STATE OF TENNESSEE
OFFICE OF THE ATTORNEY GENERAL

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Opinion No. 20-10

Application of Appraisal Ratios to Real Property Assessments

Question

Proposed Senate Bill 2453, 111th Gen. Assem. (2020), as amended, would add the following sentence to Tenn. Code Ann. § 67-5-1509(a): "Except as provided in § 67-5-1302, real property assessments that are under appeal are not eligible for equalization." Is this legislation constitutional?

Opinion

The proposed amendment is constitutionally problematic because of its effect on appeals for non-reappraisal years. While locally assessed real property is not generally entitled to equalization, the proposed amendment could result in violation of the uniformity requirement of article II, section 28, of the Tennessee Constitution because it would prevent equalization through application of the county's appraisal ratio to all locally assessed real property under appeal. Since the value of property under appeal will be determined as of the year being appealed, the appraisal ratio for that county must be applied to values determined for non-reappraisal years to bring them in line with other real property in the county.

ANALYSIS

The Tennessee Constitution provides that "all property shall be taxed according to its value, upon the principles established in regard to State taxation." Tenn. Const. art. II, § 29. "The constitution does not give any clue as to how value is to be determined; instead it leaves the method of determining value to the legislature" and grants it "broad authority" to establish a valuation method. Marion County v. State Bd. of Equalization, 710 S.W.2d 521, 523 (Tenn. Ct. App. 1986). To this end, the legislature has provided that generally "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values." Tenn. Code Ann. § 67-5-601(a).

The Tennessee Constitution further provides that "[t]he ratio of assessment to value of property in each class or subclass shall be equal and uniform throughout the State, the value and definition of property in each class or subclass to be ascertained in such manner as the Legislature shall direct." Tenn. Const. art. II, § 28. In discussing this provision, the Supreme Court explained that the legislature "was given very broad discretion with respect to determining the value and definition of property in each of the authorized classifications or subclassifications." Sherwood

Co. v. Clary, 734 S.W.2d 318, 321 (Tenn. 1987); *accord In re All Assessments*, 58 S.W.3d 95, 95 (Tenn. 2000).

The Constitution designates three classes of property: real property; tangible personal property, and intangible personal property. Tenn. Const. art. II, § 28. The Constitution then divides the class of real property into four subclasses: public utility real property; commercial and industrial real property; residential real property; and farm real property. *Id.* The Constitution divides the class of tangible personal property into three subclasses: public utility, commercial and industrial, and all other tangible personal property. *Id.* Whether designated as real or personal, public utility property is in a different subclass than commercial and industrial property, residential property, and farm property.

Under the property tax code, public utility property is assessed by a different authority, on a different schedule, and by a different method than commercial and industrial property, residential property, and farm property. The Office of State Assessed Properties (OSAP), under the direction of the Comptroller, assesses all public utility property on an annual basis. Tenn. Code Ann. § 67-5-1301(b). Public utility companies are required to file with the Comptroller, by April 1 of each year, a schedule of all real and personal property owned or leased by them. Tenn. Code Ann. § 67-5-1303(a). OSAP's assessment attempts to capture the actual value of public utility property for each tax year. Tenn. Code Ann. § 67-5-1303.

The assessor of property for each county assesses all commercial and industrial property, residential property, and farm property in the county. *See* Tenn. Code Ann. §§ 67-5-801, *et seq.* (real property); §§ 67-5-901, *et seq.* (tangible personal property); §§ 67-5-1001, *et seq.* (agricultural property). Taxpayers that have commercial and industrial tangible personal property must file with the assessor, by March 1 of each year, a schedule that lists all tangible personal property and applies the appropriate depreciation percentages to that property. Tenn. Code Ann. § 67-5-903. Thus, like public utility property, commercial and industrial tangible personal property is assessed on an annual basis according to its value.[1] While all real property, whether commercial and industrial, residential, or farm, is *assessed* on an annual basis as well, Tenn. Code Ann. § 67-5-504(a), the assessor is not required to *revalue* and reappraise real property on an annual basis. Instead, the assessor conducts a reappraisal every four, five, or six years, depending on the reappraisal schedule applicable to each county. Tenn. Code Ann. § 67-5-1601(a). Between reappraisal years, the assessed value of real property generally remains unchanged.

The legislature has recognized that the intervals between reappraisal years may result in inequalities between properties whose value and assessment are determined annually and those whose value and assessment are based on a reappraisal several years in the past. Among its various duties, the State Board of Equalization is required to "[t]ake whatever steps it deems are necessary to effect the equalization of assessments, in any taxing jurisdiction within the state in accordance with the laws of the state." Tenn. Code Ann. § 67-5-1501(b)(3). As part of its duties, the State Board must "determine whether or not property within each county of the state has been valued and assessed" properly. Tenn. Code Ann. § 67-5-1605(a). To help the State Board perform this function, the Division of Property Assessments (DPA), a division within the Comptroller's office,

[1] By statute, all other tangible personal property is "deemed to have no value," Tenn. Code Ann. § 67-5-901(a)(3)(A), and the Supreme Court has held that this statute is constitutional. *Sherwood Co. v. Clary*, 734 S.W.2d 318, 321-22 (Tenn. 1987).

must "conduct appraisal ratio studies in all counties of the state at least every two (2) years unless otherwise determined by the board." Tenn. Code Ann. § 67-5-1605(b)(1). The State Board then "determine[s] the overall ratio of appraisal for property in each county of the state." Tenn. Code Ann. § 67-5-1606(a).

An appraisal ratio is the ratio between the assessed values of properties in the taxing jurisdiction and the current market values of those properties. A ratio of 1.000 represents a 1:1 relationship between appraised values and fair market values. In a jurisdiction with a 1.000 ratio, a property appraised at $100,000 would be expected to sell for $100,000. Accordingly, each county's appraisal ratio reflects the general level of valuation of its locally assessed real property as compared to the full current year value of that property.[2] The appraisal ratio set for each county is then used to equalize and compute the assessments of locally assessed commercial and industrial tangible personal property in accordance with Tenn. Code Ann. § 67-5-1509(a) and public utility property in accordance with Tenn. Code Ann. §§ 67-5-1302 and 67-5-1606.

The statute at issue, Tenn. Code Ann. § 67-5-1509(a), requires that the county's appraisal ratio be applied to locally assessed commercial and industrial tangible personal property, as well as to public utility property. The statute does not mention commercial and industrial real property, residential real property, or farm real property since it is the value of those properties to which the other annually valued properties are being equalized. The legislature has authorized various reappraisal schedules for the counties, rather than requiring annual reappraisals, based on its recognition of the administrative and financial burdens on assessors if they were required to engage in a county-wide reappraisal process each year.

While the State Board plays a major role in administering the property tax system, all property taxes in Tennessee are imposed locally by counties, cities, and a few special districts.[3] The overarching purpose of the complicated procedures discussed above is to ensure that within each taxing jurisdiction all properties of all types are valued on the same basis. This is necessary to prevent properties that are locally assessed on a reappraisal cycle (farm, residential, and commercial real property) and those that are assessed each year, either locally (commercial tangible personal property) or centrally (public utility property), from being valued unequally. The appraisal ratio determined for each county reflects how the level of valuation of its locally assessed real property compares to that of its property that is assessed at its current-year value. For example, if a county's last full reappraisal was three years in the past, the locally assessed real property in that county might be valued at only 90% of its actual value in the current tax year. So that county's appraisal ratio will be 0.900, and that ratio will be applied to all of the property in that county that is valued annually so that all property is taxed on the same basis, as if in that county's reappraisal year.

As previously noted, this process is necessary because county assessors perform real property reappraisals every four, five, or six years while commercial and industrial tangible

[2] Municipalities, special school districts, and other districts that levy property taxes use the valuations determined for county purposes. *See* Tenn. Code Ann. §§ 67-5-1701(a)(1) & -1704(a).

[3] Special districts may include "a drainage district, special school district or other special taxing district." Tenn. Code Ann. § 67-5-803.

personal property and public utility property is reappraised annually. The present statutes seek to accomplish equalization and were developed as a result of extensive litigation brought many years ago by railroads, asserting that their annual valuations discriminated against them because they were being taxed at full value while other property in the county was effectively taxed at only a fraction of full value. *See Louisville & Nashville RR Co. v. Public Serv. Comm'n*, 493 F. Supp. 162 (M.D. Tenn. 1978), aff'd, 631 F.2d 426 (6th Cir. 1980), *cert. denied*, 450 U.S. 959 (1981); *Louisville & Nashville RR Co. v. Public Serv. Comm'n*, 249 F. Supp. 894 (M.D. Tenn. 1966), *aff'd*, 389 F.2d 247 (6th Cir. 1968). The equalization granted to railroads was later extended to other taxpayers in the public utility class. *See In re All Assessments*, 58 S.W.3d 95 (Tenn. 2000). This extensive litigation over many years has resulted in the present system, designed to ensure fair treatment of all property taxpayers.

The present system also was influenced by congressional legislation that followed on the heels of the railroad litigation. In 1976, Congress passed the 4-R Act (Railroad Revitalization and Regulatory Reform Act). *See* Pub. L. No. 94-210, 90 Stat. 31. The Act prohibits the States from assessing railroad property at a value that has a higher ratio to its true market value than the ratio applicable to commercial and industrial property in the same jurisdiction. *See* 49 U.S.C. § 11501(b)(1). In 1980, Congress passed similar acts that prohibited state tax discrimination against motor carrier property, *see* 49 U.S.C. § 14502(b)(1), and airline property. *See* 49 U.S.C. § 440116(d)(2)(A)(i). Thus, the appraisal ratios must be applied to the property of railroads, motor carriers, and airlines in each county to comply with federal law.

The amendment to Tenn. Code Ann. § 67-5-1509(a) proposed by SB 2453 would specifically provide that real property for which an appeal is pending is not entitled to equalization (just as other real property in the county would not receive an adjustment based on the appraisal ratio derived by DPA). The proposed amendment is generally consistent with the principle that the appraisal ratio of a particular county is not to be applied to locally assessed real property. The whole purpose of the system is to place properties with a current-year value on the same level as locally assessed real property, which may have been valued several years beforehand. To apply the ratio to some, but not all, of that locally assessed real property would undermine that ratio in a never-ending circle. Consequently, the appraisal ratio must be applied *only* to property that has been valued as of a different year than locally assessed real property.

Many real property appeals are triggered by the reappraisal process itself. A reappraisal sometimes results in a significant increase in valuation, and a taxpayer can challenge an increase by filing an appeal with the county board of equalization. Before the county board and the State Board of Equalization, the taxpayer has the burden of showing the property's correct market value for the year of the reappraisal. *See Dooly v. State Bd. of Equalization*, No. E2012-01022-COA-R3-CV, 2013 WL 1799962, at *4 (Tenn. Ct. App. Apr. 29, 2013), *perm. app. denied* (Tenn. Oct. 16, 2013). Once that market value is proven, it becomes the property's new value just as if it had been reappraised at that value. Granting equalization by applying an appraisal ratio determined for a later year would not promote uniformity. To the contrary, it could create non-uniformity because real property whose value was not appealed in the reappraisal year does not receive an adjustment.

Nevertheless, the proposed amendment's blanket ban on equalization for all real property under appeal may pose constitutional uniformity problems for appeals that are not triggered by a reappraisal. For example, if a property is sold in the third year of a reappraisal cycle, the new owner may wish to appeal the assessment. Similarly, improvements made to real property after the general county reappraisal might be the subject of a current-value appeal. In these instances, the owner would be required to prove the actual market value for that tax year. Once established, that market value should be entitled to equalization to the extent that an appraisal ratio applies in the taxing jurisdiction.

Consistent with the foregoing discussion, and consistent with existing State Board of Equalization precedent, *see In re Appeals of Laurel Hills Apts., et al.*, slip op. at 1 (State Bd. of Equalization Apr. 10, 1984), equalization would be required because the property would have been valued in the tax year under appeal rather than the reappraisal year that established values for all other real property. Denying equalization under these circumstances would violate the Constitution's uniformity requirement, since it would result in real properties in the same classification and for the same year being valued, assessed, and taxed on different bases.

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