayer need only show that there is an error in methodology," Bancroft wrote in the *Institute for Professionals in Taxation*.

Tax department director DiCianno concurs with Bancroft's assessment. DiCianno said that unless the assessor used department-approved methods to determine the taxable value, "then, in my mind, that value is not proper even if it doesn't exceed full cash value."

Washoe County Assessor Wilson, who faces reelection in 2010, said the bitter disputes over the taxable-value system have led him to consider whether it would be better to scrap the current system and move Nevada back to a market-based system.

"A pure market-based system distributes the tax burden more fairly among the citizens of a jurisdiction," he said.

But Wilson, described by some as earnest but indecisive, is quick to add a caveat.

"Having said that, I didn't say I was in favor of it."

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