By Joel Marcus

# Taxation of Business Enterprise Values

The only property in the state of New York subject to taxation is real property. The state legislature has reinforced this point by stating, "Notwithstanding [all other general or local laws to the contrary], personal property, whether tangible or intangible, shall not be liable to ad valorem taxation."

Although local assessors can only levy property taxes on real estate alone, their valuations embrace elements of business value, personal property and intangible property. Depending on the nature of the real estate property type, assessors tend to inflate valuations.

This inflation is best explained by breaking down real property assessments based on asset class.

**Hotels.** By nature, a hotel operation combines real estate, e.g. bricks and mortar, with business enterprise and personal property. When a patron rents a room, he pays for the use of furniture, hotel services, room service and the reputation of the hotel (franchise value).

**Shopping Centers.** Much debate has taken place around the country regarding the significant elements of business enterprise value as they relate to shopping centers. An experienced developer has multiple centers and an organization of people who orchestrate the selection and mix of retail tenants, using their expertise to provide incentives that can attract anchor department stores. The marketing, advertising and development skills of the developer account for a mall's success. However, the assessor rarely takes this into account when he capitalizes all of the mall's net income. Of course, the mall derives income from sources such as licenses for pushcarts, car dealer displays, special events and other items. Despite the fact that none of these income streams derive from real property, no deduction is ever given for the business enterprise value created by the developer. When malls are rated, sales per foot is the benchmark, not rental rates per sf, which recognizes business enterprise value.

**Office Buildings.** Here, profits generated by the owner from sales of services requested by tenants are included in assessors' total net income for a property. These services may include items such as build-outs and extra services not part of the lease provisions. If the tenant ordered a door or extra cleaning from a vendor, these actions would not be classified as real estate income. However, if the property owner's business provides the service, it somehow transforms itself into real estate value.

If a building has an emergency power generator, it is generally separately assessed, even though the owner reports the tenant's rent, which includes use of the generator. The assessor also values the office building, in effect doubling taxation.

**Signage.** Assessors tax billboards and electronic signs on buildings based on the owner's net income from these signs rather than taxing them on the physical value of the signs. An owner of a building that received advertising revenue for the use of billboards on its property will often find that the assessor uses that income to value the real estate. However, when a company like MetLife puts its name on its own building, it pays no extra tax.

Billboards and electronic signs on buildings are also taxed based on the owner's media business net income rather than physical value. Depending on the content and type of business using signage, it produces income, which is often assumed to be part of real estate value. If Ernst and Young put its name on its own office building, no extra tax would be due, but a Jumbotron in Times Square might pay real estate taxes on its income from advertisers, if assessors could get their hands on it.

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If the trade name "Trump Place" were separately rented from its owners, would rental payments be real estate income? What difference in value would occur if a hotel had no TVs, beds, furniture, brand name, good reputation, trained workforce or reservation system? That bare-bones hotel building is the only property that's assessable. It is the fee-simple estate stripped of its intangible business enterprise and personal property that, by law, should be the basis of a property tax bill.

Successful business enterprise models are by nature intangible, brought about by time, expertise and business skills. They consistently produce additional rental income. Property owners and their representatives must help define the parts of a property that are real estate, separating out the non-real estate assessable property; otherwise owners will have paid much in taxes without realizing it. —RENY

*The views expressed in this article are those of the author and not those of Real Estate Media or its publications.*

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