

To: Members of City Council
From: Rob Dubow, Finance Director
Re: Estimated Losses for Potential Property Tax Appeals
Date: June 13, 2012

We have been asked about the potential impact on appeals of using existing assessments for FY13 property tax bills. The memo below from Frances Beckley, the Revenue Department's Chief Counsel summarizes those impacts.

We have also attempted to put a dollar figure on potential appeals losses, in accordance with a request from Council staff. Based on the number of appeals that were made last year and after discussions with the Law Department, we estimate that appeal losses would be well over \$100 million. This total would be split between the City and the School District in line with the ratio of the property tax.

If the property tax millage rate is not adjusted to account for those appeal losses, the Administration's revenue projection would have to be lowered and the FY13-17 Five Year Plan would not be balanced. In addition, the School District would face an increased deficit, both from Property and Use and Occupancy taxes.

To: Rob Dubow, Finance Director
From: Frances Ruml Beckley, Revenue Chief Counsel
Re: Using 2011 Certified Market Values to Impose 2013 Real Estate Taxes
Date: June 13, 2012

Some have proposed trying to impose real estate taxes for 2013 using the market values that the Office of Property Assessment ("OPA") certified in 2011¹ as the basis for imposing 2013 real estate tax, despite the fact that the OPA will certify new market values this fall. You have asked me to explain why I characterize the result of such a proposal as "a train wreck."

Because the issue was highly technical, few Philadelphians other than Commercial property owners and real estate tax professionals paid attention when the State Tax Equalization Board ("STEB") ruled last summer that the City's real estate tax assessment system was inadequate and effectively ordered all real estate tax assessment appeals to be decided using a common level ratio ("CLR") of 18.1% rather than the City's established predetermined ratio of 32%.² Property owners who were paying attention – again, mostly large commercial property owners – filed roughly 2000 timely real estate tax assessment appeals. If those real estate tax assessment appeals had been decided at 18.1% without a cross-appeal of the

¹ In many, if not most, cases, the fair market value certified in 2011 actually was determined in 2004 and has been frozen since then.

² As long as STEB determines that the common level ratio is within 15% of the ratio the City is using, the City can continue using its established predetermined ratio. In order to be within 15% of 32%, the CLR must be 27.2% or higher, so neither 18.1% nor 25.2% qualifies.

properties' fair market value, the City and School District would have lost roughly \$80 million in real estate tax revenue.³

Fortunately, when the City and School District⁴ objected to STEB's initial determination that the CLR for 2012 was 18.1%, STEB agreed to accept additional data and review its initial findings. Upon reconsideration, STEB determined the common level ratio to be 25.2% -- decreasing the reduction that a property owner automatically receives for filing a real estate tax assessment from roughly 40% to roughly 20%. In other words, the change to the CLR reduced the City and School District's potential revenue loss from roughly \$80 million to roughly \$40 million.

The School District filed a cross-appeal to every real estate tax assessment appeal filed for 2012. The School District argued that (i) while the law required the use of the common level ratio in assessment appeals, it also required that the ratio be applied to a property's fair market value and (ii) many of the properties in question had been significantly undervalued by the OPA. If the School District is successful in establishing a higher fair market value for a property, that can offset or even eliminate the effect of using a lower ratio to calculate the property's tax liability and so could reduce potential revenue loss. This record might tempt you to conclude that the impact of having a common level ratio imposed on Philadelphia has not been that drastic this year and therefore it would not be so bad to use 2011 certified market values to impose 2013 real estate taxes. That would be wrong.

First, there is no reason to believe that the CLR for 2013 will be significantly higher than it was for 2012. Therefore the CLR will not be within 15% of the City's 32% ratio, and the CLR will apply to all assessment appeals.⁵

Second, there is reason to believe that the STEB will be less willing to reconsider Philadelphia's CLR if it were to come in at the low end of the spectrum. When the 18.1% initial CLR was announced last summer, virtually everyone was caught by surprise. Philadelphia was able to make a sympathetic case for reconsideration both because of that surprise and because the data set supporting that result was the first produced by new management at OPA. Neither of those arguments will be available next year. Third, there is reason to be confident that a low CLR will result in an explosion of assessment appeals. Last fall the issue was novel and unknown. By this October, the fact that merely filing an assessment appeal will produce a virtually automatic reduction in tax liability will have been well publicized. Last fall two thousand assessment appeals were filed; next fall -- with a low CLR -- it is not an exaggeration to say that we should anticipate tens of thousands *at a minimum*.

Fourth, there is reason to believe that even with our best efforts, the School District's cross-appeals will recover only a fraction of the discount provided by a low CLR. At one end of the spectrum, large commercial properties tend to have been given certified market values closer to their real fair market values than the average so the increase from certified market value to actual fair market value may not be sufficient to offset using the CLR. At the other end of the spectrum, we will not have the resources -- either of lawyers or evaluators/appraisers -- to effectively contest the huge number of modest residential properties that presumably will appeal. And even if cross-appeals ultimately were successful, they could take years to resolve.

Finally, the avalanche of assessment appeals is only one problem. Not merely Pennsylvania statutes, but also the Pennsylvania constitution, require that property be taxed uniformly. Case law has established

³ Lower assessments also would have caused a decrease in the School District's revenue from the business use and occupancy tax.

⁴ The Law Department's Tax Unit -- my group -- represents both the City and School District in tax cases.

⁵ Some respected tax practitioners have stated that they believe uniformity requires that the CLR be applied to all properties in the City, not just those for which an assessment appeal has been filed. If there were a low CLR for a second year, they might bring a mandamus action to make the City do that.

that taxation is not an exact science and absolute uniformity is not required; departures from fairness are tolerated ***when they are unavoidable***. However, to use the 2011 certified market values – that are universally recognized as arbitrary and unreliable – to impose tax when unquestionably more accurate assessments are available is essentially indefensible. Using the 2011 certified market values would be inconsistent with the assessment statute that explicitly requires mandatory annual assessments. Using 2011 certified market values would violate the Pennsylvania constitution’s guarantee of uniform taxation. It seems all but certain both that a blanket challenge would be made to imposing such a tax and that such a challenge would be successful. Whether the remedy would be to substitute a court-ordered real estate tax for the flawed tax or simply to invalidate the flawed tax is less clear.