

AN AFFRONT TO COMMON SENSE (Newsletter Winter/Spring 2004)



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This year, many commercial property owners will again render unto Caesar about 5% of their property's value in real estate taxes. Every 20 years, the municipal government in whose jurisdiction the property is located, will have demanded, received and spent the entire value of the property. Some of that money will be returned to the taxpayers as services, often delivered grudgingly by an indifferent civil service. It is a burden that property owners shoulder with resignation. Outsourcing of government services is fiercely resisted by the powerful civil service unions; even though it produces substantial cost savings it rarely features in the politicians' lexicon in Atlantic Canada. (Its sister activity privatisation, has typically delivered a better quality service at cost savings of 25% to 40% according to studies conducted by The Economist). So it's a case of grimace and bear it? Not quite, it pays to be pro-active.

Hydra: The Two Headed Monster

Property taxes are the product of the mill rate, set by the municipality, and the assessment, usually computed by the province. It is a system which allows both to evade responsibility. When assessments increase, the municipality quietly pockets the extra cash and diverts taxpayers' wrath onto the unfortunate provincial assessors. Provincial politicians protest that the fault lies with the municipality since the latter set the mill rate, i.e. the level of taxes each of us pay. In practice our ability as commercial taxpayers to influence the mill rate, is very limited; the commercial tax rate is always going to be substantially higher than the residential rate because businesses do not vote. It's Hobson's choice: in order to control your property tax burden you have to control the assessment ... and since property taxes typically comprise 40% of your property's total operating costs they are *the* critical budget item; every other property expenditure pales by comparison.

The Assessment Process: Arbitrary, Acrimonious and Academically Suspect?

Sometimes! It depends on the province and occasionally on the individual field assessor. It is necessary to tailor your assessment appeal strategy accordingly.

There is no doubt that the assessment process is arbitrary. Each province in which we are currently conducting property tax appeals (Newfoundland, Nova Scotia, Prince Edward Island, New Brunswick, Quebec, Ontario, Alberta) uses "market value" as the basis for the assessed value. This system is fairly effective for residential properties because of the quantity of sales data and homogeneity of the markets. However any similar relationship between a commercial property's assessment and its market value is fortuitous coincidence, except in the broadest of terms. Assessment is a mass appraisal process and the assessors do not have the time and resources to address the appraisal of commercial properties in the depth required to ensure an accurate result. Lack of training, experience and education also play a major role. As a consequence it is not uncommon for a property owner to be paying \$70,000 per year in taxes on sketchy calculations, completed years ago, which are somewhat less likely to produce a reliable result than a lottery ticket. We reviewed one such New Brunswick case last week. The more thoughtful legislators recognised the arbitrary nature of the assessment process and built a provision into their provincial legislation requiring that assessments have to be "uniform" with other assessments. No such protection exists for taxpayers in New Brunswick or Quebec. The ultimate safeguard is the *appeal process*, included in every provincial Assessment Act ... in New Brunswick and Quebec it is the *only* protection afforded the taxpayer. Since this appeal process is such a critical element for "getting it right", appeals will be greeted with shrieks of delight by the more enlightened provincial Assessment Departments ... and in fairness, only in New Brunswick are they treated with outright hostility.

Service New Brunswick - Secretive, Obstructive, Out of Touch!

Assessment is just one of several functions conducted by Service New Brunswick, a provincial body formed out of several government departments in 1990. It formerly laboured under the Orwellian title "The Geographic Information Corporation" but changed its name on April fools day 1998, adopting the modern penchant of government departments to rebrand themselves as something warm and fuzzy. SNB's Assessment Division deploys a strategy which commercial taxpayers in the province often find secretive, obstructive and out of touch with the real world. If you own property in New Brunswick you may be familiar with SNB's tactics and probably wonder how best to respond. Take heart, others have gone before you and there are a number of court cases rapping SNB's knuckles that should help you curb their worse excesses.

Secretive

The purported aim of the political establishment is to make government open and transparent. To that end each province has passed a Freedom of Information Act. The assessment records on your property are now available to you, or your agent, in New Brunswick ... but it took a Court of Queen's Bench decision to pry them out of the provincial Assessment Department. In 1995, Repap New Brunswick Inc. which owned five pulp and paper mills on the Miramichi, and was the Province's largest taxpayer, were refused copies of their own assessment records despite the fact that they paid millions of dollars a year in property taxes. Repap made their formal request on March 1, 1995 under the Right to Information Act. That request was ignored and when the Assessment Department failed to reply within the prescribed time under the Act, Repap referred the matter to the Court of Queen's Bench. Six days later the Minister (Assessment Department) sent Repap's cheque back and refused to release the assessment records on the grounds that they were "confidential". The Assessment Department refused to release any information other than the assessed values shown on the assessment and tax roll. Repap wanted to know *"how the properties were assessed and upon what the assessment was based"*. They sought *"a less expensive way of receiving that information than the adversarial means of an exchange of valuations"*. The Court ruled that the records could hardly be confidential since they referred to the owner's property, decreed they should be made available and awarded costs of the

court action to Repap. (*Repap New Brunswick Inc. versus Minister of Economic Development and Tourism: Court of Queen's Bench of New Brunswick F/M/39/95*). Since then Service New Brunswick has provided copies of the assessment records to the property owner or its agent, albeit sometimes reluctantly and often painfully slowly (a two to three month response time is not unusual). Last year SNB's Saint John office stopped providing the assessment records on which the assessment was based until they had time to revise them. Their intention was only to supply them after they had requested and received additional information from the property owner and in some cases, had actually issued the Referral Register Decision. Mr. Ken Reid, the Regional Director advised us that he was unaware of the Court of Queens Bench Repap case but promptly released the assessment records again after we sent him a copy of the Court decision.

Obstructive

The Repap case is significant: the Court decision reveals a civil service mindset that guards its secrets and attempts to thwart the appeal process by forcing the taxpayer into a costly and adversarial action based on the exchange of valuation (appraisal) reports. This is costly, time consuming and risky for the taxpayer because they are not able to ascertain whether it is worthwhile proceeding with the appeal until a great deal of expenditure has been incurred. The court decision eliminated that hurdle but Service New Brunswick have since embarked on a strategy the impact of which is again to raise the cost of the appeal process and thereby discourage appeals. Once the taxpayer, or their agent, files an appeal, SNB assessors respond with a demand for information on the property similar to the following:

"We are reviewing the assessment of your property. In order to make a proper assessment, you are requested to provide: (1) amount of commercial/industrial space available/gross leasable area; (2) detailed copies of the leases or lease abstract (control sheet); (3) income and expense statements for the past 3 years; (4) the rent roll; (5) tenant inducements in whatever form identified; (6) if the property is presently for sale, the asking price and any offers; (7) detailed cost of renovations for the past 3 years; (8) any recent appraisal, calculation or estimate of value; (9) floor plan; (10) plot plan; (11) name and phone number of the person who may accompany the assessor in completing a physical inspection of the property; (12) provide a copy of a maintenance log for the past ten years or a list of repairs and associated costs; (13) outline any planned or required capital expenditures."

... all this for a 38 year old, 23,000 ft.² industrial building! The taxpayer is given just 30 days to respond and Service New Brunswick always directs the "request" to them rather than their professional advisor. Whilst most commercial taxpayers recognise the "request" as a crude attempt to discourage them from proceeding with their appeal we, and they, have concerns about the SNB's storage and access procedures to safeguard the confidentiality of the data. The Assessment Act does require that the information be kept confidential but the type and volume of data requested is extra-ordinary and we doubt that any of their offices has the necessary secure storage facilities, a procedure for restricting access to them by designated personnel, and an audit process to ensure compliance. We do know that confidential data collected from one taxpayer is used in a public forum, the N.B. Assessment and Planning Review Board, as evidence involving another taxpayer's property so you should be careful what information you provide to the assessor. Bear in mind that it may be used as evidence in a Court case involving one of your competitors. The Assessment Act does require that you only provide information that *"will assist the Director to make a proper assessment of the real property"* ... you are not required to do their work for them ... so information that is not relevant, that could confuse the assessor, or is already in their possession (they must have *some* information), should be excluded from your response. We have not been able to find any case law on this type of request ... the other provinces ask for the information **before** they assess the property ... so it is worthwhile keeping a copy of the request. If your case proceeds to the Appeal Court it could be

valuable evidence on the validity of your assessment. Since the information is required "in order to make a proper assessment", the lack of it is prima facie evidence that the original assessment was not conducted properly. The use of the information by the assessor *after* it is received, will be critical in any subsequent court appeal. If the information is simply discarded, or is not employed in a meaningful way in the assessment calculations, it will speak to the validity of the assessor's work.

Out of Touch

Real estate which houses a manufacturing process is more likely to be improperly assessed, other things being equal, than other types of property because its value depends in large part on its ability to efficiently serve the production process itself. In order to properly assess the property the assessor must know the difference between job shops and machine, or worker, paced assembly lines, batch flows and continuous flows ... and they must ask the correct questions. How does the present building design facilitate or impede production? Does the site configuration assist or constrain materials handling and truck loading? Is there a pool of skilled labour available locally? If not, who bears the cost of training and education; the Province or the employer? Where are the markets for the products? How do they get there? How are changes in technology impacting on the production process? Unfortunately Service New Brunswick do not appear to train their personnel to ask these questions ... and as a consequence, when they are given the information by the plant manager, the assessors usually fail to comprehend its significance, as the following court cases so sadly demonstrate.

In a court case involving a food processing plant in Hartland (*Small Fry Snack Foods Inc. versus Director of Assessment - Regional Assessment Review Board, December 2001*), the Service New Brunswick assessor Ms. Elaine English testified that the plant operations manager had told her about problems involving the plant layout, which arose as a result of a change in the product the plant processed, but that she "*did not consider functional obsolescence in the initial costing*". Although Ms. English was a senior level assessor in SNB's Woodstock office with 25 years experience the Board noted that in fact "*her experience with industrial properties like that of the Appellant was limited*". They further noted that the valuation report tendered in evidence by Service New Brunswick "*falls far short of the requirements ... of the General Regulation to the Assessment Act*" and "*is woefully deficient in virtually every respect. Because it lacks a signature the Board does not even know who is the author*" and "*this document (it is difficult to call it a report) was full of misinformation, partial information and error*". The Board then discarded Service New Brunswick's evidence because it "*is so lacking in specifics, and rationale for calculation*" ... and allowed the appeal. A satisfactory result for the Small Fry Inc. but at the cost of a court case which could have been avoided had Service New Brunswick deployed a more knowledgeable assessor.

A similar situation pertained with another food processing property, this time located in Saint John (*Baxter Foods Limited versus Director of Assessment - Regional Assessment Review Board, June 2001*). Both parties to the action, and the Review Board, had agreed that the assessment should be computed by the Cost Approach, i.e. cost the buildings and deduct; (1) Physical Obsolescence (due to age and disrepair), (2) Functional Obsolescence (due to functional inadequacy or super-adequacy), (3) External Obsolescence (due to deteriorated market conditions); then add the land value. Service New Brunswick had assigned an assessor, Michael DeMerchant to calculate the assessment. The Board determined that Mr. DeMerchant, a Regional Assessor, had done a good job in calculating the cost of the building, its Physical Obsolescence and the land value. Mr. DeMerchant told the Board he had however ignored Functional Obsolescence (the plant was an old, multi-storey structure) because he "*was only doing a 'bricks and mortar' appraisal*" ... something that alas, has yet to be codified in the NB Assessment Act, or anywhere else for that matter. His Counsel however demurred, pointing out to the Board that Mr. DeMerchant's "*Valuation Report was **not** an appraisal, but a costing of the subject property, prepared to support the original assessment*" ... something too, that has yet to make it to

the NB Assessment Act. Refusing to be impressed by all of this pioneering work, the Board decided to play it safe, stick with the existing legislation and accepted appraisal principles; they ruled that Functional and External (Economic) obsolescence were factors to be taken into account in arriving at the assessed value ... and duly reduced the assessment to reflect them.

SNB's reluctance to be confused by the facts resulted in another appeal (*NB Publishing Co. versus Director of Assessment - Regional Assessment Review Board, November 2001*). The taxpayer owned a multi-storey industrial building in Saint John, constructed in 1963 specifically for the purpose of accommodating a two storey high printing press and the related services necessary to publish a newspaper. The Board noted that *"the building was in essence built around the huge printing press which actually has its footing in the basement and extends upward through the two upper floors. This is a massive piece of equipment and occupies a significant portion of the building"*. On November 11th 1997 the newspaper made public its decision to transfer the printing to Moncton early in 1998. The newspaper was still in operation in the building on January 1st 1998, the "base date" for valuation purposes for the 1998 assessment year and Mr. Michael DeMerchant, the Provincial Assessor ignored the plant closure and assessed the building as though it was not going to take place! The Review Board plainly considered Service New Brunswick's decision to ignore the facts ludicrous and in tones of mounting incredulity observed that *"It was Mr. DeMerchant's position, and obviously that of the Respondent (Service New Brunswick) that no matter what you found out what was to happen after January 1 of any taxation year, you must ignore it! He believes the Assessment Act requires him to focus on conditions on January 1, 1998 no matter what happens, no matter how catastrophic an event takes place on January 2, 1998 and, even if you knew this event would happen in November of 1997". ... "It would be beyond common sense to blind oneself to factors which are **known** before the effective date of the assessment as opposed to those which may be discovered to have happened **after** the effective date"*. The Board then reduced the assessment to reflect functional and external obsolescence.

The issue of common sense, or rather the lack thereof, also featured recently in another assessment appeal case decision involving Service New Brunswick. (*Food City Limited versus Director of Assessment - Assessment and Planning Appeal Board, December 2003*). The property concerned was a large food distribution warehouse and supermarket located on River Road in the Town of Oromocto. In order to calculate the assessed (market) value Service New Brunswick had first costed the building using, as was their wont, a "Boeckh costing manual" ... a costing system they had used since time eternal. Despite their extensive and lengthy use of the Boeckh costing manual, Service New Brunswick were unaware that the costs included the 15% H.S.T. ... a "pass through" tax which replaced the G.S.T. in New Brunswick ... *"This rather startling revelation came to light when two local agents of the Respondent (Service New Brunswick) advised the Board they were unaware of this"* according to the Board decision. Once they became aware that all of their assessments computed on a "cost to build" basis included H.S.T., Service New Brunswick promptly decided that this was correct ... even though they had laboured for years on the assumption that it was incorrect! Alas, the Board disagreed noting that *"It would be **an affront to common sense** that the cost of an item could be increased by the amount of a local tax which is rebated to the taxpayer, with an off-set of one with the other"*. SNB has now appealed the Board's decision to the Court of Queen's Bench. That appeal will be heard on July 5th 2004. The Board decision notes that assessors Mr. Peter Dobbelsteyn and Mr. Gerald Carroll gave evidence on behalf of Service New Brunswick. Mr. Carroll is the Manager of Valuation and was in charge of the recently completed (2003) re-assessment of all heavy industrial property in the province. Two costing manuals were employed in that exercise, a Heavy Industrial Manual (which excluded H.S.T.) and the Boeckh manual (which included H.S.T, but which at that time was thought by SNB to exclude H.S.T.). One assumes that Service New Brunswick will have to re-do their entire re-assessment of the heavy industrial sector now, irrespective of the decision of the Court of Queens Bench. The cost of the appraisal work in New Brunswick is charged back to the taxpayer as part of

their property tax bill. No doubt heavy industrial property owners can expect a refund of their assessment appraisal fee ...

Be Pro-Active

If you operate a speciality type property such as a hotel/motel, sawmill, pulp mill, gasoline service station, oil refinery, mine, etc. or utilise your premises for a production process, you are very much at risk if the Service New Brunswick assigns personnel without the appropriate experience, education and training to calculate your assessment. Service New Brunswick charges each taxpayer an annual fee on the property tax bill, for assessing their property. Since you are paying for their work, you should request that the assessor responsible for your file provide you with his/her curriculum vitae detailing their experience, education and training. The provincial licensing body, the New Brunswick Association of Real Estate Appraisers (NBAREA) requires as a minimum, that unsupervised appraisers valuing commercial property, must have attained the Appraisal Institute of Canada's "AACI" designation. If the assessor is not suitably qualified, insist on somebody with the appropriate expertise: SNB's mission statement, clearly enunciated on its web site, is "*customer service, customer consultation and customer satisfaction*" (www.snb.ca/e/4000/4003e.asp). Unfortunately neither the province nor the municipality will refund your taxes for previous years even if you were over-assessed as a result of the assessor's negligence. However if the assessor is a member of the NBAREA they have to carry \$1.0 million professional liability insurance, so this may be the avenue whereby you can recover your loss directly from the assessor him/herself. Check if the assessor is a member by visiting NBAREA's web site www.nbarea.org/getmembers.asp. NBAREA is there to protect you, the public.

If you want to avoid Service New Brunswick's costly request for information process, ask that they provide you with a copy of your assessment records now, before next year's appeal period. Despite the legislative requirements, most assessments are not reviewed each year. Instead Service New Brunswick simply indexes them upwards: the initial calculations on which the original assessment was based, remain the same. Check that the physical information (lot, building size and description) is correct. Review the calculations for accuracy and verify that the appropriate appraisal methodology has been applied. If any of the foregoing are incorrect the error will have been magnified by the indexing process. Call our New Brunswick Tax Team Rick Escott or André Pouliot at 1-800-567-3033 if you require professional assistance.