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Personal property tax traps for the unwary real estate owner

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Watch out. Some towns are going on personal property crusades. Ostensibly, they're hiring consultants to find personal property that owners of real estate have failed to report. When they find some, not only is the property owner assessed for the additional personal property, but the towns are entitled to add on a hefty penalty of 25%. This can amount to tens of thousands of dollars in taxes.

OK.... If the property owner has been playing hide the ball, then a town is entitled to a penalty, but what has been happening is down right bizarre. Some towns have been asking for IRS cost segregation reports and then using them to wrongly re-classify fixtures as personal property. What happens is that the property owner ends up getting doubly assessed: the fixture is incorporated into the value of the real estate and taxed as part of the real estate. Then it is again taxed as personal property after being re-classified.

Here's why this practice needs to stop.

Cost segregation has nothing to do with whether a part of a building should be legally classified as personal property or as real estate under state law. The law for determining whether an item is real estate or personal property depends largely on the intent of the party or parties who were involved with affixing the item to the real estate.

Much of this law evolved during fights between landlords and tenants concerning what a tenant would be entitled to take with him/her at the end of lease. Some of the law evolved in fights between banks and delinquent mortgagors over whether an item affixed to a building was covered by the mortgage.

But none of this law had anything to do with IRS cost segregation studies. Regardless of how a landlord or tenant might regard an item, the IRS has developed rules that allow different components of buildings to be depreciated at different rates. The IRS rules define what parts of a building can be considered "personal property" and thereby be depreciated at an accelerated rate.

While the IRS definition of personal property includes many items, such as machinery, that everyone commonly thinks of as personally property, it also includes carpeting, floor tiles, and false architectural features such as a false balcony.

Unfortunately, some towns may not make such fine distinctions and take the position that if the property owner classifies portions of a building as "personal property" for IRS purposes, then the town will also make the same classification.

The result is that the carpets, floor coverings, wall coverings and other components of the building, are included as part of the value of the building and then are again taxed as personal property.

Another similar trap for the property owner is to declare tenant improvements on the personal property declaration. Some towns ask real estate owners to list all tenant improvements on their personal property declarations. Most standard tenant improvements, such as paint, room partitions,

floor coverings, and the like, are clearly components of the building. None the less, I've seen instances where a town taxed such items as personal property. They even taxed architect's fees as personal property simply because some unsuspecting property owner printed out its accounting report of "tenants improvements" and included the total amount on the declaration page as requested.

So how should this be stopped? With respect to cost segregation studies don't give them to the town. They have no right to ask for it. Lease information and income and expense reports towns are legally entitled to have. Not cost segregation studies. Nor should they.

As for tenant improvements, only list on the personal property declaration, those tenant improvements that are clearly personal property, i.e., those improvements that the tenant gets to take with them when they leave. My guess is that there won't be many.

It's much easier to use some foresight when it comes to declaring personal property than to fight about it later. The town is entitled to receive and property owners are legally obligated to declare all items of personal property on the annual declaration forms.

Towns are not entitled to use the IRS laws to doubly tax personal property. Nor are towns entitled to trap unwary property owners by asking them to list all tenant improvements when clearly most such improvements are integral parts of the building.

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