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## Why your property taxes rose when the property's value fell

Lawmakers' 2005 'relief' bill was badly written, most likely unconstitutional

John Dougherty

CARSON CITY — Nevada's plummeting real-estate market has exposed serious flaws with a controversial property-tax-relief law rushed through the state legislature in 2005.

State property-tax experts say the deep-rooted problems leave the tax-relief law — also known as the partial property-tax abatement — vulnerable to a constitutional challenge that could unravel the state's entire property-tax system.

Assembly Bill 489 limits the annual increase in property taxes for residential properties to 3 percent a year, while capping commercial and most rental properties at 8 percent. The split tax cap, critics claim, violates Article 10 of the Nevada Constitution, which requires a uniform and equal rate of assessment and taxation.

"I'm kind of surprised ... that there hasn't been somebody to challenge the 3 and 8 percent caps because now would be the time to do it," said Barbara Smith Campbell, former chairwoman of the Nevada Tax Commission.

Despite widespread opinions that the controversial and somewhat confusing property-tax relief is unconstitutional, no one has challenged it in court. During the time of rapidly rising real-estate prices, the abatement provided tax relief to all property owners, even if it was unequally applied.

Business owners who were subjected to the 8 percent cap were loathe to incur a backlash from the general public if they challenged the law and risk the

possibility a judge would throw out both caps, leaving everyone exposed to dramatically higher taxes.

"Do you want to have the wrath of the public on you because you have cost them money?" asked Carole Vilardo, executive director of the Nevada Taxpayers Association. "No way! That would be bad PR."

But the unexpected, precipitous decline in real-estate prices the last three years has changed the playing field.

The fundamental reason for establishing the property-tax caps no longer exists. The Nevada Legislature created the tax caps to protect homeowners from rapidly rising real-estate prices to "avoid severe economic hardship to the owner of the residence."

In an ironic twist, during periods of real-estate deflation, the abatement law has become a mechanism that often results in a mandatory increase in property taxes. Even as property values have fallen by 50 percent or more, state and local governments continue to hike property taxes by 3 or 8 percent per year for certain properties.

Critics said the legislature never intended for the abatement law to be used in this manner. Carson City property-tax attorney Norm Azevedo said he could find nothing in the legislative history of the bill that supports increasing property taxes during a period of falling property values.

"Government needs money to run," said Azevedo, who prior to entering private practice was the former chief counsel for the Nevada Tax Commission. "But it's difficult when property owners see the only thing going up is their property-tax bill. It's a tough pill to swallow."

The possible misapplication of the abatement law will only serve to increase scrutiny of whether it meets constitutional muster. Campbell is not alone in her view that the abatement law could be struck down as unconstitutional.

"If the 3 and 8 were challenged, it is my personal opinion, it would probably be unconstitutional," said Vilardo of the Nevada Taxpayers Association.

The split tax abatement "raises an equity issue that you are not treating all property uniformly and equally," said Glen Atkinson, retired professor emeritus of economics at the University of Nevada, Reno and a leading expert in Nevada tax policy.

Even one of the architects of the legislation expressed doubt that it would hold up to a legal challenge.

Former Assembly minority leader Lynn Hettrick, who is now Gov. Jim Gibbons' deputy chief of staff, said he was opposed to creating a split abatement in 2005 when he guided the bill through the Assembly and said the abatement law "could be" unconstitutional.

County assessors, who strongly supported the tax-cap proposal in 2005, are also concerned that the legislature's failure to adopt a uniform cap that applies to all classes of property owners is vulnerable to legal attack.

"You run the risk of the Supreme Court throwing the whole property-tax-cap mechanism out," said Clark County Assessor Mark Schofield.

Faced with skyrocketing property values in the winter and spring of 2005 and dire warnings from county assessors that property taxes would soar, the legislature ignored constitutional questions over the split rate and hurriedly passed the abatement bill with the split caps by a 21-0 vote in the Senate and a 41-1 vote in the House.

The law provided immediate relief to residential and commercial property owners faced with the doubling and tripling of property taxes, even if it was unequally applied.

But then, the unexpected occurred. The real-estate bubble burst in 2007, sending property values plummeting and creating an unexpected consequence: Because the property-tax-abatement formula had severed the direct link between the assessed value of property and the levied taxes, suddenly hundreds of thousands of property owners were hit with higher property taxes even as property values plunged.

Record numbers of property owners filed protests before county boards of equalization. The Clark County Board of Equalization has been swamped with more than 6,000 protests this year, up from 1,300 in 2008.

Property owners are expected to show up before county equalization boards in record numbers beginning next month — challenging property-tax valuations for 2010-11 amidst a continuing downward real-estate market.

County assessors must mail property-tax valuations to property owners by Dec. 18. Property owners must file protests with county Boards of Equalization by Jan. 15. The valuations will be used to determine taxes for 2010-11, which will be levied next June.

Property owners with older parcels will generally face continued increases in taxes unless county assessors lower the assessed values on their property to levels about equal to 2004 assessments. Only then will taxes decline for property that has been on the tax roll since at least that year, Vilardo said.

The legislative counsel's summary of AB 489 suggests that tax abatement was to be used as a way to provide tax relief during times of rising real-estate prices, not as a way to justify higher taxes in a declining market.

The summary states:

"Under this bill, the Legislature declares that an increase in the tax bill of a homeowner of more than 3 percent from the previous year constitutes ... a severe economic hardship for purposes of the Nevada Constitution.

"If (emphasis added) such an economic hardship occurs, this bill provides for a partial abatement of the taxes of the homeowner who would otherwise experience the hardship."

In other words, the intent of the bill was to limit an increase of property taxes to no more than 3 percent during a period in which rising property values would have resulted in much higher property taxes.

Nowhere does the legislative counsel suggest that the law should be triggered in a period of declining real-estate values nor be used to mandate a 3 or 8 percent increase in property taxes in a declining real-estate market.

"I don't know how they are administering the [abatement law] in the manner they are doing to increase taxes while values are declining," Azevedo said. "I don't recall anything in the legislative history that supports that."

Azevedo urged the legislature to reexamine the abatement law and make necessary changes so that property owners are not hit with higher taxes in a declining market.

"I can't find support for taxing value that was supposedly untaxed the previous year, later in time," he said.

Supporters of the abatement say that property owners were protected from much higher taxes when prices were rising. And now that the market is falling, the law requires property owners to pay for some of the taxes that they escaped during the real-estate boom.

"When your assessed value went up, you only got a 3 percent increase each year in your [tax] bill," Hettrick said.

And now that assessed values are falling, Hettrick said property owners have to wait until the assessed values fall far enough so that the taxes computed using the current assessed value are less than the taxes computed under the cap. (See analysis of tax-cap impact.)

State and local governments have a strong incentive not to change the way the abatement is calculated in today's declining market. Thousands of property owners are still paying higher taxes than in previous years, cushioning the financial strains facing state and local governments as tax revenues from other sources, including sales and gaming taxes, continue to plunge.

A successful legal challenge to the abatement law could open the door to wholesale property-tax reform that, in turn, could lead to a return to a market-based assessment system, property-tax experts said.

The legislature abandoned a market-based property-tax system in 1981 and adopted a taxable-value system where county assessors place full-cash value on land while improvements are valued on their replacement cost less depreciation.

The taxable-value system has become increasingly unworkable in the wake of two Supreme Court rulings requiring county assessors to adopt appraisal methodologies approved by the state Tax Commission.

The commission, however, has been reluctant to pass detailed appraisal guidelines for county assessors. Regulations it passed in 2008 are being challenged in court for being too vague and giving assessors too much leeway in determining property values. The commission has also ignored state law for 10 years by failing to provide a required property-tax-assessment manual to county assessors.

The failure of the Tax Commission to provide uniform appraisal methodologies leaves the taxable-value system vulnerable to constitutional challenge, some legal experts say. That, combined with questions over the legality of the property-tax-abatement law, leaves the state's property-tax system exposed to constitutional challenges on at least two fronts.

If the abatement law were struck down, the legislature might be inclined to restructure the entire property-tax system, said Assemblyman James Settelmeyer, a Republican from Gardnerville.

"If there is no abatement, then there may be a desire to go to a pure market-based system," Settelmeyer said.

But other leaders say it is very unlikely the legislature will address either issue unless forced to the table by successful lawsuits. Legislators, Hettrick said, are extremely sensitive to property-tax issues because property owners tend to be voters.

And, he said, most property owners want some assurance that property taxes won't skyrocket in the future if and when the real-estate market rebounds. Therefore, the tax caps and their associated problems are more desirable than no cap at all.

"Politicians understand who votes," Hettrick said. "You are not going to see them attack the 3 and 8 percent tax caps."

*John Dougherty is the principal of InvestigativeMedia.com and has long been one of America's leading investigative reporters. He has been retained by the Nevada Policy Research Institute to report on critical issues of Nevada governance.*

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