Real Estate Tax Valuation Issues
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Kentucky's ad valorem real property tax is perhaps the oldest tax on the books in the Commonwealth, being first adopted in 1792. Real property tax is rooted in the Kentucky Constitution which requires that all non-exempt property be assessed as of each January 1st, at its fair cash value, estimated at the price the property would bring at a fair voluntary sale. Ky. Const. § 172; KRS 132.191(1). Valuation is the heart of real property taxation.

WHAT IS FAIR CASH VALUE?

"Fair cash value" as used in the Kentucky Constitution means "the price which would be agreed upon by a party who desired to, but was not compelled to, buy the property and an owner who desired to, but was not compelled to sell it." *Evans v. Allen*, 205 S.W.2d 514, 515 (Ky. 1947). So, fair cash value is synonymous with fair market value. *Dep't of Revenue v. Hobart Mfg. Co.*, 549 S.W.2d 297, 300 (Ky. 1977).

WHAT PROPERTY INTEREST IS VALUED AT FAIR CASH VALUE?

Kentucky's highest court has held that fair cash value to be assessed is the value of the property itself. *Fayette Cty. Bd. of Sup'rs v. O'Rear*, 275 S.W.2d 577 (Ky. 1954). This concept is straightforward for an owner occupied property. However, when a property is subject to a lease, particularly when there is a single tenant, arguments have arisen regarding whether the fair cash value should be determined by reference to the property itself or the property subject to a lease. *O'Rear* settled this by rejecting the argument that a property's fair cash value was the fair market value of the property subject to a lease and holding that the property's fair cash value was the fair market value of the property itself. So, when an owner sells a single-tenant property subject to a lease, the sale evidences the value of the lease, not the value of the property itself. Indeed, the methodology approved in *O'Rear* was to estimate the value of the land and the value of the improvements using the cost approach to derive the fair cash value of the property itself. As such, the maximum value of a property is the fair market value of the property without the leasehold. *Hobart*, 549 S.W.2d at 300.

WHAT ARE THE THREE APPROACHES TO VALUE?

Kentucky property tax cases and KRS 131.191 recognize three approaches used to determine the fair cash value of a property: the cost approach, the sales comparison approach, and the income approach. KRS 131.191. The "cost approach" is "a method of appraisal in which the estimated value of the land is combined with the current depreciated reproduction or replacement cost of improvements on the land…." *Id*. The cost approach was used in *O'Rear*. The "sales comparison approach" is "a method of appraisal based on a comparison of the property with similar properties sold in the recent past…." *Id*. The "income approach" is "a method of appraisal based on estimating the present value of future benefits arising from the ownership of the property." *Id*. The income approach must be supported by another approach. *Helman v. Ky. Bd.* of Tax Appeals, 554 S.W.2d 889, 890-91 (Ky. App. 1977).

WHAT ABOUT VALUING LEASED PROPERTIES?

Owner occupied properties, which are not subject to leases, may be valued using the cost, sales and income approaches. See, e.g., *Kroger Limited Partnership I v. Jenkins*, 2019-CA-001133-MR (Ky. App. July 17, 2020). Leased properties may also be valued using these three approaches to value. *College Heights Corp. v. Oxendine*, No. 2011-CA-000546-MR (Ky. App. Feb. 22, 2013). Indeed, Kentucky case law requires a wholistic approach to valuing a property subject to a lease that considers the three approaches to value. As noted in Helman, 554 S.W.2d at 891, "A number of other elements (in addition to income form a property) necessarily enter into the value, such as original cost, location, cost and character of improvements, rental history, location as to future growth of the adjacent area, sales of adjacent property, sales of comparable property, type of building or property, etc."

CAN SALES OF VACANT PROPERTIES BE USED AS COMPARABLE SALES TO VALUE OCCUPIED PROPERTIES?

Owner-occupied commercial properties are almost always vacant when sold. So, it makes sense that sales of vacant properties should be able to be used in the sales comparison approach as comparable sales to value properties that are currently occupied. Well stated by the Kentucky Supreme Court, "[W]here the properties are reasonably similar, and a qualified expert states his opinion that they are sufficiently comparable for appraisal purposes, it is better to leave the dissimilarities to examination and cross-examination than to exclude the testimony altogether." *Commonwealth, Dept. of Highways v. Oakland United Baptist Church*, 372 S.W.2d 412, 413 (Ky. 1963). This is because sales of comparable property can sometimes be scarce. Id. So, rather than exclude such sales, they should be adjusted by an appraiser to account for any differences, just like an appraiser would adjust for location, size, etc.

SHOULD THE DEED VALUE ALWAYS BE THE ASSESSMENT VALUE?

"[W]here the property is sold at or near the assessment date and the sale is fair and voluntary the sale price is the best evidence of the property's fair cash value, estimated at the price it will bring at a fair voluntary sale." *Evans v. Allen*, 205 S.W.2d 514, 516 (1947) (quotation omitted). When a property is sold, a statement of full consideration sworn under oath is required to be provided on the deed transferring title with criminal penalties for false statements. KRS 382.135; KRS 382.990. The statement of full consideration provided on a deed is often used as the assessment value for the property. KRS 382.135; KRS 132.480. However, "[t]he sale price of property is not, under all circumstances, the sole criterion for the guidance of the assessing authority in fixing the value for taxation purposes…." *Evans v. Allen*, 205 S.W.2d at 516. Accordingly, "the circumstances of the sale must be examined to determine the emphasis to be placed upon the sale price." *Grant County Fiscal Court v. McGee*, 582 S.W.2d 69, 71 (Ky. App. 1979). Thus, the statement of consideration generally, but not necessarily, reflects the true fair cash value of a property though that value may be rebutted with evidence of value.

Although the statement of consideration is equal to the fair cash value in a typical sale, there are instances when the statement of consideration is not the fair cash value. For example, the purchaser may have paid an inflated price. See, e.g., Dep't of Revenue v. Anaconda American Brass Co., 435 S.W.2d 65 (Ky. 1968). Or, the nominal statement of consideration on the deed may not equal the fair cash value because, for example, the statement of consideration was based on the book value. See, e.g., Commonwealth Indus. Inc. v. Hancock Property Valuation Administrator, No. 2001-CA-000291-MR (Ky. App. May 17, 2002). Sometimes, the statement of consideration on a deed does not equate to the real property's fair cash value for valid reasons; for example, in a sale of a business, the amount attributable to the real property may be unknown at the time the deed is recorded because the real property was sold with other assets or for some other valid reason.

Valuing real property is an art, not a science. There is no formula, but there are rules that the Kentucky courts have provided to ensure that real property is valued at its fair cash value in accordance with the Kentucky Constitution.

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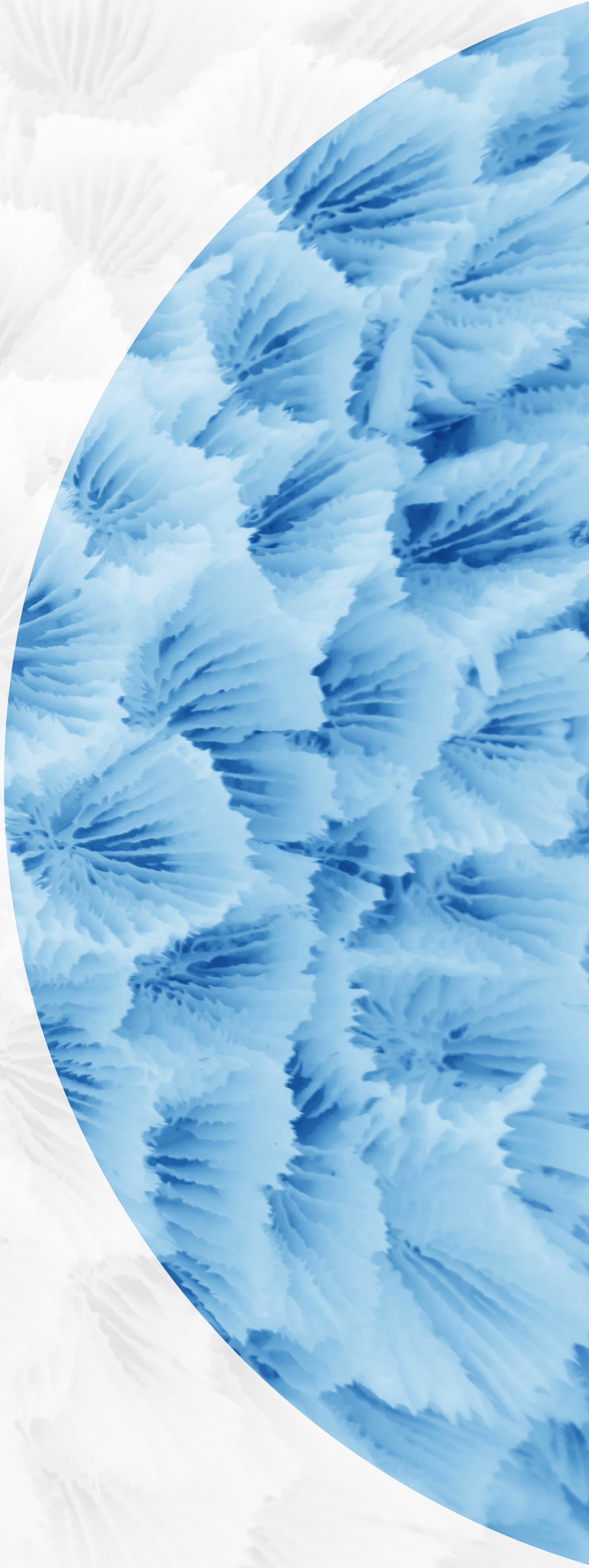

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