
STATE OF INDIANA

DEPARTMENT OF LOCAL GOVERNMENT FINANCE



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To: County Assessors, Township Assessors, & Assessing Officials

From: J. Barry Wood, Director, Assessment Division *JBW*

Date: August 21, 2009

Re: Abnormal Obsolescence & Personal Property Assessments

The purpose of this memorandum is to address questions received by the Department of Local Government Finance ("Department") concerning abnormal obsolescence adjustments claimed on the March 1, 2009 personal property returns.

The Indiana Administrative Code defines "abnormal obsolescence" as:

...obsolescence which occurs as a result of factors over which the taxpayer has no control and is unanticipated, unexpected, and cannot reasonably be foreseen by a prudent businessman prior to the occurrence. It is of a nonrecurring nature and includes unforeseen changes in market values, exceptional technological obsolescence, or destruction by catastrophe that has a direct effect upon the value of the personal property of the taxpayer at the tax situs in question on a going concern basis. 50 IAC 4.2-9-3 (a).

When a taxpayer seeks an obsolescence adjustment, it must be able to pass a two-pronged test showing that it can: 1) identify the causes of the alleged obsolescence; and 2) quantify the amount of obsolescence to be applied to its asset(s).

On many of the personal property tax returns that claimed an abnormal obsolescence adjustment, taxpayers were able to establish the first prong by identifying the factors that caused the obsolescence. However, the second prong, quantification, has proven to be an issue. **This memorandum, therefore, will focus on quantification.**

Each prong requires a connection to an actual loss in property value. This means the quantification of obsolescence is tied to **the actual loss of value suffered by an asset**. For example, when identifying factors that cause obsolescence, a taxpayer must show the causes of obsolescence also caused an actual loss of value to the property.

In the commercial context, this loss of value usually means a decrease in the property's income generating ability. In turn, when the taxpayer quantifies the amount of obsolescence to which he believes it is entitled, the taxpayer must convert the actual loss of value (shown in the first prong) into a percentage reduction and apply it against the improvement's overall value. In addition,

taxpayers are required to “substantiate the facts, circumstances, and amount of the claim in order to properly determine the true tax value of the subject property.” 50 IAC 4.2-9-4(a). Taxpayers are also required to “provide documentation of the resulting valuation of the personal property at the tax situs in question on the assessment date on a going concern basis.” 50 IAC 4.2-9-4 9(b).

The following are examples of the calculations used by certain taxpayers to **incorrectly** determine their abnormal obsolescence adjustment:

- The taxpayer determined that his equipment was idle 50 percent of the time so he reported only one-half of the cost when pooling the assets.
- The taxpayer calculated the true tax value and then deducted one-half of it as obsolete.
- The taxpayer calculated the decline in productivity by using either historical data or forecasted data to arrive at a factor to represent an inutility penalty. This factor is then applied to the calculated true tax value.

These methods do not comply with generally accepted appraisal principles, and the taxpayers failed to link the cause of the obsolescence with an actual loss in property value.

Calculating an abnormal obsolescence adjustment should begin with an amount representing “Replacement Cost-New,” rather than substituting that amount with the equipment’s original or historical cost. (This substitution does not follow the generally accepted appraisal principle.)

Assessors should review 50 IAC 4.2-4-8(d), which covers the adjustment for obsolescence and includes the following two **correct** examples:

EXAMPLE 1

Taxpayer ABC has depreciable personal property qualifying for an adjustment for abnormal obsolescence. The cost-to-cure the cause of the abnormal obsolescence is eight hundred thousand dollars (\$800,000), and is less than the anticipated benefits to be obtained from the use of the affected asset. The depreciable asset has an adjusted basis of six million five hundred thousand dollars (\$6,500,000), and an acquisition date and depreciable life, which result in a true tax value factor of twenty percent (20%) (the total true tax value, of all of ABC's depreciable personal property in this taxing district, computed by the application of the prescribed pool percentages is greater than thirty percent (30%) of the total adjusted cost). The taxpayer should compute the abnormal obsolescence adjustment as follows:

Reported basis of asset qualifying for abnormal obsolescence adjustment	\$6,500,000
<u>Prescribed True Tax Valuation Factor</u>	<u>x 20%</u>
True Tax value of item prior to adjustment for abnormal obsolescence	\$1,300,000
Cost-to-cure cause of Abnormal Obsolescence	\$800,000
<u>Prescribed True Tax Valuation Factor</u>	<u>x 20%</u>
Allowable adjustment for Abnormal Obsolescence	\$160,000
True Tax value of item prior to adjustment for abnormal obsolescence	\$1,300,000
<u>Minus Allowable adjustment for Abnormal Obsolescence</u>	<u>- \$160,000</u>
True Tax Value of Item	\$1,140,000

In Example 1 (shown above), the cost-to-cure (a fair market value term) is converted to represent an amount in true tax value dollars when calculating the allowable adjustment. This conversion maintains an “apples to apples” relationship to Indiana’s true tax value system.

EXAMPLE 2

Taxpayer XYZ has depreciable personal property qualifying for an adjustment for abnormal obsolescence. The cost-to-cure the cause of the abnormal obsolescence is four hundred sixty thousand dollars (\$460,000), and exceeds the benefits expected from any further use of the affected asset. The depreciable asset has an adjusted basis of two million three hundred thousand dollars (\$2,300,000) and an acquisition date and depreciable life which result in a tentative true tax value factor of twelve percent (12%) (the total true tax value, of all of XYZ's depreciable personal property in this taxing district, computed by the application of the prescribed pool percentages is less than thirty percent (30%) of the total adjusted cost). The taxpayer is able to demonstrate that the salvage value of the affected item is seventy-two thousand dollars (\$72,000). The taxpayer should compute the adjustment as follows:

Reported basis of asset qualifying for abnormal obsolescence adjustment	\$2,300,000
<u>Prescribed True Tax Valuation Factor</u>	<u>x 30%</u>
True Tax Value of item prior to adjustment for abnormal obsolescence	\$ 690,000
<u>Less Documented Net Realizable Value</u>	<u>- 72,000</u>
Allowable Adjustment for Abnormal Obsolescence	\$ 618,000

In Example 2, the taxpayer is establishing a documented net realizable value or fair market value and using that amount to calculate the adjustment. In this example, the assessed value of the asset is the lesser of the true tax value or the fair market value of that asset.

Many taxpayers are filing returns that calculate a true tax value and then apply a factor that represents the relationship between the historical cost of the assets to the fair market value. **This combination of the true tax value system and the fair market system is essentially taking a double deduction and should not be allowed.** “[I]n no instance may the adjustment for abnormal obsolescence exceed the true tax value of the affected item prior to such adjustment, or result in a true tax value less than the scrap or net realizable value of the affected asset.” *Id.* The latter key language is where many adjustments claimed by taxpayers are questionable since they fail to establish a scrap value, a documented net realizable value or a fair market value that is less than the true tax value of the asset.

Other sections relevant sections of the Indiana Administrative Code include:

- 50 IAC 4.2-9-6 states that no adjustment will be allowable for normal obsolescence. The methods of valuation of business tangible personal property automatically reflect this type of obsolescence by providing the use of historic cost, short depreciable life, and accelerated depreciation on depreciable assets.
- 50 IAC 4.2-4-7 lists the true tax value percentages to be used for the four pools of the Form 103-Long and the Form 102. These percentages bear no relationship in the

determination of the fair market value of an asset. They are used to calculate the resultant value of property in accordance with the rules of 50 IAC 4.2 and the Indiana Code.

- 50 IAC 4.2-9-7 (b) states that taxpayers may request an abnormal obsolescence adjustment on the Form 106 when filing the tax return for the year in question. The adjustment is reported on Line 65 of the Form 103-Long or Line 61 of the Form 102. The adjustment(s), if requested, must:
 - (1) identify specifically all property for which an adjustment is requested;
 - (2) indicate the original cost of the property;
 - (3) indicate the true tax value of the property if no adjustment would be allowed; and
 - (4) indicate the true tax value of the property as a result of the requested adjustment.

The Form 113/PP must be used to change an assessment if an adjustment is reduced or denied in total. A letter stating the assessor's intent to deny an adjustment cannot be substituted for the Form 113/PP. These notices must also be sent in compliance with 50 IAC 4.2-3-1 (c) and 50 IAC 4.2-3-2 (d), which address the limitations of time for action by the assessor (September 15 or four months after the return is filed) or by the County Board of Appeals (PTABOA) (October 30 or five months after the return is filed). **A tax bill can never serve as first notice to a change of a personal property assessment since it would fail to meet the limitations of time for action requirement.**

Please contact your assessment division field representative or Barry Wood at (317) 232-3762 or bwood@dlgf.in.gov with questions.