

Watch out, the Assessors are Coming!

PERSONAL PROPERTY TAX AUDITS

A new era is upon us. In the past, Assessors generally accepted annual personal property tax declarations as filed. In recent years, there is an increasing trend for municipalities to engage an outside auditor to determine if the declaration accurately presents the personal property owned by a taxpayer. Additional assessments resulting in higher taxes generally result from these audits. In many instances, the additional assessments result from record keeping not conforming to the idiosyncrasies of the property tax regulations. The following represents an overview of meeting the current property tax audit challenge.

RULES IN GENERAL: A personal property tax declaration must be filed for all personal property on hand (subject to certain exemptions), as of October 1 of each year. The declaration requires separate information by type of property (i.e., machinery and equipment, furniture and fixtures, computer equipment, and machinery and equipment purchased after October 1, 1990).



Cost for each type **must be listed by year of acquisition**. Property that is fully depreciated and property that is not in use must also be declared if still on hand.

To determine market value, a depreciation percentage is assigned to each year, with all acquisitions in excess of seven years (six years for computers) assigned a value equal to 30% of original cost.

PERSONAL PROPERTY TAX AUDIT PROCEDURES:

As a practical matter, the auditors cannot visit the taxpayer to validate the accuracy of the declaration. Instead, costs included on the annual declaration are compared to other financial information provided by the taxpayer.

This “audit” of information (**done at the auditor’s office**), serves as the basis for acceptance or as it usually happens, adjustment of the annual declaration. Income tax returns serve as the main source of audit information.

The information concerning depreciable assets included on the annual income tax return is assumed correct. This assumption results in immediate complications as:

- Income tax returns are generally filed on year-ends other than the assessment date (October 1);
- Costs for income tax purposes can differ or be combined differently than on the property tax declaration;
- Dating of acquisitions and disposals may not be exact;
- Fully depreciable assets disposed of are not always removed from a company’s accounting records; and
- The listing of depreciable assets can be lengthy and complicated.

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PRACTICAL GUIDELINES: We recommend that more attention be given to annual property tax declarations. It is important to understand and comply with the regulations and maintain accurate, updated supporting records. Many problems are created because income tax filings include information inconsistent with property tax regulations and declarations. Using professionals that understand the rules to prepare and/or counsel on property tax matters is advisable as property taxes are no longer the forgotten ground for tax auditors.

Depreciable property included on the property tax declaration, financial statements and income tax return should be reconcilable. Income tax depreciation schedules should:

- Not include any fully depreciated assets that have been disposed of. If included, they will be assessed at a minimum of 30% of original cost.
- Classify purchases and disposals as before or after October 1. If possible, make all disposals before October 1. Although for property tax purposes all purchases are best after October 1, operating needs and depreciation rules generally take precedence.
- Software (computer, telephone, etc.), and leasehold improvements are exempt from personal property taxes and should be clearly indicated. Because of the differences in depreciable lives and attempts by assessors to include leasehold improvements as additional to real property assessments, care must be exercised as to what constitutes leasehold improvements.

It is very important to maintain a record of costs included in the purchase price of personal property not includible for property tax purposes. These costs include sales tax and freight.

Do not overlook office supplies. One-month office supplies expense is included on the declaration and is taxable as inventory. The auditor verifies this amount by comparing it to office supplies expense on the income tax return. Unfortunately, many taxpayers include an office expense category on the income tax return that includes various office expenses besides supplies. Office supplies should only include paper, pens, pencils, clips, diskettes, etc. and not general office expenses such as copier usage charges, subscriptions, coffee, etc.

YOU ALSO HAVE THE RIGHT TO A HEARING – EXERCISE THAT RIGHT!

Hearings include the tax assessor and a representative of the auditing firm. Successfully to challenge any assessment, it is necessary to prove the personal property in question was not on the premises as of October 1 or prove that the cost used by the assessor as the basis for market value was inappropriate. One method is to match recent equipment purchases to replaced equipment still included on the depreciation schedules by providing invoices verifying sales or trade ins. Invoices also provide proof that costs included for personal property taxes include inappropriate amounts (i.e., software included with computers and stated separately on the purchase invoice, sales tax and freight included with purchase price, etc.).

Also, consider using equipment service records to support a position.

With the proper information, it is reasonable to expect successful challenges to proposed additional assessments. Any additional assessment can be appealed to boards of tax review and the court system.

THE FUTURE: Property tax audits have become a way of life similar to income tax, sales tax, gift tax, and other audits. Governments need money and there is only one place to obtain it. So expect these audits to become an every three-year occurrence. Use the easiest and least costly method to prepare for them: maintain records that result in and support the least appropriate property tax liability.

Consideration should also be given to using valuation methods or depreciation schedules other than those included on the preprinted property tax declaration. Any alternative valuation methods or computations must be included with the declaration as filed.

At DHL&S, we find you the right deductions, the right classifications, the right tax accounting election and methods, and the best ways to decrease your tax exposure. Moreover, we stay in touch with you throughout the year, updating you on new tax laws and how they apply to your business.

If you have any questions, or need help with a Personal Property Tax Audit, or any tax issue, give us a call. **We are at (203) 929-3535.**