

Leasehold Improvements

Current State of Affairs

- Counties are receiving many leasehold improvement (LHI) appeals based on a number of arguments.
- Some inconsistencies in taxpayer treatment of LHI.
- Some inconsistencies in county treatment of LHI.
- Desire to explore options for improvement in the LHI process led to recent discussions.

Taxpayer Arguments

- Taxpayer does not own the property.
 - Lease states that property becomes property of the landlord (LL) at the end of the lease.
 - Lease states that the property becomes the property of the LL at the end of construction.
 - Taxpayer treats the upfit allowance as a sale of the asset to the LL, and does not continue to keep the asset on its books.

Taxpayer Arguments

- Property is double-taxed because it has also been included in the real property.
- Property may or may not be double-taxed but, regardless, it cannot be considered personal property.

Inconsistencies by Taxpayer

- LHI sometimes treated as a depreciable asset.
- LHI sometimes treated as an asset sold to the LL when the LL paid an upfit allowance to tenant (rather than treating the allowance as deferred rent and then depreciating the asset).
- Incorrect items being listed as LHI.
- Taxpayer unable to identify the assets that comprise the cost that they have listed as LHI.

Inconsistencies by County

- Large variation in the adequacy of the Schedule of Values to establish what is considered real v. personal property.
- Inability to allow for additional value when property is owner-occupied, or vice versa.
- Large variations between counties in base value rate for the same type of property.
- Failure to adjust income approach when using rents derived from tenant-occupied properties to determine the value of owner-occupied properties, or vice versa.

Recent Discussions

- Internal research and discussions
- Met with four audit companies
- Met with 10 counties
 - 5 from eastern half of state
 - 5 from western half of state
- Seeking your comments and suggestions today

Recent Discussions

- Listened to concerns and suggestions.
- We offered for discussion purposes a suggestion for significant change.
- Results:
 - Will consider revising some PPAA and BPP Listing Form language.
 - Significant variation in county practices
 - Variety of opinions
 - **No major consensus for a particular solution**

Two Big Questions

- Are the improvements:
 - Real property, or
 - Personal property?
- Who is the owner of the property?

Real Property Defined

- G.S. 105-273

(13) Real property, real estate, or land. – Any of the following:

- a. The land itself.
- b. Buildings, structures, improvements, or permanent fixtures on land.
- c. All rights and privileges belonging or in any way appertaining to the property.

Personal Property Defined

- **G.S. 105-273**

(14) Tangible personal property. – All personal property that is not intangible and that is not permanently affixed to real property.

Property Must be Taxed to Owner

- **G.S. 105-302**
- (a) Taxable **real property** shall be listed in the name of the owner, and it shall be the owner's duty to list it unless the board of county commissioners shall have adopted a permanent listing system as provided in G.S. 105-303(b).

Property Must be Taxed to Owner

- **G.S. 105-306**
- (a) Taxable **personal property** shall be listed in the name of the owner on the day as of which property is to be listed for taxation, and it shall be the duty of the owner to list the property.

Who is the Owner?

- It depends on who you ask!
- And, it depends on who is asking!

Who is the Owner?

- Keep in mind G.S. 105-306(c)(8):
- If the person in whose name personal property should be listed is unknown, or if the ownership of the property is in dispute, **the property shall be listed in the name of the person in possession of the property**, or if there appears to be no person in possession, in the name of "unknown owner."

Our Current Position

- From the 2007 NCDOR Personal Property Appraisal and Assessment Manual (PPAA):
- Real estate - The land and appurtenances, including all things not movable in nature and more or less permanently affixed to the land.
- Real property - The "bundle of rights" that go with physical ownership of real estate, including the interests, benefits, and rights inherent in same.

Our Current Position

- From the 2007 PPAA:
- Personal property - All tangible property other than real estate. Generally includes movable items, that is, those not permanently attached or affixed to the real estate. In determining whether an item is personal or real, there can be considered the manner in which it is affixed to the real property as well as the intention of the owner with regard to the removal of the asset at the end of a lease period. ... If the item can be removed without serious injury to the building or to the item itself, then it could safely be termed as tangible personal property.

Our Current Position

- From the 2007 PPAA:
- Leasehold improvements - Real estate improvements to leased property contracted for, installed, and paid for by the lessee; and which may well remain with the real estate, thereby becoming an integral part of the leased fee real estate upon expiration or termination of the current lease, but which are the property of, and should be charged to, the current lessee who installs same.

Our Current Position

- From the 2007 PPAA:

Examples of items that may appear to be realty but should be considered personal property in certain situations are:

1. Wiring
2. Venting
3. Flooring

(continued...)

Our Current Position

- From the 2007 PPAA (cont'd):

4. Special climate control (Heating and air conditioning systems associated with particular equipment or product)

5. Conveyors

6. Boilers and furnaces

7. Shelving and displays

8. Leasehold improvements (owned by lessee)

Our Current Position

- From the 2007 PPAA:
- It is important to remember that there are no absolutes in making the determination of whether assets should be classified as real or personal property. Frequently, the appraiser must examine leases and other documents to determine the intent of the owner of the property. In addition, the appraiser may have to determine how the property is affixed to the realty and also, whether the property is there for the benefit of the process or for the benefit of the employees or the building.

Our Current Position

- From the 2007 PPAA:
- It is most important that all taxable property be assessed only once as either real or personal, and that property is classified as either real or personal uniformly throughout each county. Of slightly lesser importance is whether the property is classified as real or personal property. In other words, however property is classified, the assessor must ensure that all taxable property is uniformly assessed.

Our Current Position

- From the 2007 PPAA:

...several guidelines may be helpful to keep in mind when real vs. personal property issues arise.

1. Have a guideline in the schedule of values clearly classifying what your county considers as real or personal property.
2. As a personal property appraiser, become generally familiar with your county's Schedule of Values and discuss real vs. personal property issues with your real property appraisal department.

Our Current Position

- From the 2007 PPAA:
 3. Property used as part of a process, or in place for the equipment is generally considered personal property. Special wiring, foundations, and process piping are examples of this and are typically not appraised as real property in the Schedule of Values.
 4. Property used for the building, or for the comfort of employees is generally considered real property.

Our Current Position

- From the 2007 PPAA:
 5. The owner's intent is important to consider. If the owner intends property to be permanently attached to the real estate, then that should be taken into account.
 6. It can only be appraised once as real OR personal, but not both.

Our Current Position

- While not perfect, the current position is a good marriage of the legal requirements and the practical requirements.
- However, the position needs to be uniformly, consistently, and rigorously applied, not just within individual counties, but across all counties.

Questions??

Comments??