

# Kentucky Property Taxes on Commercial Real Estate

## Dentons SALT Insights

Property taxes, especially real property taxes, matter to businesses or non-profits with locations in Kentucky, because such taxes often present a material cost that may be either managed so that only the appropriate amount of tax is levied or avoided when an exemption applies.

### KEY CONTACTS

Mark Loyd  
Bailey Roese  
Brett Miller  
Stephanie Bruns  
Jeff Bennett  
Brad Hasler  
Kelli A. Wikoff  
Kimberly M. Nolte  
Gary R. Thorup  
Eric Smith

With real property taxes, it is best to think about procedure first. This is because applicable administrative procedures for real property taxes must be exhausted to obtain relief. *Cromwell Louisville Assocs. v. Jefferson Cnty. Prop. Valuation Adm'r*, 323 S.W.3d 1 (Ky. 2010). And, real property tax administrative procedures differ from those other taxes, are complicated and involve tight time frames.

Substantive tax issues are constitutional in nature. The Kentucky Constitution requires that real property be valued at its fair cash value. Ky. Const. § 172. Constitutional protections of uniformity and equal protection inure to taxpayers. Ky. Const. §§ 2 & 171-74; U.S. Const. amend. XIV. And, the Kentucky Constitution provides for property tax exemptions for institutions of religion, institutions of purely public charity, and for institutions of education as well as for public property used for public purposes. Ky. Const. § 172.

### Procedure

Procedural rules are very important in property tax. Although, in Kentucky, the County Sheriff sends out property tax bills for real property in the fall, the time to contest a real property tax assessment value is the spring which is when the county property valuation administrator (PVA) is required to give taxpayers notice of changes in their assessment values. KRS 132.450. Even if the PVA does not change the assessment value from the prior year's value, a taxpayer may dispute the current year's value. This may happen, for example, when the value of a property decreases or when the taxpayer, for whatever reason, did not dispute the value in the prior year.

A taxpayer initiates the process of contesting a real property tax assessment value by requesting a conference with the PVA for the county in which the property is located before end of the “open inspection” period, the thirteen day period beginning on the first Monday in May. KRS 133.120; KRS 133.045. The process applies throughout Kentucky, whether your real estate is located in Jefferson County, Fayette County, Boone County or any other Kentucky County.

The PVAs’ position is that the request required by statute for a PVA conference must be filed with the PVA before the end of the open inspection period; otherwise, the right to appeal is lost. PVAs typically send the notice via first class mail, which can be quite unreliable. So, what happens if the taxpayer does not receive the PVA’s notice of change in value? What happens if the notice is delayed, lost, or misdelivered? A taxpayer has a constitutional right to due process.

Oftentimes, the PVA conference will result in a resolution but not always. A taxpayer that is still aggrieved by an assessment may appeal to the Board of Assessment Appeals (BAA) in the county in which the property is located. KRS 133.120. A taxpayer or the PVA aggrieved by the BAA’s decision, may appeal to the Kentucky Board of Tax Appeals (KBTA). KRS 133.120. As this point, a real property tax appeal is handled similarly to any other tax appeal and may then be appealed to a Circuit Court, then to the Kentucky Court of Appeals, the Kentucky Supreme Court, or to the United States Supreme Court, assuming that the matter is not resolved by agreement, which can occur at any time during the process.

A CPA or an attorney as well as certain other representatives may represent a taxpayer before the PVA and the BAA. But, beginning with the KBTA, a party that is not an individual, must be represented by an attorney authorized to practice law in Kentucky; otherwise, the KBTA has been known to dismiss appeals filed by a non-attorney. 802 KAR 1:010.

## Fair Cash Value

Opinions can differ about what the fair cash value of a property is. However, real property taxation in Kentucky is governed by constitutional law, as noted above, and the Kentucky General Assembly has recognized this:

The General Assembly recognizes that Section 172 of the Constitution of Kentucky requires all property, not exempted from taxation by the Constitution, to be assessed at one hundred percent (100%) of the fair cash value, estimated at the price the property would bring at a fair voluntary sale, and that it is the responsibility of the property valuation administrator to value property in accordance with the Constitution.

KRS 132.191(1). Significantly, PVAs are directed to assess property as its fair cash value in accordance with the Constitution at the price the property would bring in a fair voluntary sale.

Evidence of fair cash value may take the form of three statutorily recognized valid valuation methods: 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 “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.* Kentucky property tax cases use these three approaches to value in determining the fair cash value of a property.

When a property is sold, the PVA will often assess the property for the value disclosed on the deed; however, the deed value is not always the same as the fair cash value. Because of this, disputes can arise regarding the value. For example, in *Haier US Appliance Solutions, Inc. v. Jefferson Co. PVA, et al.*, No. K17-S-105, Order No. K25929, reversed, No. 19-CI-4516, (Jefferson Cir. Ct.), *appealed*, 2020-CA-1234 & 1262 (Ky. App.), the Jefferson County PVA assessed a property at the value reflected on the deed, and the taxpayer contested the value. While the KBTA’s hearing officer issued a Recommended Order setting the fair cash value at an amount different than the deed value, the KBTA declined to adopt it and instead issued its Final Order setting the fair cash value at the deed value; the Jefferson Circuit Court reversed the KBTA, and both parties appealed. Clearly, reasonable minds may differ.

Somewhat recently, PVAs in several counties have been assessing leased properties at an assessment value determined using a formula that takes the contract rent of the long-term lease and divides it by a capitalization rate determined by reference to the remaining term of the lease and the creditworthiness of the tenant; when leases are at above market rates, this formula results in an assessment value that is substantially higher than nearby similar properties. Kentucky's highest court has soundly rejected this, holding that the fair cash value is the value of the property itself. *Fayette Cty. Bd. of Sup'rs v. O'Rear*, 275 S.W.2d 577 (Ky. 1954). It would seem that the O'Rear case should halt the PVA's practice.

### **Uniformity and Equal Protection**

When it seems like your property is being over-assessed or someone else's property is being under-assessed, there is somewhere to turn. The Kentucky Constitution and the United States Constitution provide protection to taxpayers with regard to their property taxes in relation to other properties. The Kentucky Constitution mandates that "[t]axes...shall be uniform upon all property of the same class subject to taxation within the territorial limits of the authority levying the tax." Ky. Const. § 171. Similarly, the United States Constitution (Equal Protection Clause of the Fourteenth Amendment) and the Kentucky Constitution (Section 2) guarantee equal protection under the laws, including Sections 171 to 174 of the Kentucky Constitution. "The Equal Protection Clause 'applies only to taxation which in fact bears unequally on persons or property of the same class.'" *Allegheny Pittsburgh Coal Co. v. Cty. Comm'n of Webster Cty., W. Va.*, 488 U.S. 336, 343 (1989).

What happens when a real property taxpayer believes that other properties are being under-assessed in violation of uniformity or equal protection? There is a procedure for such a taxpayer to request the county BAA to review assessments of such under-assessed properties, though such procedure is not limited to constitutional violations. KRS 133.120(2)(g). There is similar procedure in KRS 133.120(2)(f) for local governmental entities, though this latter circumstance does not implicate uniformity or equal protection concerns as does the former circumstance. Interestingly, in *Grant County Board of Education v. Ark Encounter, LLC*, No. 19-CI-00204 (Grant Cir. Ct. July 29, 2020), *affirming*, File No. K18-S-15, Final Order No. K-25927 (KCC May 31, 2019), the Grant County Board

of Education attempted to appeal a BAA decision to the KBTA regarding the PVA's property tax assessment of property owned by Ark Encounter, LLC. The KBTA dismissed the appeal because the Board of Education was not the PVA or a taxpayer, who has a right of appeal under KRS 133.120.

What about the opposite situation? A taxpayer's property may be over-assessed in relation to other properties; i.e., while other properties are assessed at their fair cash value, the subject property is assessed at more than its fair cash value. In such an instance, a taxpayer would raise the issue of the violation of uniformity or equal protection in disputing the value of their property, first with the PVA, then the BAA, then the KBTA, etc.

### **Constitutional Exemptions**

Exemptions from property tax are provided by the Kentucky Constitution. Section 170 provides for multiple real property tax exemptions, including: public property used for public purposes; real property owned and occupied by institutions of religion; institutions of purely public charity; and, institutions of education not used or employed for gain by any person or corporation, and the income of which is devoted solely to the cause of education. Also, while not technically an exemption, Section 172A provides "for the assessment for ad valorem tax purposes of agricultural and horticultural land according to the land's value for agricultural or horticultural use" which is provided for in KRS 132.450; the practical effect of this is that agricultural land is generally valued at a lower value. With these constitutionally-provided exemptions, disagreements between PVAs and taxpayers arise periodically regarding the scope of the exemption.

Exemption issues can arise in the context of commercial property. For example, in *Freeman v. St. Andrew Orthodox Church, Inc.*, 294 S.W.3d 425 (Ky. 2009), a question arose regarding the application of the exemption for real property owned and occupied by institutions of religion to houses being rented to individuals on property owned by a church. In holding that the rental houses did not meet the "occupied" requirement, the Kentucky Supreme Court noted that to hold otherwise "would extend the exemption to property owned by the church and rented as commercial real estate, including shopping centers

and other commercial enterprises.” Id. Real property, however, that is owned and occupied by institutions of religion would come within the clear text of the exemption.

With certain notable exceptions, “When any real ... property which is exempt from taxation is leased ... in connection with a business conducted for profit, the leasehold ...[is] subject to state and local taxation....” KRS 132.195(a). This can arise, for example, when property owned by a purely public charity is leased to a business. The question then becomes, what is the value of the leasehold? The law is well-settled that a leasehold’s fair market value for taxation purposes is obtained by subtracting the fair market value of the real property with the leasehold from the fair market value of the real property without the leasehold. *Grand Lodge of Kentucky Free and Accepted Masons, et al. v. City of Taylor Mill et al.*, 2015-CA-001617-MR (Ky. App. 2017).

Examples illustrate this concept. Suppose that the fair cash value of the property without the leasehold was \$1,000,000. If the lease is a below market lease, say for annual rent of \$1, then the fair cash value of the property with the leasehold would be \$0, and the fair cash value of the leasehold would be \$1,000,000, which would

be subject to tax. This makes sense because all of the value is in the lessee’s hands. Conversely, If the lease is an above market lease, say for annual contract rent of \$200,000 with a capitalization rate of 10%, the value of the property with the lease would be \$2,000,000 (\$200,000/10%); so, the value of the leasehold would be \$0 (the value of the property without the lease of \$1,000,000 less the value of the property with the lease of \$2,000,000), and none of the value of the fair cash property would be subject to tax. This makes sense because all of the value is in the lessor’s hands.

Note that the maximum fair cash value of the property is the value without the leasehold, which is consistent with *O’Rear, supra*.

Property tax is simple on the surface. It is all about value. However, it is really very complicated, especially since it is rooted in constitutional law.

This is a modified version of Mark A. Loyd’s regular column, *Tax in the Bluegrass*, “Kentucky Property Taxes on Commercial Real Estate” which appeared in Issue 3, 2021 of the Kentucky CPA Journal.

July 22, 2021



## STATE AND LOCAL TAX TEAM



**Mark A. Loyd**  
Chair, Tax Department  
[mark.loyd@dentons.com](mailto:mark.loyd@dentons.com)



**Bailey Roese**  
Partner  
[bailey.roese@dentons.com](mailto:bailey.roese@dentons.com)



**Brett J. Miller**  
Partner  
[brett.miller@dentons.com](mailto:brett.miller@dentons.com)



**Stephanie Bruns**  
Managing Associate  
[stephanie.bruns@dentons.com](mailto:stephanie.bruns@dentons.com)



**Jeffrey T. Bennett**  
Partner  
[jeff.bennett@dentons.com](mailto:jeff.bennett@dentons.com)



**Brad Hasler**  
Partner  
[bradley.hasler@dentons.com](mailto:bradley.hasler@dentons.com)



**Kelli A. Wikoff**  
Partner  
[kelli.wikoff@dentons.com](mailto:kelli.wikoff@dentons.com)



**Kimberly M. Nolte**  
Associate  
[kimberly.nolte@dentons.com](mailto:kimberly.nolte@dentons.com)



**Gary R. Thorup**  
Shareholder  
[gary.thorup@dentons.com](mailto:gary.thorup@dentons.com)



**Eric Smith**  
Of Counsel  
[eric.smith@dentons.com](mailto:eric.smith@dentons.com)