What is Property Tax Proration?

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When people buy and sell real estate, buyers and sellers must pay several costs before transferring the property to a new owner, called closing costs. Within these closing costs, buyers and sellers need to negotiate the proration. There are many types of proration, including property taxes, insurance premiums, interest, rental income, and so on.

Property tax proration is a way to split property taxes fairly and ensure each side is paying evenly. Buyers and sellers need to take escrow items, a proration agreement, and property tax assessments into consideration during this process.

Defining Property Tax Proration

Property tax proration is dividing property taxes evenly between the buyer and the seller. Sellers will take responsibility for the property taxes up until the day the property is officially sold. The buyer takes on the property taxes from the day the purchase is final.

How to Calculate Property Tax Proration

Most proration issues have simple calculations, but property taxes do not. The important aspect to consider is that property taxes work based on a fiscal year instead of a calendar year. In addition, every state has a different property tax calendar. This means that people should look up the way their state or county collects taxes before making any calculations.

Settlement statements are also long and consist of itemization amounts, especially those affecting the buyer and seller. The settlement sheets will have two separate columns for the seller and buyer. An attorney, paralegal, or legal secretary will be in charge of making the calculations and guiding both parties through the process.

Calculating property tax proration has a few steps. First, the attorney will determine property taxes for the current property year or the seller can provide a copy of the tax bill. The next step is to calculate the number of days the seller owned the property during the tax year. Divide that number by 365 to find the percentage for the tax year when the seller owned the property. Last, multiply the percentage with the property tax bill to find the amount of property tax the seller should pay to the buyer.

To find the amount the buyer needs to pay at closing, subtract the seller's property tax amount from the total property tax bill.

Escrow Items

When signing closing papers, the buyer and seller will have an opportunity to acknowledge additional installation fees in addition to the monthly mortgage payment. The lender will then create an escrow account, so anything the buyer pays beyond principal and interest will add up in the escrow until the payment is due.

The buyer will pay the lender in monthly installments. Some of the payments are:

- Homeowner's insurance
- Local property taxes
- Property mortgage insurance
- Condominium maintenance fees
- Homeowner association (HOA) fees

Some of these payments may divide into quarterly, biannual, or annual amounts. When the buyer makes monthly payments, it will include principal, interest, and inclusion of taxes and insurance due on the property. This is PITI, or principal, interest, taxes, and insurance. After itemizing a monthly payment on the closing papers, PITI items will display the amount due on the closing date.

Calculating HOA Fees

Most homeowner associations collect monthly dues directly, while some bill quarterly or annually. If the homeowner has not paid these dues, then the seller's proceeds will pay the dues and receive a credit for the unused portion of the dues.

What Is in a Proration Agreement?

It is often necessary to use tax totals from the previous year to calculate the tax proration amounts. For most municipalities, the new tax rates occur from July 1 to June 30 and go public the previous November. It's important to determine which party is responsible for paying in an emerging tax increase.

This is when a proration agreement added to the mortgage closing helps solve any issues. With this agreement, the buyer and seller will handle the difference together.

Sometimes, if the buyer sees the need to reimburse the seller a portion of prepaid taxes in the purchase contract, he or she will ask for no tax prorations. It's important for the seller to understand what no prorations means, because otherwise, the seller will need to pay taxes during a period when someone else occupies the property.

Variations of Property Tax Assessments

Depending on the municipality, the dates for the property tax rate may be different. Usually, the taxes in the current fiscal year turn into an outstanding debt against the property on January 1.

From July 1 until December 31, property owners pay an estimate that is usually equal to half the total amount from the last tax year. Some states, such as Illinois, will stagger the tax payment dates, depending on the county or the population. Larger counties may make tax payments on March 1 and September 1, while smaller counties might choose June 1 and September 1 for payments.

Using last year's taxes is the strongest indicator of how much to pay for PITI monthly installments. Taxes from the previous year are also helpful for settlement sheets to determine the monthly tax proration. The month of the closing date will have one final step before the selling and buying process ends.

With the monthly installment amount, divide by the number of days in the month. The seller will take responsibility for the days from the first of the month until the day of closing. The days that follow after closing become the buyer's responsibility.

Closing costs require several steps and payments before the closing date. The buyer and seller need to understand what is required of each party to close the sale. Property tax proration divides the property taxes between the seller and the buyer. When calculating tax proration, it’s important to understand property taxes work based on a fiscal year and then perform the necessary calculations with an attorney, legal secretary, or paralegal. Buyers and sellers should also consider escrow items and a proration agreement. Once the buyer and seller settle everything, the rest of the process should move smoothly.

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