STATE OF INDIANA
Board of Tax Review

PEPPERMILL ASSOCIATES, LP	)	On Appeal from the Marion County Property
	)	Tax Assessment Board of Appeals
	)	
Petitioner,	)	
	)	Petition for Review of Assessment, Form 131
v.	)	Petition No. 49-401-95-1-4-00047
	)	Parcel No. 4022528
MARION COUNTY PROPERTY TAX	)	
ASSESSMENT BOARD OF APPEALS	)	
And LAWRENCE TOWNSHIP	)	
ASSESSOR	)	
	)	
Respondents.	)	

Findings of Fact and Conclusions of Law

On January 1, 2002, pursuant to Public Law 198-2001, the Indiana Board of Tax Review (IBTR) assumed jurisdiction of all appeals then pending with the State Board of Tax Commissioners (SBTC), or the Appeals Division of the State Board of Tax Commissioners (Appeals Division). For convenience of reference, each entity (the IBTR, SBTC, and Appeals Division) is hereafter, without distinction, referred to as "State". The State having reviewed the facts and evidence, and having considered the issues, now finds and concludes the following:

Issue

1. Whether 50% economic obsolescence depreciation should be applied rather than 10% obsolescence depreciation.

Findings of Fact

1. If appropriate, any finding of fact made herein shall also be considered a conclusion of law. Also, if appropriate, any conclusion of law made herein shall also be considered a finding of fact.

2. Pursuant to IC 6-1.1-15-3, the law firm of Landman & Beatty, on behalf of Peppermill Associates, LP (Peppermill), filed a Form 131 petition requesting a review by the State. The Marion County Board of Review's (now the Marion County Property Tax Assessment Board of Appeals) Final Determination is dated July 9, 1997. The Form 131 petition was filed on July 11, 1997.

3. Pursuant to IC 6-1.1-15-4, a hearing was held on June 8, 1998, before Hearing Officer Mark Bisch. Testimony and exhibits were received into evidence. James Beatty and Sheila Murray represented Peppermill. Daniel Spiker represented the Lawrence Township Assessor's Office. Although formal written notice of the hearing was mailed to the Marion County Assessor's Office, no one appeared on its behalf.

4. At the hearing, the subject Form 131 petition was made part of the record and labeled Board's Exhibit A. The Notice of Hearing on Petition was labeled Board's Exhibit B. In addition, the following exhibits were submitted to the State:

   Petitioner's Exhibit 1 – Calculation of obsolescence depreciation; copy of buyer's closing statement.
   Petitioner's Exhibit 2 – Calculation of obsolescence depreciation; copy of financial statements and auditor's report.
   Petitioner's Exhibit 3 – A copy of *Clark v. State Board of Tax Commissioners*, 694 N.E. 2d 1230 (Ind. Tax 1998).
   Petitioner's Exhibit 4 – A copy of *Canal Square Ltd. Partnership v. State Board of Tax Commissioners*, 694 N.E. 2d 801 (Ind. Tax 1998).

Petitioner's Exhibit 5 – A copy of *Simmons v. State Board of Tax Commissioners*, 642 N.E. 2d 559 (Ind. Tax 1994).

Respondent's Exhibit 1 – 1995 property record card for the property under appeal (one page of this card was not submitted).

5. The apartment complex is located at 4500 Shadeland Avenue, Indianapolis, Lawrence Township, Marion County.

6. The Hearing Officer did not view the property.

Issue No. 1 - Whether 50% economic obsolescence depreciation should be applied rather than 10% obsolescence depreciation.

7. The Board of Review determined that the improvements should receive 10% obsolescence depreciation. The Petitioner contended that the improvements should receive 50% economic obsolescence depreciation.

8. On behalf of the Petitioner, Ms. Murray testified that Peppermill purchased the property from the United States Department of Housing and Urban Development on September 16, 1994. Ms. Murray further testified that Peppermill paid $1,350,000 for the property and subsequently added $500,000 worth of improvements (painting and carpeting) to the property.

9. Mr. Beatty testified that the major cause of obsolescence is the location of the property, as it is in a transitional neighborhood. He further testified that the Marion County Board of Review determined the capitalization rate of 13.5% used in the Petitioner's calculation; this rate is considered average.

10. In support of Peppermill's position, Ms. Murray submitted two calculations purporting to quantify the claim for 50% economic obsolescence depreciation.

11. Mr. Spiker testified that he agrees location is a factor in real estate values; location was the reason the Board of Review applied 10% obsolescence to the property.

Conclusions of Law

1. The Petitioner is limited to the issues raised on the Form 130 petition filed with the Property Tax Assessment Board of Appeals (PTABOA) or issues that are raised as a result of the PTABOA's action on the Form 130 petition. 50 IAC 17-5-3. See also the Forms 130 and 131 petitions authorized under Ind. Code §§ 6-1.1-15-1, -2.1, and –4. In addition, Indiana courts have long recognized the principle of exhaustion of administrative remedies and have insisted that every designated administrative step of the review process be completed. *State v. Sproles,* 672 N.E. 2d 1353 (Ind. 1996); *County Board of Review of Assessments for Lake County v. Kranz* (1964), 224 Ind. 358, 66 N.E. 2d 896. Regarding the Form 130/131 process, the levels of review are clearly outlined by statute. First, the Form 130 petition is filed with the County and acted upon by the PTABOA. Ind. Code §§ 6-1.1-15-1 and –2.1. If the taxpayer, township assessor, or certain members of the PTABOA disagree with the PTABOA's decision on the Form 130, then a Form 131 petition may be filed with the State. Ind. Code § 6-1.1-15-3. Form 131 petitioners who raise new issues at the State level of appeal circumvent review of the issues by the PTABOA and, thus, do not follow the prescribed statutory scheme required by the statutes and case law. Once an appeal is filed with the State, however, the State has the discretion to address issues not raised on the Form 131 petition. *Joyce Sportswear Co. v. State Board of Tax Commissioners,* 684 N.E. 2d 1189, 1191 (Ind. Tax 1997). In this appeal, such discretion will not be exercised and the Petitioner is limited to the issues raised on the Form 131 petition filed with the State.

2. The State is the proper body to hear an appeal of the action of the County pursuant to Ind. Code § 6-1.1-15-3.

A. Indiana's Property Tax System

3. Indiana's real estate property tax system is a mass assessment system. Like all other mass assessment systems, issues of time and cost preclude the use of assessment-quality evidence in every case.

4. The true tax value assessed against the property is not exclusively or necessarily identical to fair market value. *State Board of Tax Commissioners v. Town of St. John,* 702 N.E. 2d 1034, 1038 (Ind. 1998)(*Town of St. John V)*.

5. The Property Taxation Clause of the Indiana Constitution, Ind. Const. Art. X, § 1 (a), requires the State to create a uniform, equal, and just system of assessment. The Clause does not create a personal, substantive right of uniformity and equality and does not require absolute and precise exactitude as to the uniformity and equality of each *individual* assessment. *Town of St. John V,* 702 N.E. 2d at 1039 – 40.

6. Individual taxpayers must have a reasonable opportunity to challenge their assessments. But the Property Taxation Clause does not mandate the consideration of whatever evidence of property wealth any given taxpayer deems relevant. *Id.* Rather, the proper inquiry in all tax appeals is "whether the system prescribed by statute and regulations was properly applied to individual assessments." *Id.* at 1040. Only evidence relevant to this inquiry is pertinent to the State's decision.

B. Burden

7. Ind. Code § 6-1.1-15-3 requires the State to review the actions of the PTABOA, but does not require the State to review the initial assessment or undertake reassessment of the property. The State has the ability to decide the administrative appeal based upon the evidence presented and to limit its review

to the issues the taxpayer presents. *Whitley Products, Inc. v. State Board of Tax Commissioners,* 704 N.E. 2d 1113, 1118 (Ind. Tax 1998) (citing *North Park Cinemas, Inc. v. State Board of Tax Commissioners,* 689 N.E. 2d 765, 769 (Ind. Tax 1997)).

8. In reviewing the actions of the PTABOA, the State is entitled to presume that its actions are correct. See 50 IAC 17-6-3. "Indeed, if administrative agencies were not entitled to presume that the actions of other administrative agencies were in accordance with Indiana law, there would be a wasteful duplication of effort in the work assigned to agencies." *Bell v. State Board of Tax Commissioners,* 651 N.E. 2d 816, 820 (Ind. Tax 1995). The taxpayer must overcome that presumption of correctness to prevail in the appeal.

9. It is a fundamental principle of administrative law that the burden of proof is on the person petitioning the agency for relief. 2 Charles H. Koch, Jr., *Administrative Law and Practice,* § 5.51; 73 C.J.S. Public Administrative Law and Procedure, § 128.

10. Taxpayers are expected to make factual presentations to the State regarding alleged errors in assessment. *Whitley*, 704 N.E. 2d at 1119. These presentations should both outline the alleged errors and support the allegations with evidence. "Allegations, unsupported by factual evidence, remain mere allegations." *Id* (citing *Herb v. State Board of Tax Commissioners,* 656 N.E. 2d. 890, 893 (Ind. Tax 1995)). The State is not required to give weight to evidence that is not probative of the errors the taxpayer alleges. *Whitley,* 704 N.E. 2d at 1119 (citing *Clark v. State Board of Tax Commissioners,* 694 N.E. 2d 1230, 1239, n. 13 (Ind. Tax 1998)).

11. One manner for the taxpayer to meet its burden in the State's administrative proceedings is to: (1) identify properties that are similarly situated to the contested property, and (2) establish disparate treatment between the contested property and other similarly situated properties. *Zakutansky v. State Board of*

Tax Commissioners, 691 N.E. 2d 1365, 1370 (Ind. Tax 1998). In this way, the taxpayer properly frames the inquiry as to "whether the system prescribed by statute and regulations was properly applied to individual assessments." *Town of St. John V,* 702 N.E. 2d at 1040.

12. The taxpayer is required to meet his burden of proof at the State administrative level for two reasons. First, the State is an impartial adjudicator, and relieving the taxpayer of his burden of proof would place the State in the untenable position of making the taxpayer's case for him. Second, requiring the taxpayer to meet his burden in the administrative adjudication conserves resources.

13. To meet his burden, the taxpayer must present probative evidence in order to make a prima facie case. In order to establish a prima facie case, the taxpayer must introduce evidence "sufficient to establish a given fact and which if not contradicted will remain sufficient." *Clark,* 694 N.E. 2d at 1233; *GTE North, Inc. v. State Board of Tax Commissioners,* 634 N.E. 2d 882, 887 (Ind. Tax 1994).

14. In the event a taxpayer sustains his burden, the burden then shifts to the local taxing officials to rebut the taxpayer's evidence and justify its decision with substantial evidence. 2 Charles H. Koch, Jr. at §5.1; 73 C.J.S. at § 128. *See Whitley,* 704 N.E. 2d at 1119 (The substantial evidence requirement for a taxpayer challenging a State Board determination at the Tax Court level is not "triggered" if the taxpayer does not present any probative evidence concerning the error raised. Accordingly, the Tax Court will not reverse the State's final determination merely because the taxpayer demonstrates flaws in it).

C. Review of Assessments After *Town of St. John V*

15. Because true tax value is not necessarily identical to market value, any tax appeal that seeks a reduction in assessed value solely because the assessed value assigned to the property does not equal the property's market value will fail.

16. Although the Courts have declared the cost tables and certain subjective elements of the State's regulations constitutionally infirm, the assessment and appeals process continue under the existing rules until a new property tax system is operative. *Town of St. John V,* 702 N.E. 2d at 1043; *Whitley,* 704 N.E. 2d at 1121.

17. *Town of St. John V* does not permit individuals to base individual claims about their individual properties on the equality and uniformity provisions of the Indiana Constitution. *Town of St. John*, 702 N.E. 2d at 1040.

Issue No. 1 - Whether 50% economic obsolescence depreciation should be applied rather than 10% obsolescence depreciation.

18. The Board of Review determined that the improvements should receive 10% obsolescence depreciation. The Petitioner contended that the improvements should receive 50% economic obsolescence depreciation.

19. Economic obsolescence depreciation is defined as "obsolescence caused by factors extraneous to the property." 50 IAC 2.2-1-24.

20. "Economic obsolescence may be caused by, but is not limited to, the following:
    (A) Location of the building is inappropriate for the neighborhood.
    (B) Inoperative or inadequate zoning ordinances or deed restrictions.
    (C) Noncompliance with current building code requirements.
    (D) Decreased market acceptability of the product for which the property was constructed or is currently used.
    (E) Termination of the need of the property due to actual or probable changes in economic or social conditions.
    (F) Hazards, such as danger from floods, toxic waste, or other special hazards."
    50 IAC 2.2-10-7(e)(2).

21. Depreciation is a concept in which an estimate must be predicated upon a comprehensive understanding of the nature, components, and theory of depreciation, as well as practical concepts for estimating the extent of it in improvements being valued. 50 IAC 2.2-10-7.

22. The elements of functional and economic obsolescence can be documented using recognized appraisal techniques. These standardized techniques enable a knowledgeable person to associate cause and effect to value pertaining to a specific property.

23. It is incumbent on the taxpayer to establish a link between the evidence and the loss of value due to obsolescence. After all, the taxpayer is the one who best knows his business and it is the taxpayer who seeks to have the assessed value of his property reduced. *Rotation Products Corp. v. Department of State Revenue,* 690 N.E. 2d 795, 798 (Ind. Tax 1998).

24. Regarding obsolescence, the taxpayer has a two-prong burden of proof: (1) the taxpayer has to prove that obsolescence exists, and (2) the taxpayer must quantify it. *Clark v. State Board of Tax Commissioners,* 694 N.E. 2d 1230, 1233 (Ind. Tax 1998).

25. As discussed, the Board of Review applied 10% obsolescence depreciation. Both parties agree that the improvements have experienced some level of obsolescence depreciation, satisfying the first prong of the two-prong burden articulated in *Clark*.

26. "There are two methods of measuring external [economic] obsolescence: (1) capitalizing the income or rent loss attributable to the negative influence; and (2) comparing comparable sales of similar properties, some exposed to the negative influence and others not." International Association of Assessing Officers (IAAO) Property Assessment Valuation, 173 (2nd ed. 1996).

27. "The *capitalization of income method*: capitalizes the income of subject property into an estimate of value, with site value deducted; indicated improvement value is compared with estimated cost new to provide indication of improvement value remaining." *Id* at 183.

28. "The *sales comparison method*: estimates cost new of subject property; comparable properties are found and site values deducted; contributory improvement values remain; contributory improvement values are deducted from cost for each sale property, yielding measure of accrued depreciation; accrued depreciation figure is converted to percentage and applied to subject property." *Id*.

29. Peppermill's representatives presented two calculations purporting to measure the amount of economic obsolescence depreciation present in the property under appeal.

30. The Form 130 petition (Attachment to Board's Exhibit A) indicates, "Based upon the discrepancy between TTV [true tax value] on the one hand and the Purchase Price plus renovations on the other, Petitioner requests that 50% obsolescence be applied to the property." Ms. Murray presented a calculation in support of this contention (Petitioner's Exhibit 1).

31. However, Peppermill's method of comparing true tax value and the purchase price (plus renovations) to measure economic obsolescence depreciation does not conform to the previously described generally recognized standards of assessment and appraisal practice.

32. Additionally, this argument ignores the simple reality that the true tax value assessed against the property is not exclusively or necessarily identical to fair market value. *State Board of Tax Commissioners v. Town of St. John,* 702 N.E. 2d 1034, 1038 (Ind. 1998)(*Town of St. John V*), *aff'g in part and rev'g in part Town of St. John III.* Using obsolescence depreciation as a means to make the

true tax value of the property equate to the sales price therefore also has no basis in generally accepted standards of assessment and appraisal practice.

33. Further, Mr. Beatty offered the following testimony relevant to the expenditure of $500,000 in renovations: "…it's not clear to me that that was done before the first of March of 1995." This testimony further undermines the credibility of Peppermill's calculation, which included these expenditures.

34. The mandate of the local taxing officials is to assess the value of the property on the assessment date, in this case March 1, 1995. "In determining true cash [true tax] value, '**only facts as they exist on the first day of March of each year are material** to the determination of questions of assessment and valuations of property for purposes of taxation.'" *Governours Square Apartments v. State Board of Tax Commissioners*, 528 N.E. 2d 864, 866 (Ind. Tax 1987) (citing *Stark v. Kreyling*, (1934), 207 Ind. 128, 132, 188 N.E. 680, 681) (Emphasis added). However, "if the data for [the current and subsequent years] help to establish a fact **existing on March 1** [of the assessment year], such data should be utilized." *Id*. (Emphasis added).

35. Peppermill failed to offer any explanation as to the manner in which renovations that may have been performed at some unspecified time after the assessment date establish a fact that existed on March 1, 1995.

36. Indeed, Peppermill offered no explanation as to the reason renovations involving painting and carpeting are appropriate items to include in a calculation that purports to quantify economic obsolescence, which is "caused by factors extraneous to the property." 50 IAC 2.2-1-24.

37. For the above reasons, the State is under no obligation to give, and does not give, this calculation any weight.

38. Peppermill presented a second calculation, purporting to measure economic obsolescence depreciation by using the income capitalization method (Petitioner's Exhibit 2). As previously discussed, the income capitalization method is a generally accepted means of measuring economic obsolescence depreciation.

39. Although recognized or valid methods of calculation may be presented in support of obsolescence depreciation claims, the numbers set forth in these calculations must be valid and supported too. Before applying the evidence to reduce the contested assessment, the State must first analyze the reliability and probity of the evidence to determine what, if any, weight to accord it. Without valid and supported data, the State is under no obligation to give, and will not give, these calculations any weight.

40. In its income capitalization calculation, Peppermill divided the 1993 net operating income ($263,393, taken from the financial statements of the apartment complex) by a capitalization rate of 13.5% and concluded that the property had a total value of $1,951,060.

41. "One point should be emphasized: the income and expenses that are proper and acceptable for income tax purposes are not the same as those that are appropriate for the income approach. Only the reasonable and typical expenses necessary to support and maintain the income-producing capacity of the property should be allowed. This is important, because the investor is interested in both short-term and long-term profits, even though the taxable income for income tax purposes for any given period may or may not be related to the real estate value in question." IAAO Property Assessment Valuation, 204 (2nd ed. 1996).

42. Simply using data from financial statements to measure obsolescence depreciation therefore does not conform to generally accepted standards of assessment and appraisal practice.

43. It does not appear that Peppermill's income capitalization approach conforms with generally accepted standards of assessment and appraisal practice.

44. "The basic steps in the income approach are as follows:

    1. Estimate potential gross income.
    2. Deduct for vacancy and collection loss.
    3. Add miscellaneous income to get effective gross income.
    4. Determine operating expenses.
    5. Deduct operating expenses from the effective gross income to determine net operating income before discount, recapture, and taxes.
    6. Select the proper capitalization rate.
    7. Determine the appropriate capitalization procedure to be used.
    8. Capitalize the net operating income into an estimated property value." *Id*.

45. "The first step in the income approach to value is to estimate the potential gross income for the property in question. *Potential gross income* is annual economic rent for the property at 100 percent occupancy. *Economic rent* is the annual rent that is justified for the property on the basis of a careful study of comparable properties in the area." *Id*.

46. As discussed, Peppermill's calculations are based on the 1993 gross income of the property under appeal. They contain no analysis of potential gross income or economic rent based upon a "careful study of comparable properties in the area", as required by generally accepted standards of assessment and appraisal practice.

47. "The vacancy factor for any particular property must be determined by a study of other comparable properties and an analysis of their rental histories, as well as the recent history of vacancies in the subject property." *Id* at 211.

48. Peppermill's calculations are based on the 1993 vacancy loss of the property under appeal. They contain no vacancy factor "determined by a study of other comparable properties and an analysis of their rental histories", as required by generally accepted standards of assessment and appraisal practice.

49. The net operating income is determined by deducting 1993 operating expenses from the effective gross income. "Determining *operating expenses* requires a thorough analysis of typical expenses by property use type to determine proper and improper expenses." *Id* at 227.

50. Peppermill's calculations are based on the actual expenses incurred by the property under appeal in 1993. They contain no identification of expenses determined by "a thorough analysis of typical expenses" for apartment complexes, as required by generally accepted standards of assessment and appraisal practice.

51. Further, Peppermill failed to offer any explanation that would establish the relevance of financial data for the year ending December 31, 1993 to the assessment date of March 1, 1995. Peppermill's representatives are required to show how financial statements relate to the issue of obsolescence depreciation. *Simmons v. State Board of Tax Commissioners*, 642 N.E. 2d 559, 562, n. 2 (Ind. Tax 1994).

52. For the above reasons, the State does not find that Peppermill's income capitalization calculation can be relied upon to serve as the basis of quantifying the obsolescence percentage sought by the Petitioner.

53. Additionally, the Form 130 petition asserted, "Although the property is currently experiencing little vacancy, the neighborhood itself warrants obsolescence." The acknowledgement by Peppermill's representatives that the property has

experienced "little vacancy" further undermines the credibility of any claim that the property has experienced 50% economic obsolescence depreciation.

54. The Petitioner has therefore failed to quantify any amount of claimed economic obsolescence depreciation, as required by the second prong of the two-prong test articulated in *Clark*.

55. For all the reasons above, the Petitioner failed to meet its burden in this appeal. Accordingly, no change is made to the assessment as a result of this issue.

Summary of Final Determination

ISSUE 1 - *Whether 50% economic obsolescence depreciation should be applied rather than 10% obsolescence depreciation.*

56. The Petitioner failed to meet its burden on this issue. No change is made in the assessment as a result of this issue.

The above stated findings and conclusions are issued in conjunction with, and serve as the basis for, the Final Determination in the above captioned matter, both issued by the Indiana Board of Tax Review this ____ day of________________, 2002.

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Chairman, Indiana Board of Tax Review