TEXAS HOTEL OWNERS: PROCEED WITH CAUTION

Confusion regarding the tax code's rendition requirements creates a penalty trap.

By Rachel Duck, CMI, tax consultant at Popp Hutcheson PLLC

A provision in the Texas Property Tax Code requires hotel assessments based on an income analysis to include personal property. However, misunderstanding associated rendition requirements can cause unexpected penalties for hotel owners.

In Texas, both real and personal property are taxed at 100 percent of assessed value. Prior to 1999, a hotel's real and personal property were valued under separate accounts. A hotel's income and expense stream, however, incorporates value generated by both real and personal property.

For instance, a nightly hotel room rate covers the rent for the real property (the room itself), as well as personal property (the furniture and fixtures in the room). This blended income formerly created unique challenges when using the income approach to value hotels for property tax assessments.

In a move geared toward simplification and protection against potential double taxation, lawmakers added Section 23.24 to the tax code in 1999. This provision is designed to prevent furniture, fixtures and equipment included in a real property valuation from being taxed a second time under a separate, personal property account.

This particular statute, which was amended in 2009, now stipulates that for properties such as hotels, the value of real and personal property must be combined into one assessment if the assessor uses an income analysis.

Specifically, Section 23.24(b) states that "in determining the market value of the real property appraised on the basis of rental income, the chief appraiser may not separately appraise or take into account any personal property valued as a portion of the income of the real property, and the market value of the real property must include the combined value of the real property and the personal property."

Section 23.24 simplifies the valuation process for hotels valued under an income analysis, presuming that total income reflects the contributory value of the real and personal property and that separating the two is an unnecessary step when both portions are taxed at a 100 percent assessment ratio.

The state legislature amended Section 22.01 in 2011 to include subsection "m," which holds that "a person is not required to render for taxation personal property appraised under Section 23.24."

Rachel Duck
CMI, Tax Consultant, Popp Hutcheson PLLC

Taxpayer Pitfall

As a result of these provisions, many hotel owners assume that their personal property will be included in the real property assessment and do not submit annual renditions to county appraisal districts. But what happens if a jurisdiction does not value a hotel using the income approach?

The caveat in Section 23.24 is that the property is valued "on the basis of rental income." Because the income approach is just one of three recognized approaches to value, this statute does not eliminate the independent consideration of personal property in ad valorem taxation for hotels in Texas.

Although assessors value most hotels based on income, there are several common scenarios in which they may use an alternative method, triggering the creation or continuation of a separate personal property account.

Jurisdictions often value newly constructed hotels using the cost approach during the first one to two years of operation, prior to stabilization. Harris County almost exclusively values hotels on the cost approach for the first year following construction.

Hotels that have been in operation for some time but have reached a point of significant renovation or decline in value may also be valued using the cost approach. In such scenarios, the assessor will value personal property under a separate account, and may require the property owner to submit a personal property rendition report.

Failure to render in a timely fashion results in a penalty equivalent to 10 percent of the total taxes due. Unfortunately, hotel owners are often unaware of rendition requirements until they are penalized for a late rendition.

Rendition Required

The following example illustrates how incorrect assumptions about an assessor's valuation methodology can result in unexpected rendition penalties.

Let's assume the assessor has valued a hotel under an income analysis since the taxpayer acquired it in 2010. Based upon this history and prior interactions with the assessor, the owner did not file a personal property rendition with the county appraisal district for tax year 2018.

The property had suffered a significant decline in performance over the past few years despite dramatic increases in land value in the area. After reviewing the documentation provided, the assessor decides to value the hotel at land value, with a minimal contributory value assigned to the improvements.

Since this approach is based upon a cost analysis, as opposed to an income approach as was the case in prior years, Section 23.24(b) no longer applies. The switch in methodology triggers the creation of a separate business personal property account for the hotel.

Because the taxpayer's discussions with the assessor begin at an informal hearing after the rendition deadline, the owner does not learn of the change in methodology or resulting new personal property account until the opportunity to comply has passed. Consequently, the taxpayer incurs a 10 percent penalty for failure to file a timely personal property rendition.

An Ounce of Prevention

It can be challenging to establish complete clarity on an assessor's methodology prior to the rendition deadline. As in the previous example, scheduled discussions with assessors often occur after the deadline. A hotel owner may choose to file a protective rendition to avoid the possibility of unexpected penalties.

In any case, the key to avoiding unnecessary penalties is to communicate as early and often with the county assessor as possible, or hire someone who is able to do so on the taxpayer's behalf.

With a thorough understanding of the property tax code and clear communication with county assessors, hotel owners in Texas may bypass the penalty trap.

Rachel Duck is a tax consultant at Popp Hutcheson PLLC, which represents taxpayers in property tax matters and is the Texas member of American Property Tax Counsel (APTC), the national affiliation of property tax attorneys. She can be reached at rachel.duck@property-tax.com.

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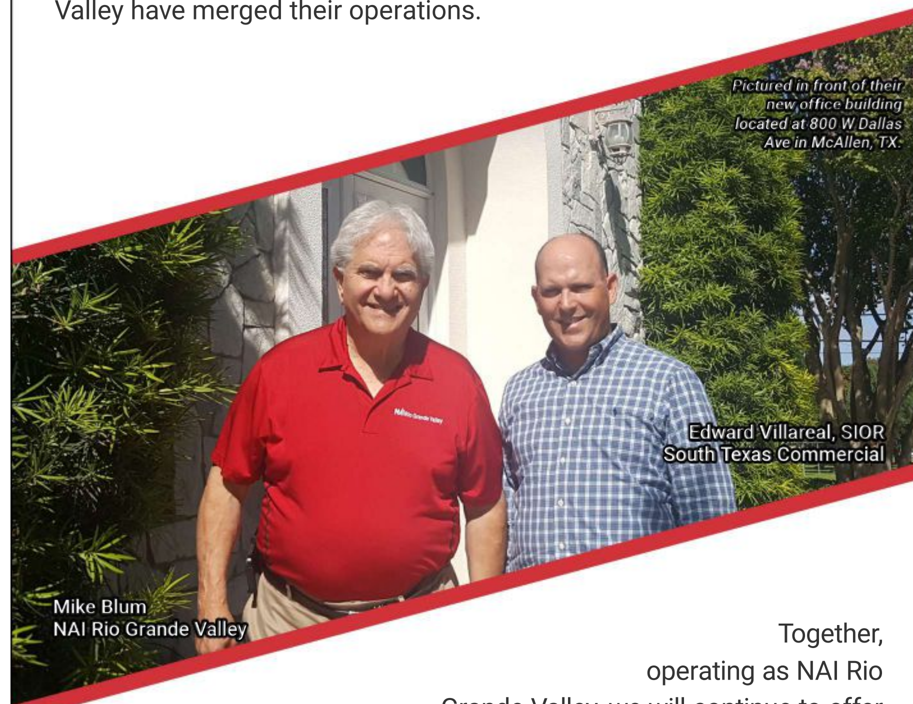

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