Alternate Methods of Valuing Property for the Purpose of Property Taxation

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Indiana Department of Local Government Finance
Cheryl A. W. Musgrave, Commissioner

100 North Senate Avenue, N-1058(B)
Indianapolis, Indiana 46204

Prepared by David Schwab, Assistant Director of Assessment

This report discusses three methods of valuing property for ad valorem purposes, describes their application to property taxation by several states, and draws a distinction between the method of valuation and adjustments to value.

The value of a property for taxation purposes is determined in two steps: appraisal and assessment. In everyday language, these two terms are used interchangeably; however, their differences must be understood. Key to this understanding is a firm grasp of the differences between ***valuing*** property and ***adjusting these values*** by deductions or other limits.

Property **APPRAISAL** determines a properties monetary value, or "gross assessed value." Fair taxation requires uniform property appraisals: similar properties must be appraised at similar value (International Association of Assessing Officers 2004, p. 13). In Indiana, property appraisal is performed by elected county and/or township assessors.

On the other hand, property **ASSESSMENT** adjusts gross assessed value to arrive at "net assessed value." The legislature determines the adjustments to real property appraised values. In Indiana, the county auditor applies the deductions, exemptions, and/or limits authorized by the state legislature. Further impact on tax bills can occur through the application of credits and caps.

In sum, appraisal and assessment are two separate processes, and keeping them distinct is necessary to understand the separate functions of (1) valuation; and (2) adjustments to valuation. Keeping the concepts separate also aids in understanding the differences between valuing property (the assessor's role) and the final taxable assessed value (the legislature's role, implemented by the auditor.)

This report discusses property appraisal and assessment separately. The appraisal section focuses on the three property valuation standards used in the United States: market value, market value-in-use, and acquisition value. The assessment section presents three adjustments commonly used in Indiana and other states: fractional assessments; the homestead credit; and valuation increase limits. The legislature can alter the (1) property appraisal system; (2) adjustments to the appraisal value; or (3) both.

Appraisal: Property Valuation Standards

Three valuation standards are used in the United States. These are: market value, market value-in-use, and acquisition value. All of these approaches arrive at "gross assessed value."

Market Value Standard

Under the market value standard, property is valued at the price it would bring in an arm's length transaction between a disinterested buyer and seller on an open market. As defined by the International Association of Assessing Officers:

> The most probable price (in terms of money) which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus (International Association of Assessing Officers 1997, p. 85).

All states except California, Indiana, and Minnesota base their assessment standards on market value. These three states use difference standards discussed later in this report.

Market value supports the economic principle that a properties' value is determined by supply and demand. Some properties are more desirable than others because of location or other factors; the market value standard takes this into account while recognizing that the relative appeal of a property will change over time.

Market Value-in-Use Standard

The market value-in-use standard combines the market value standard discussed above with a use-value standard. Use-value is defined by the International Association of Assessing Officers as:

> The concept that holds value to be inherent in property itself, that is, the value is based on the ability of the asset to produce revenue through ownership (International Association of Assessing Officers 1997, p. 149).

Use-value is often used to value real property whose use characteristics are more important value determinants than the market price.

The market value-in-use standard combines elements of both use value and market value. According to the 2002 Real Property Assessment Manual, true tax value is defined as:

> The market value-in-use of a property for its current use, as reflected by the utility received by the owner, or a similar user from the property (State Board of Tax Commissioners 2002, p. 2).

Although the market value-in-use standard for all property is unique to Indiana, the concept is widely used in other states for appraising business personal property with a specialized purpose. For example, a machine may be so specialized that its market value, reflected in functional obsolescence, is almost nothing. However, its market value-in-use is substantially higher, and a better reflection of the current worth of the machine to its owners.

In addition, Minnesota has a similar concept known as limited market value, where the scope of the market determining true tax value is limited by statute (Minnesota Department of Revenue 2003, p. 1). For example, in Minnesota agricultural land is statutorily appraised at market value, but the market is limited to farmland.

Acquisition Value Standard

The final standard used in the United States is acquisition value. Acquisition value appraises property at its purchase cost (International Association of Assessing Officers 2004, p. 25). Annual adjustments are limited to small increases (generally 1% of total cost or less) to account for inflation[1]. However, upon its sale the property is reappraised at its market value.

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[1] California does exempt tax levies designated for the payment of local debt from these caps, provided the debt was initially incurred at the public's behest (for example, a municipal debt bond issue).

Only California has a full acquisition cost system, which has been a part of the California Constitution since the ratification of Proposition 13 in 1978. While the California Constitution has since been amended several times to offset the unforeseen consequences of Proposition 13, the foundation remains intact (California State Board of Equalization 2005, p. 2).

Under acquisition cost, taxpayers in identical homes may pay different amounts of property tax. This is because property is only appraised upon transfer from one owner to another. Thus, acquisition cost favors taxpayers who choose to stay in one home for a long time; likewise, it punishes those taxpayers who are new to the area and those who build new homes. Also, because acquisition cost severs the link between market value and appraised value, property taxes may not reflect market conditions.

Assessment: Property Tax Adjustments

As referenced, property assessment is defined by the International Association of Assessing Officials as the determination of "net assessed value." The assessment is the result of the implementation of desired public policy goals through adjustments to appraised value. There are a number of different ways to implement a desired public policy through property tax assessment. Each state determines assessed value as a function of appraised value through a variety of ways.

Fractional Assessment

Some states set taxable value as a percentage of appraised value. In Utah, the assessed value of a primary residence property is 55% of its appraised fair market value. All other personal and real property is assessed at 100% of fair market value. Additionally, homeowners 65 and older may receive another 20% reduction, making their primary residence assessed at 35% of fair market value (State of Utah 2008, p. 1). Idaho has a similar process in which a homeowner's primary residence is eligible for a deduction of 50% of assessed value (Idaho State Board of Equalization 2003, p. 1).

Montana assesses real property at 100% of its fair market value and reduces assessed value by deductions that are a percentage of assessed value. Primary residencies in Montana receive a 34% homestead exemption (Montana Department of Revenue 2007, p. 4).

South Carolina has a fractional assessment system in which all classes of property are assessed differently. Manufacturing and utility properties are assessed at 10.5% of fair market value. Commercial personal property is assessed at 10.5%. A person's primary residence is assessed at 4% and other real property is assessed at 6% (South Carolina Department of Revenue 1999, p. 3).

Property Tax Deductions

Many states have plans similar to Indiana's homestead deduction[2]. Some states allow homestead deductions to those over 65 years of age. North Carolina has a senior citizen homestead

[2] A complete list of Indiana deductions, exemptions, and credits is attached as an Appendix.

deduction that is the greater of $20,000 or 50% of the appraised value, but does not have a general homestead deduction (Baer 2005, p. 1). Some states have a general homestead exemption in addition to a senior homestead deduction. Many states have additional homestead deduction specifically for senior citizens who meet residency and income requirements (Baer 2005, p. 5).

In Hawaii, homeowners receive a standard homestead exemption on primary residencies. The exact amount of the exemption varies from county to county. Hawaii grants additional exemptions for older homeowners. Homeowners ages 55 to 59 receive one and a half times the standard homestead deduction. Homeowners 60 to 69 receive twice the standard homestead exemption. Individuals age 70 or older receive two and a half times the standard homestead exemption (Baer 2005, p. 7).

Valuation Increase Limits

Some states limit the growth of assessed value. This provides property tax relief for those who continue to live in the same residence. Michigan limits growth in taxable value by 5% or the rate of inflation, whichever is less (Michigan Department of the Treasury 2008, p. 1). In New Mexico, the assessment of a residence that did not change hands in the prior year may not increase by more than 3% (Property Tax Division 2008, p. 1).

California limits the growth of assessed value and allows transfer of assessed value to another property in the same taxing district with a similar or lesser market value (California State Board of Equalization 2005, p. 1).

Some states not only limit the growth of assessed value but completely freeze assessed value for certain populations. Illinois, Oklahoma, and South Dakota are among the states the freeze assessed value for senior citizens who meet certain and maintain certain income requirements (Baer 2005, p. 18).

The International Association of Assessing Officials' *Standard on Property Tax Policy 2007* notes that limitations of the growth of assessed value policies often create large inequality problems between similar houses that were purchased at different times (International Association of Assessing Officers 2004, 14).

Conclusion

This brief report has discussed the separate aspects of (1) property tax appraisal; and (2) adjustments to valuation to arrive at the assessment. The three appraisal standards presented were market value; market value-in-use; and acquisition value. Fractional assessment, assessment deductions, and value increase limitations were discussed as methods used to modify the appraised value to arrive at the assessed value in order to achieve policy goals.

Indiana currently uses a market value-in-use system modified by a system of deductions, credits, and caps. Changes to the appraisal system or the assessment system may affect resultant tax bills.

Appendix

DEDUCTION (Indiana Code)	MAXIMUM AMOUNT ***	ELIGIBILITY REQUIREMENTS
Homestead Credit (6-1.1-20.9) *	A designated percentage of net tax bill * (PL 146-2008 Sec. 848 grants an owner entitled to homestead credit for 2007 pay 2008 an additional homestead credit and section 849 gives those entitled to the standard deduction for 2008 pay 2009 a homestead credit.)	1) individual must own or be buying a homestead under contract which provides buyer is to pay taxes; 2) with respect to real property, or a mobile or manufactured home that is not assessed as real property, the individual must own the real property, mobile or manufactured home not assessed as real property, or be buying under contract on the date the application form is filed; 3) a taxpayer other than individual may apply for the credit if an individual uses the residence as the individual's principal place of residence, the residence is located in Indiana, the individual has a beneficial interest in taxpayer, taxpayer owns or is buying under recorded contract that requires taxpayer to pay taxes and the residence consists of a single family dwelling, including mobile and manufactured homes, and the real estate surrounding the dwelling cannot exceed one acre; 4) the Sales Disclosure Form is an application for the first year, but **NOT** subsequent years for mobile or manufactured home not assessed as real property.
Homestead Standard Deduction (6-1.1-12-37(b))	Until 12/31/2008: $45,000 (PL 146-2008 Sec. 116 grants an individual entitled to the standard deduction a supplemental deduction for taxes due and payable in 2009) (See Below) **Note:** As of January 1, 2009, the amount of the standard deduction is the lesser of: (1) sixty-percent (60%) of the assessed value of the real property, or (2) forty five thousand dollars ($45,000).	Until 12/31/08: A person entitled to receive the homestead credit for taxes payable in the following year is entitled to a standard deduction for the assessed value of the real property, mobile home or manufactured home that qualifies for the homestead credit. (See above). Law as of 1/1/09: 1) residential real property improvements located in Indiana that an individual uses as the individual's principal residence, including a mobile or manufactured home not assessed as real property; 2) As of March 1, or in the case of a mobile home that is assessed as personal property, the immediately following January 15, property must be owned, occupied by tenant-stockholder of cooperative housing corporation, or under contract to purchase that provides that the buyer is to pay the property taxes; 3) consists of dwelling and real estate not to exceed one acre surrounding the dwelling; 4) one standard deduction per married couple or individual.
Supplemental Homestead Deduction (PL 146-2008 Sec. 116)(Effective on January 1, 2009 and applies to property taxes first due in 2009 and thereafter.)	Equal to the Sum of the Following: (1) thirty-five percent (35%) of the assessed value that is less than six hundred thousand dollars ($600,000). (2) twenty-five percent (25%) of the assessed value that is more than six hundred thousand dollars ($600,000).	A person who is entitled to a standard deduction from the assessed value of property under IC 6-1.1-12-37 is also entitled to receive a supplemental deduction from the assessed value of the homestead to which the standard deduction applies after the application of the standard deduction but before the application of any other deduction, exemption, or credit for which the person is eligible.

* The rate used is specific to the county. Depending on the county, you may also receive a County Homestead Credit on your residence. Please consult with your County Auditor.
** Any unused portion after application to residence property applies next to personal property and lastly as Excise Tax Credit on either motor vehicle excise tax (IC 6-6-5-5) or aircraft license tax (IC 6-6-6.5)
*** The sum of the deductions provided to a mobile home or to a manufactured home that is not assessed as real property may not exceed one-half (1/2) of the assessed value of the mobile home or manufactured home. (IC 6-1.1-12-40.5)

DEDUCTION (Indiana Code)	MAXIMUM AMOUNT ***	ELIGIBILITY REQUIREMENTS
Mortgage (6-1.1-12-1)	The lesser of: (1) $3,000; (2) amount of mortgage or contract indebtedness on assessment date of that year; or (3) one half (1/2) of the total assessed value.	1) must be resident of Indiana; 2) on the date the statement is filed, owns or is contract purchasing real property, mobile or manufactured home not assessed as real property ; 3) property located in Indiana; 4) owes a debt secured by a mortgage or recorded contract on the real property or mobile or manufactured home not assessed as real property, which provides that the contract buyer is to pay the property taxes; 5) for real property, file during the year for which the deduction is sought and for mobile or manufactured homes not assessed as real property, file during the twelve months before March 31 of the year for which the deduction is sought, if mailed the mailing must be postmarked on or before the last day for filing; 6) contract buyer must submit copy of memorandum of the recorded contract, containing a legal description with the first statement filed under this deduction.
Over 65 (6.1.1-12-9)	$12,480	1) on the date of filing, the person owns or is buying the real property, mobile or manufactured home which is not assessed as real property under a contract that provides buyer to pay taxes ; 2) individual is at least 65 by December 31 of the year preceding the application year; 3) combined adjusted gross income not exceeding $25,000; 4) the individual has owned the real property, mobile home, or manufactured home for at least one (1) year before claiming the deduction; 5) assessed property value not exceeding $182,430; 6) Surviving, un-remarried spouse at least 60 years of age if deceased was 65 at the time of death; 7) Individual receives no other property tax deduction for the year in which the deduction is claimed, except the deductions provided by sections IC 6-1.1-12-1, IC 6-1.1-12-37, and IC 6-1.1-12-38; and 8) the person: 1) owns the real property, mobile home, or manufactured home; or 2) on the date the application for the deduction is filed, the person is buying the real property, mobile home, or manufactured home under contract.
Blind (6-1.1-12-11;12)	$12,480	1) individual is blind as defined in IC 12-7-2-21(1); 2) the real property, mobile or manufactured home is principally used and occupied by the individual as the individual's residence; 3) as of the date the statement is filed, individual owns real estate or mobile or manufactured home not assessed as real property or is buying under a recorded contract provides buyer is to pay taxes; 4) taxable gross income does not exceed $17,000; and 5) with respect to real property, file during the year for which the individual seeks deduction and with respect to mobile or manufactured home, file during the 12 months before March 31 of the year for which deduction is sought.

DEDUCTION (Indiana Code)	MAXIMUM AMOUNT ***	ELIGIBILITY REQUIREMENTS
Over 65 Circuit Breaker Credit (6-1.1-20.6-8.5)	Tax liability minus the product of tax for preceding year multiplied by 1.02.	1) qualified for standard deduction in preceding calendar year and qualifies in current year; 2) for single individual, adjusted gross income cannot exceed $30,000, for married couple adjusted gross income cannot exceed $40,000; 3) homestead qualifies as a "qualified homestead property" for the calendar year and filing requirements are met. ("**qualified homestead property**" means the individual owns or is purchasing the homestead on contract or has beneficial interest, is or will be at least 65 on or before December 31 of the calendar year immediately preceding the calendar year in which the taxes are due, and the gross adjusted value of the homestead on the assessment date is less than $160,000. 4) with respect to real property, file during the year for which credit is sought; 5) with respect to mobile or manufactured home not assessed as real property, file during the twelve months before March 31 of the year for which credit is sought; 6) file in same manner as for 6-1.1-12-9 (over 65 deduction); 7) applies to taxes due and payable after December 31, 2008.
Disabled (6-1.1-12-11)	$12,480	1) A person is "disabled" if they are unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment which can be expected to result in death or has lasted or can be expected to last for a continuous period of not less than 12 months; 2) the real property, mobile or manufactured home is principally used and occupied by the individual as the individual's residence; 3) as of the date the statement is filed, individual owns real estate or mobile or manufactured home not assessed as real property or is buying under a recorded contract that provides buyer is to pay taxes; 4) taxable gross income not exceeding $17,000; and 5) with respect to real property, file during the year for which the individual seeks deduction and with respect to mobile or manufactured home, file during the 12 months before March 31 of the year for which deduction is sought.
Disabled Veteran (6-1.1-12-14;15)	$12,480**	1) as of the date the statement is filed, owns real estate or mobile or manufactured home not assessed as real property or is buying under a contract that requires buyer to pay taxes; 2) served in U.S. military service for at least 90 days and honorably discharged; 3) either totally disabled or at least age 62 with at least 10% disability; 4) written evidence of the disability; and 5) assessed value of real and personal property combined is not greater than $143,160; 6) with respect to real property, file during the year for which deduction is sought and with respect to mobile or manufactured home, file during the 12 months before March 31 of the year for which deduction is sought. 7) surviving spouse may apply;
Veteran with Service Connected (6-1.1-12-13;15)	$24,960**	1) as of date the statement is filed, individual owns real estate or mobile or manufactured home not assessed as real property or is buying on recorded contract that requires buyer to pay tax; 2) honorable discharge after serving in U.S. military during a war; 3) service connected disability of at least 10% with written evidence of disability; 4) with respect to real property, file during the year for which the deduction is sought, and with respect to mobile or manufactured home, file during the 12 months before March 31 of the year for which deduction is sought. 5) surviving spouse may apply;
Veteran World War I (6-1.1-12-17.4)	$18,720**	1) as of date the statement is filed, resident of Indiana owns or is buying real estate or mobile or manufactured home not assessed as real property or is buying on recorded contract that requires buyer to pay tax, but may not be denied deduction if absent from principal place of residence while in nursing home or hospital; 2) veteran of World War I; 3) assessed value of the residence property does not exceed $206,500; and 4) ownership of the real estate for at least one year prior to claiming deduction.

DEDUCTION (Indiana Code)	MAXIMUM AMOUNT ***	ELIGIBILITY REQUIREMENTS
Surviving Spouse of World War I Veteran (6-1.1-12-16;17(b))	$18,720**	1) as of date the statement is filed, surviving spouse owns real estate or mobile or manufactured home not assessed as real property or is buying on recorded contract that requires buyer to pay tax; 2) spouse of deceased person who served in the U.S. military before November 12, 1918; 3) honorable discharge; and 4) not claiming the Deduction for Disabled Veterans or Surviving Spouses. 5) with respect to real property, file during the year for which the surviving spouse wishes to obtain the deduction and with respect to mobile or manufactured homes, file during the 12 months before March 31 of each year for which deduction is desired.

* The rate used is specific to the county. Depending on the county, you may also receive a County Homestead Credit on your residence. Please consult with your County Auditor.

** Any unused portion after application to residence property applies next to personal property and lastly as Excise Tax Credit on either motor vehicle excise tax (IC 6-6-5-5) or aircraft license tax (IC 6-6-6.5)

*** The sum of the deductions provided to a mobile home or to a manufactured home that is not assessed as real property may not exceed one-half (1/2) of the assessed value of the mobile home or manufactured home. (IC 6-1.1-12-40.5)

Specific deduction claim forms are available from the county auditor or on the Indiana Department of Local Government Finance Web site: http://www.in.gov/icpr/webfile/formsdiv/dlgf.html.

DEDUCTION (Indiana Code)	MAXIMUM AMOUNT ***	ELIGIBILITY REQUIREMENTS
Solar Energy Heating or Cooling Systems (6-1.1-12-26)	Assessed value (AV) with the device, less the AV without the device. In other words, the value of the device.	1) individual must own the real property or mobile or manufactured home not assessed as real property or be buying on contract on the date the application is filed; 2) real property or mobile home not assessed as real property is equipped with a solar energy system or wind power device; hydroelectric power device, or geothermal energy heating or cooling device; 3) with respect to real property, file during the year for which the person desires to obtain the deduction, and with respect to mobile home which is not assessed as real property file during the 12 months before March 31 of each year for which the deduction is sought.
Wind Power Device (6-1.1-12-29)		
Hydroelectric Power Device (6-1.1-12-33)		
Geothermal Device (6-1.1-12-34)		

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