

Unfair Hotel Property Taxes Can Be Stopped - By Jerome Wallach, Esq.

2005-11-15

Owners dealing with tax assessments need to recognize that the valuation of the fee simple interest is not at all simple. When assessors value a hotel property for real property tax purposes that value should be limited to only the real property component.

Some assessors still cling to the now fading notion that the valuation of hotels can be achieved simply by taking market values, derived from sales of similar properties, and comparing those sales numbers to the property being assessed. Wide recognition exists that this approach no longer applies. Rather, valuing the fee simple interest of the real property component is best achieved by capitalizing income, a complicated exercise.

Before capitalization, the income attributable to the use of the realty must be separated from the total income generated by the operation of the business, i.e., the enterprise value. Clearly, enterprise income derives from the total assets of the business, which can include real property, tangible personal property, and intangible elements. The assessor should not assess enterprise value. The following discussion provides owners with an understanding of how non-realty items should be handled by assessors in valuing hotels for property tax purposes.

Furniture, fixtures and equipment (FF&E)

FF&E, one component of the business enterprise, consists primarily of personal property. Most authorities agree with the elimination of income from FF&E prior to capitalization. However, two adjustments should be made, one to provide for the periodic replacement of the personal property, constituting the return of FF&E and one for a yield on the investment in personal property, comprising the return on FF&E. Most jurisdictions accept this adjustment approach. Some experts contend that in addition to excluding personal property income from the income capitalization, another step should be taken. That step requires subtracting the depreciated cost of the FF&E from the amount arrived at after capitalization, in order to totally exclude the value of personal property actually in use.

Intangibles

Owners need to consider the extent to which various intangibles contribute to the income stream. When the value of intangible items becomes difficult to quantify, sharp differences of opinion arise among taxing authorities, as the following indicate:

Income Attributable to Business Value - Most taxing authorities agree that income attributable to business value should not be capitalized along with other income. However, a significant number feel that the fees paid to management, and excluded from income, are sufficient. Others think that the value accruing to the operation from good management exceeds its direct cost.

Income Attributable to the Flag or Major Chain Affiliation - Similarly, some assessors assert that the exclusion from income of fees paid for the flag affiliation is a satisfactory adjustment to the income stream. Yet, in many cases flag affiliation within a given market generates greater revenues than non-flag properties in the peer group.

Income Attributable to Good Will, Business and Credit Relationships - These require genuine expert scrutiny and analysis. Examples of this type of income might include the icon status of the hotel, the celebrity of ownership, well recognized advertising slogans such as "we'll leave the light on for you", the reputation of ownership as to creditworthiness among lenders as well as vendors, the reputation for going the extra distance to achieve customer satisfaction and the like. All of which are difficult to measure against any objective standard but which can clearly contribute to the income stream. Assessing authorities strongly resist acceptance of this exclusion.

Income Attributable to the Startup Costs or the Amortization Thereof - More easily calculated costs include: actual startup costs encompassing entrepreneur's efforts and expenses, pre-opening advertising, training the work force and assembling the various components of the operation. Having determined these costs, an appropriate return on them along with an amortization of the sum total should be excluded from the income stream.

What Owners Should Do

A successful tax appeal depends on taking the position that none of the items mentioned here falls into the category of real property. In point of fact, they comprise intangibles, not subject to tax. Various authoritative sources support the position that income generated by intangibles should be excluded from the income stream prior to capitalization. Therefore, owners serve their own best interests by carefully delineating the income from each of the items discussed and then calculating the net operating income attributable only to the real property component. Only then can an owner ascertain whether the assessment on his/her hotel is fair and equitable.

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This article comes from Hotel News Resource

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