Course 1 – Section 18: Taxes Affecting Real Estate

Section 18 – Part 1

SLIDE 1 – Taxes Affecting Real Estate (Cover Page)

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Topics

In this section we will cover the following topics:

I. Real Property Taxation

II. Federal Income Taxes

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Learning Objectives

Upon completion of this lesson, you should be able to:

- Distinguish among immune, exempt and partially exempt property
- Describe the various personal exemptions available to qualified owners of homestead property
- Compute the property tax on a specific parcel, given the current tax rate, assessed value, eligible exemptions and transfer of assessment limitation difference (save our homes portability) if applicable
- List the steps involved in the tax appeal procedure
- Describe the purpose of Florida's Green Belt Law
- Calculate the cost of a special assessment, given the conditions and amounts involved

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- Describe the tax advantages of home ownership
- Explain how to determine taxable income of investment real estate
- Distinguish between installment sales and like-kind exchange

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Key Terms

Here are some key terms we'll encounter in this lesson:

- **ad valorem** – a tax, duty, or fee which varies based on the value of the products, services, or property on which it is levied
- **assessment limitation (save our homes benefit)** –provides that the assessed value of homestead property will not increase more than 3% or the percentage change in the Consumer Price Index, whichever is less
- **assessed value** – a tax assessor's determination of the value of a home in order to calculate a tax base
- **capital gains** – taxable profits an investor realizes from the sale of real estate or investments

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- **community development districts** – a governmental unit created to serve the long-term specific needs of its community
- **equity** – determination of the value of a property after existing liens are deducted
- **debt service** – the cash that is required for a particular time period to cover the repayment of interest and principal on a debt often calculated annually
- **exempt property** – any property that can't be claimed by creditors in order to satisfy the borrower's debts
- **installment sale** – a method of sale that allows for partial deferral of any capital gain to future taxation years.

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- **immune properties** – property that is immune from taxes such as government buildings
- **just value** – the market value of a property; the price the property should sell for at a particular point in time
- **like-kind exchange** – a valuable tax deferral strategy that allows an investor to sell a business or investment property and replace it with another "like-kind" property and avoid capital gain taxes
- **mill** – one one-thousandth of a dollar ($.001); a tax rate of one mill means that the owner pays one dollar for every thousand dollars of assessed value

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- **special assessment** – A real property tax proportionately levied on homeowners and landowners to cover the costs of improvements that will be for the benefit of all upon whom it is imposed
- **tax rate** – (same as millage rate) the ad valorem tax rate of a taxing district, derived by dividing revenues required from taxpayers by the district's tax base
- **taxable income** – annual income from an investment property that is subject to taxation, generally equal to net operating income plus reserves minus depreciation and interest expense

taxable value – The assessed value of a property net of all exemptions

SLIDE 9 - **Real Property Taxation (Cover Page)**

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Taxing Entities

Real estate taxation refers to the taxation of real estate as property. Real estate property taxes are imposed by "taxing entities" or "taxing districts" at county and local levels of government.

There are no federal taxes on real property. The Constitution of the United States specifically prohibits such taxes. The federal government does, however, tax income derived from real property and gains realized on the sale of real property. The federal government can impose a tax lien against property for failure to pay any tax due the Internal Revenue Service.

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County and local government– Counties, cities and municipalities, townships and special tax districts levy taxes on real property to raise funds for providing local services.

It is common for the county to collect all real property taxes and distribute it among the other taxing bodies.

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Tax districts – County and local governments establish tax districts to collect funds for providing specific services. The boundaries of such districts typically do not coincide with municipal boundaries.

The major tax district in most areas is the school district. Other important tax districts are those for fire protection, community colleges, and parks.

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Tax districts – A property tax bill might include tax levies from such districts as the following.

- bridge and highway
- nursing home
- storm water management
- township
- fire district
- school district
- retirement fund
- health services
- historical museum
- sanitorium
- forest preserve/land management
- public library district
- park district
- community college district

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Ad Valorem Taxation

General property taxes are levied on an ad valorem basis, meaning that they are based on the assessed value of the property. Assessed value is determined according to state law, usually by a county or township assessor or appraiser. The actual tax, though based on assessed value, may be derived as a legislated percentage of the assessed value. Land and improvements may be assessed separately. Ad valorem taxes are paid annually.

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Tax base totaling – The tax base of an area is the total of the appraised or assessed values of all real property within the area's boundaries, excluding partially or totally exempt properties:

tax base = assessed values - exemptions

Taxing entities generate the annual revenues they require by levying taxes on the tax base. The tax rate, or millage rate, determines how much of a tax levy the tax base will receive. The tax rate for each taxing entity is calculated by dividing the amount of revenue required by the tax base. This rate is then applied to the taxable value of each individual real property to determine its tax levy.

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Value assessment – County or township officers, called assessors or appraisers, value the real property within their jurisdiction for purposes of levying taxes. This valuation process results in an assessed value. Assessment practices differ from state to state. In many states, assessed value does not reflect the market value that an appraisal for other purposes might aim to estimate.

For instance, in some areas, assessors use a sales comparison approach to assess the value of land and a cost approach to value improvements.

The role of the assessor in the taxing process is limited to making the valuation and notifying the owner of the assessed value; other tax officials determine the tax rate and the tax levy.

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Equalization – Some taxing bodies recognize that local assessments can lead to unfairly high or low values for properties in certain areas. Therefore the jurisdiction may establish equalization factors to level out the unevenness of valuations. For instance, if assessed values of properties in one county are consistently ten percent below the average for other counties, an equalization board may multiply each assessed value in that county by a factor of 110% to raise them to the average level for the state.

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Appeals - Property owners may object to the assessed value of their property, but not to the tax rate. An owner usually has a certain period to protest after receiving notice of the assessed value. According to local law, a property owner must present evidence that the assessor made an error to a review board or appeal board. Typical evidence would include market data on comparable properties that sold recently, or evidence that neighboring properties had less appreciation or even declined in assessed value in comparison with the protestor's property.

An owner who is dissatisfied with the actions of the appeals or review board can take the protest to court.

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Protest Procedure

Once a home's assessed value has been established, the homeowner has the right to appeal the assessment within 25 days.

- If the county appraiser sides with the homeowner, the lower assessed value will be used
- If the county appraiser rejects the appeal, the homeowner may petition the Value Adjustment Board (VAB) for an appeal.
  - The purpose of the Value Adjustment Board (5 elected members – 3 county commissioners and 2 school board members) is to hear appeals regarding denied exemptions, petitions relating to assessments, and appeals concerning ad valorem tax deferrals.

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- If the board rejects the appeal, the homeowner may pay taxes under protest while filing a suit in court
- The court review of the appeal (Certiorari Proceeding) will either result in the court siding with the homeowner and the assessed value of the home will be lowered or the county assessment will be upheld.

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Exemptions From Property Taxes

Immune Property - Property the county will not tax at all (Federal and State Buildings, Airports, Municipal Buildings, etc.)

Exempt or Partially Exempt Properties – Properties that are subject to taxation but whose owners or exempt or partially exempt from paying. The county assessor will determine the taxable value of the property but the owners are not held liable for the bill. This includes churches and other non-profits

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Ad Valorem Taxation

Homestead exemption – A homestead is a parcel of real property that is owned and occupied as a family home. Some states exempt a portion of the value of the homestead from judgments to protect families against eviction by creditors. States and counties may *exempt a portion of the assessed value of the principal residence from property taxation*.

A property owner generally qualifies for a homestead exemption by meeting two criteria:

Is head of a family

Resides on the property for a required length of time

Some states also allow a single person to claim the homestead exemption.

Depending on state law, home owners may have to apply every year for the exemption, or they may receive it automatically without filing.

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Tax exemption

- For real and personal property belonging to FL resident
- For leasehold interests in property in FL
- Requires legal title and permanent residency on homestead
- Must be filed annually by March 1st
- $25,000 exemption deducted from value of homestead for tax purposes
- Additional $25,000 deducted for levies valued greater than $50,000 based on a graduated scale
  - The additional $25,000 exemption does not apply to school taxes

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Protection of Homestead

- Save Our Homes
  - limits increases in the assessed value to no more than 3% or the CPI (Consumer Price Index), whichever is less.
- Also protects from:
  - Forced sale to satisfy judgment liens (No protection from foreclosure)
  - From death of spouse when only spouse's name is on title

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Additional Homestead Exemption

- Additional exemption up to $50,000 for 65 years or older and low income living in certain counties
- Additional exemption for disabled veterans, blind people, surviving spouses of first responders, and permanently disabled persons
- Properties used for religious, literary, scientific, government, or charitable purposes fully exempt
- Homestead considered abandoned if rented

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(Based on county, income, and level of disability) Additional Exemptions May Exist For:

- Disabled Veterans
- 65 Years of Age or Older
- Quadriplegics or Other Low Income Individuals

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Greenbelt Law Exemption

The term “greenbelt” refers to lands receiving an Agricultural Classification by the Property Appraiser’s Office as defined by state law (Florida Statues 193.461). The Agricultural Classification typically results in a significant tax savings for the property owner, due to a lower value assessment.

The property owner must apply for an agricultural classification. County appraisers then verify that the land is being used for agricultural purposes.

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Requirements for Greenbelt Classification include:

- Size of the land, as it relates to a specific agricultural use;
- Efforts made to care for the land as it pertains to the agricultural endeavor such as fertilizing, tilling, mowing, reforesting or other accepted agricultural practices;
- Other factors applicable through state law (Chapter 12D-5.004) such as:
  - opinions of appropriate experts in the fields
  - business or occupation of owner
  - economic merchantability of the agricultural product
  - gross sales from the agricultural operation
  - zoning and other factors

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Ad Valorem Taxation

Tax rate derivation – Tax district budgeting:

The derivation of a tax rate, or millage rate, begins with the taxing body determining its funding requirements to provide services for the year. This requirement is formalized in the annual budget.

Then the county or district looks at its sources of revenue, such as sales taxes, business taxes, income taxes, state and federal grants, fees, and so forth. The part of the budgeted expenditures that cannot be funded from other income sources *must come from real property taxes.* This budgetary shortfall becomes the ad valorem tax levy.

The tax levy is derived every year, since budget requirements and revenue tallies are performed on an annual cycle.

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Tax rate derivation – Tax rate:

Each individual taxing body has its own tax rate. The tax rate is determined by dividing the taxing body's budgeted amount to be collected from real estate taxes by the tax base:

tax requirement

--------------------- = tax rate (millage rate)

tax base

If, for example, a taxing body needs $500,000 from property taxes, and the tax base for the district is $15,000,000, the tax rate for this body is:

500,000

------------- = .03

15,000,000

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Tax rate derivation – Tax rate:

This tax rate of .03 or 3% may be expressed in a number of ways, depending on local practice: as mills, as dollars per $100 of assessed value, or as dollars per $1,000 of assessed value.

A mill is one one-thousandth of a dollar ($.001). A tax rate of one mill means that the owner pays one dollar for every thousand dollars of assessed value. Thus the rate of .03 above could be expressed as:

30 mills

$3 per $100

$30 per $1,000

3 percent

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Tax rate derivation – Tax rate limitations:

Some states, counties or other taxing districts place limitations or caps on the absolute millage rate or the annual increase in millage for property taxes. In such situations, taxing bodies are *forced to limit their budget requirements*, unless there has been a sufficient increase in tax base to produce the required funds without raising the millage rate.

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Tax billing and collection

Individual owner billings – Each property owner's tax bill is determined by multiplying the tax rate for each taxing district times the taxable value of the property. Taxable value is *the assessed value after all exemptions and adjustments have been taken into account*.

For example, a certain property is owned and occupied as a primary residence and qualifies for a homestead exemption. The assessed value of the property is $80,000, and the exemption is $25,000. The property is taxed by the school district at a rate of 5 mills, and by the county at a rate of 2 mills. The property tax bill for these items would be calculated as follows:

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I. Taxable Value

	Assessed value	$ 80,000
–	Homestead exemption	$ 25,000
	Taxable value	$ 55,000

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Ad Valorem Taxation

Payment deadlines are usually set by law and differ from region to region. Different taxing bodies may have different fiscal years, and as a result may issue tax bills at different times of the year. It is more common for a county to issue a bill that consolidates the bills of all the lesser taxing bodies. The consolidated bill may be payable annually, semi-annually, quarterly, or on some other schedule as prescribed by law.

In many cases where the owner has a mortgage and a required escrow account, the escrow officer will pay the tax bill. The owner will only receive notice of the assessed value and the tax statement.

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Real Estate Applications

Tax rate calculation

1: Formulas: Tax rate (millage rate) =

2: Example: A municipality has a revenue requirement of $10,000,000 after accounting for its revenues from sale of utilities. This requirement has to be covered by property tax. The real estate tax base, after homestead exemptions, is $300,000,000. The tax rate will be:

$$\frac{10,000,000}{300,000,000} = .0333 \text{ or } 33.33 \textit{ mills}$$

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Real Estate Applications

Homestead exemption calculation

1: Formula and example:

Assessed value	$ 180,000
– Homestead exemption	25,000
= Taxable value	155,000

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Real Estate Applications

Taxing the property

1: Formulas: (1) Taxable value of property x tax rate (mill rate) for each taxing authority in jurisdiction.

(2) Total tax = sum of all taxes by taxing authority

2: Example

School tax	$100,000 x 10 mills	=	$ 1,000
City tax	$100,000 x 4 mills	=	400
County tax	$100,000 x 3 mills	=	300
Library tax	$100,000 x 1 mills	=	100
TOTAL TAX			$ 1,800

Section 18 – Part 2

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Special Assessments

A special assessment is a tax levied against specific properties that will benefit from a public improvement. Common examples are assessments for sidewalks, water service and sewers. Special assessments are based on the cost of the improvement and apportioned on a pro rata basis among benefiting properties according to the value that each parcel will receive from the improvement.

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For example, a dredging project is approved to deepen the canals for a canal-front subdivision. The project cost is $50,000. Although there are 100 properties in the subdivision, only the 50 that are directly on the canal stand to benefit. Therefore, assuming each canal-front lot receives equal benefit, the 50 properties are each assessed $1,000 as a special assessment tax. Note that once the work is completed and paid, the assessment is discontinued.

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If a taxing entity initiates an assessment, the assessment creates an involuntary tax lien. If property owners initiate the assessment by requesting the local government to provide the improvement, the assessment creates a voluntary tax lien.

Special assessments are usually paid in installments over a number of years. However, taxpayers generally have the option of paying the tax in one lump sum or otherwise accelerating payment.

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Real Estate Applications

Special assessments calculation

1: Formula: (1) Identify total costs to be assessed

(2) Calculate prorated share for each property impacted

(3) Multiply cost x prorated share

2: Example: A canal will be dredged at a cost of $20,000. The improvement affects 30 properties with a total canal frontage of 4,000 feet. One property has 200' of frontage. Its assessment bill will be:

(1) 200' ÷ 4,000' = 5% share

(2) $20,000 x 5% = $1,000 assessment

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Tax Lien Enforcement

If taxes remain unpaid for a period of time specified by state law, the tax collecting agency may enforce the tax lien in several ways, depending on what the law prescribes.

Sale of tax certificates – Some states sell tax certificates. The buyer of a tax certificate agrees to pay the taxes due. After a period of time specified by law, the holder of the tax certificate on a property may then apply for a tax deed.

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Tax deed – A tax deed is a legal instrument for conveying title when a property is sold for non-payment of taxes. The application for a tax deed causes the taxing agency to institute a tax sale or tax foreclosure.

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Tax sale – A tax sale is frequently some type of auction. If the tax has not already been paid through the tax certificate process, the buyer of the property must pay the taxes due. There is usually a legally-prescribed redemption period during which the defaulted taxpayer has the right to buy back the property and reclaim title. If the taxpayer can redeem the property by paying the delinquent taxes and any other charges before the tax sale occurs, this right is known as an equitable right of redemption. If the taxpayer can redeem the property after the tax sale, this right is known as a statutory right of redemption.

In this case, the taxpayer must pay the amount paid by the winning bidder at the tax sale, plus any charges, additional taxes, or interest that may have accumulated. If the defaulted taxpayer does not redeem the property within the allotted time, the state issues the tax deed to convey title.

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Non-Payment of Real Estate Taxes

Florida taxes are due and payable **November 1st** each year and they are delinquent if not paid by **April 1st** of the following year.

- Any property taxes that are unpaid by the homeowner become a **tax certificate**
- Tax certificates are offered at a public auction
    - Bids start at 18% and go down
    - The winner of the auction is whoever will accept the lowest loan interest rate
- The auction winner must wait 2 years before initiating foreclosure proceedings during which time the property owner can pay all taxes, interest, and cost to the county

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- The tax certificate holder (auction winner) may begin foreclosure proceedings after the two year wait if the property owner has not redeemed the property
- In foreclosure, the property is auctioned to the highest bidder on the steps of the county courthouse. The tax certificate holder is paid from the sale of the property
- If the tax certificate holder does foreclose on the property with 7 years, the certificate expires and the property reverts to the state.

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Tax Lien Enforcement