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Clark County caught up in property-tax mess

Assessor Schofield using unapproved valuation methods

John Dougherty

LAS VEGAS — The Nevada Tax Commission has never approved the specific methods used by the Clark County Assessors Office to value hundreds of thousands of homes, a practice that may violate a landmark 2006 Supreme Court ruling.

The state's largest county, with more the 700,000 parcels, uses an appraisal methodology known as abstraction to determine the land values for property when there are insufficient vacant land sales available for comparison. The county reports the majority of non-custom residential homes were valued this year using the abstraction technique.

While Nevada Tax Commission regulations list abstraction as an appraisal method available to assessors, the commission has never approved the complex methodology Clark County has developed for applying the land-valuation technique. This is not a mere technical oversight, but an issue that could have profound implications for the state.

The Nevada Supreme Court ruled in *Bakst vs. State Board of Equalization* that assessors must use appraisal methodologies that have been specifically approved by the state Tax Commission. The commission, however, has never provided detailed instructions on how the state's 17 elected assessors are to use abstraction — leaving each county to develop its own model.

"The way Clark County does their abstraction analysis is not approved by regulation nor used anywhere else in the state," said Suellen Fulstone, a

Reno attorney who has won several Supreme Court decisions on behalf of Lake Tahoe basin property owners and was co-counsel on the *Bakst* case.

"In order to satisfy *Bakst*, and for that matter, the Nevada Constitution, abstraction needs to be done in the same way in Clark County as it is in Washoe and Douglas and the rest of the counties," she said.

State records and interviews with assessors reveal the technique is not applied uniformly across the state. The state Department of Taxation, the agency that administers Nevada's tax regulations, concedes in a recent report that there is "no consensus model in existence for the application" of abstraction.

The department began a "special study" last June to determine how abstraction is performed by each of the counties, but the study was subsequently postponed until next year, a tax department official said.

The lack of a uniform method on how to apply a widely used appraisal technique such as abstraction exposes the state's most populated county to taxpayer lawsuits that could result in property-tax rollbacks similar to what is occurring in Washoe County.

Reno state court Judge Brent Adams last month ordered Washoe County to refund more than \$20 million to 9,000 taxpayers in the Lake Tahoe basin who have staged a seven-year property-tax revolt challenging the county's use of appraisal methods not specifically approved by the Tax Commission.

Washoe County is appealing the ruling.

Mark Schofield, the Clark County assessor, said it remains to be seen whether Clark County taxpayers will challenge property valuations based on the fact that the county uses an abstraction methodology that has not been specifically approved by the Tax Commission.

"Am I apprehensive about that? No. Is it possible? Sure. Anything is possible," he said.

Schofield said he's confident the county could withstand a legal challenge because the state regulations list abstraction as one of the techniques that can be used by assessors.

"We could advance some pretty compelling legal arguments that we are appropriately applying the abstraction methodology as it relates to Clark County," he said.

State regulations provide a definition for abstraction and list it as one of several appraisal options available to assessors if there are not sufficient vacant land sales to establish values for land beneath residential homes and commercial property.

The state defines abstraction as a "method of estimating the value of land by subtracting from the sales prices of improved parcels the full contributory value of all items attributable to the value of the improvements, thus yielding estimates of the residual or remainder value of the land."

In other words, the sales price of an improved property less the value of the improvements equals the value of the land.

How that process is actually executed, however, is left to each individual assessor. And that's where the controversy is centered.

Schofield said that he believes the Bakst decision does not require the Tax Commission to provide detailed instructions to assessors on how to use abstraction, which has been a common appraisal technique used for decades.

The Bakst decision, he said, "didn't say the Nevada Tax Commission had to further define it down to all the i's dotted and t's crossed."

But Fulstone and other leaders of the Lake Tahoe property-tax-revolt group Village League to Save Incline Assets strongly disagree with Schofield's assessment. The Village League's arguments cannot be dismissed easily, as the group has won repeated favorable rulings from state district courts and the Nevada Supreme Court.

Les Barta, an Incline Village businessman who has been actively involved in the Village League property-tax revolt, said, "The main problem with Clark

County's abstraction formula is that it is an individualized model not authorized by law."

Barta said Clark County's use of abstraction has the same legal flaws as some of the appraisal methodologies used in Washoe County that were found to be unconstitutional by the Supreme Court. The Tax Commission, Barta said, has not provided regulations that "provide an adequate uniform model for applying" abstraction.

To understand the importance of debate over a technical appraisal application such as abstraction, one must first understand Nevada's unusual property-tax system. Rather than basing its system on market values, like the other 49 states, Nevada has a split system where land and improvements are valued separately.

In Nevada, the property beneath and around a home is supposed to be appraised at full cash value. The improvements, however, are based on their estimated replacement cost, less depreciation of 1.5 percent per year depending on the age of the home. The land value and the improvement value are added together to determine a property's taxable value.

The system creates a natural conflict between taxpayers and government entities collecting taxes. Taxpayers benefit when the full cost of the improvements, including intangible items such as the builder's profit, and site preparation are included in valuation of the structure because of the 1.5 percent per year depreciation. A 20-year-old home, for example, would have its improvement cost reduced by 30 percent.

Tax-collecting entities, however, benefit when assessors undervalue the full contributory cost of improvements and shift those costs into the land, where there is no depreciation.

This tug-of-war in the valuation of improvements versus land is, in part, why the Nevada Supreme Court ruled in the Bakst decision that assessors must use appraisal methodologies approved by the state Tax Commission. Without uniform methods, there is no assurance that assessors are valuing similarly situated improvements and land the same way, which violates the Nevada Constitution's mandate for "a uniform and equal rate of assessment and taxation."

Further complicating matters is the Tax Commission's failure to implement uniform methodologies for assessors to follow. The Supreme Court noted in the Bakst decision that the commission has been derelict in its duties to provide uniform methodologies to assessors.

The commission, which is comprised of seven gubernatorial appointees, has not published a tax manual, required for the guidance of assessors, for more than 10 years, a direct violation of state law. The commission has known for years that its regulations lack the specificity to ensure that assessors are using the same appraisal methodology statewide.

A 2007 "white paper" prepared by the state tax department identified 26 "proposed topics for regulatory discussion." The topics included such basic concepts as defining land, clarifying the meaning of improvements, clarifying the meaning of "cost of replacement" and, central to this story, clarifying the definition of abstraction. The commission has yet to act on any of the department recommendations.

The commission's failure to create a uniform appraisal regulatory system has led to a proliferation of various appraisal methodologies across the state. It also has created the possibility that assessors — if they so choose — can push more value into land than into improvements simply by manipulating complex appraisal formulas, thus generating more revenue for government agencies that rely heavily on property taxes, including public schools, county and city governments, and fire and library districts.

Tax Commission member Hank Vogler, an Elko rancher, was the only commissioner who agreed to be interviewed for this story. Vogler said the rapid decline in real-estate values over the last three years is putting tremendous pressure on local governments to collect as much in property taxes as possible to fund their operations.

"Assessors are getting pressure from the county to find every little centavo they can find to bring in some revenue," he said.

There is no doubt that Nevada assessors are using different methodologies for abstraction.

For example, said Fulstone, Clark County does not use the sales price of a residential property as the starting part in the abstraction method, as required by state regulations — but instead has developed its own methodology to adjust the sales price through a complex formula.

"There is certainly no authority for that in the regulations," she said.

In addition, Fulstone says Clark County uses a method to value homes that fails to take into account the "full contributory value of improvements" such as soft costs and entrepreneurial profit, which results in higher land values, which ultimately lead to higher taxes.

"I think the general consensus among assessors is that those costs are too hard to calculate, so they just ignore that provision of the regulations," she said.

Clark County and Washoe County also use abstraction for different types of properties. Clark County, Fulstone said, uses abstraction for non-custom, subdivision tract homes, which is how it is generally used, according to appraisal textbooks. Washoe County, however, uses abstraction for custom homes in Incline Village and Crystal Bay, the Lake Tahoe communities at the center of the property-tax revolt.

Washoe County Assessor Josh Wilson said he's using abstraction combined with a mathematical tool called regression analysis to try to capture the full contributory value of improvements on the custom properties in Incline Village and Crystal Bay to reduce the chance the land values will be assessed too high.

Meanwhile, Douglas County Assessor Doug Sonnemann said he uses abstraction in limited cases for homes on the South Shore of Lake Tahoe, but never combines it with regression analysis.

The fact that abstraction is used differently in Washoe vs. Clark vs. Douglas counties — Nevada's three largest counties — is cause for serious concern that would likely lead the current Supreme Court to rule the methodology unconstitutional, Fulstone said.

"The Tax Commission needs to set standards not just for how abstraction is done but also for the circumstances under which it can be used," she said.

Schofield said Fulstone and others are "over-reading" the significance of the Bakst decision and trying to hamstring assessors from being able to fairly and equitably value property by seeking a rigid set of regulations that must be applied statewide.

The Bakst decision, he said, "doesn't say [the Tax Commission] has to totally define the method, but that it has to adopt the use of the method. How you define it, can be done in many, many different ways," he said.

Schofield's insistence that assessors have the power to determine how they deploy the methods approved by the Tax Commission will continue to be a flashpoint of contention that may ultimately be decided by the courts. And even then, the debate will likely continue as long as Nevada uses a non-market system to determine property-tax valuations.

"The assessors take any kind of limitation as an affront to their judgment, but it's really not," Fulstone said. "Absent an objective standard like full cash value, which Nevada does not have, there is essentially no way of achieving equality and uniformity if you rely on

the judgment, however sound, of 17 different county assessors."

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