

Legislative Council Staff Brief



Study Committee on Property Tax Assessment Practices

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INTRODUCTION

The Joint Legislative Council has directed the Study Committee on Property Tax Assessment Practices to review current property tax assessment practices, including the review of statutory, administrative, and judicial directives on assessment practices and the consistency of assessment practices throughout the state. This Staff Brief provides background and discussion relevant to the study committee's charge.

Property tax constitutes Wisconsin's largest single source of state or local revenue. Assessment is a crucial component of local property tax administration in Wisconsin. Local assessors determine a property's value using statewide assessment practices prescribed by the Department of Revenue (DOR). Those assessments are then subject to an aggregate review and "equalization" at the state level.

Generally, property tax assessment is based on a property's market value. Various legal and policy questions have arisen over the past decade regarding the determination of market value for certain types of property. Specifically, Wisconsin courts have grappled with questions relating to the extent to which a lease affects a property's market value, if any, and in what circumstances vacant properties should be used as points of comparison for commercial properties.

The Staff Brief includes the following parts:

- **Part I** summarizes current law and practice regarding property tax assessment, with a particular focus on the assessment of property that raises the questions noted above.
- **Part II** provides an overview of relevant case law.
- **Part III** describes relevant legislative proposals introduced in the 2017 Legislative Session.
- **Part IV** offers a nonexhaustive discussion of issues the committee may choose to consider as it carries out its charge.

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PART I – BACKGROUND AND CURRENT LAW

AUTHORITY TO LEVY PROPERTY TAX

The Wisconsin Constitution authorizes the Legislature to empower municipalities to “collect and return taxes on real estate.” [Wis. Const. art. VIII, s. 1.] The Legislature has done so through various statutes, which authorize local government entities, including counties, cities, villages, towns, school districts, technical college districts, and certain other special purpose districts, to levy taxes.

Chapter 70, Stats., sets forth various requirements, procedures, and exemptions applicable to property taxation throughout the state. The chapter requires property taxes to be levied on all general property within the state, except property that is exempt from taxation. “General property” means all taxable real and personal property, except certain property enrolled in the managed forest and forest cropland programs and property subject to the net proceeds occupation tax for metallic minerals extraction. “Real property” generally includes “not only the land itself but all buildings and improvements thereon, and all fixtures and rights and privileges appertaining thereto.”¹ [ss. 70.01, 70.02, and 70.03, Stats.]

REQUIREMENT OF UNIFORMITY

With certain exceptions,² the Uniformity Clause of the Wisconsin Constitution requires property taxation to “be uniform.”³ [Wis. Const. art. VIII, s. 1.] The Wisconsin Supreme Court set forth the general principles of the Uniformity Clause in *Gottlieb v. Milwaukee*, in which it held that, for direct taxation of property, there can be but one constitutional class, and all property not included in that class must be absolutely exempt from property taxation. The court further held that all property within that class (i.e., all property subject to property taxation) “must bear its burden equally on an *ad valorem* basis.” [147 N.W.2d 633 (1967).] Subsequent Wisconsin Supreme Court decisions have further addressed whether particular governmental actions constitute unconstitutional partial property tax exemptions.

Statutorily designated property tax exemptions are set forth in s. 70.11 and 70.111, Stats. Section 70.11, Stats., which applies to real property, currently provides 61 categories of property that are wholly exempt from property tax under state law.

¹ “Personal property” includes all goods, wares merchandise, chattels, and effects, of any nature or description, having any real or marketable value, that are not real property. [s. 70.04, Stats.]

² The Wisconsin Constitution expressly exempts agricultural and undeveloped land from the uniformity requirement, and it authorizes certain personal property to be taxed differently than real property.

³ In contrast, the Wisconsin Constitution authorizes income tax to be imposed on a graduated and progressive basis. [Wis. Const. art. VIII, s. 1.]

PROPERTY TAX ADMINISTRATION

Primary administration of the state property tax system occurs at the local level, with oversight provided by DOR. Using statewide assessment practices prescribed by DOR, a property's value is determined by a local assessor, followed by aggregate review and "equalization" by DOR.⁴

Tax Assessors

Chapter 70, Stats., provides for the election of local property tax assessors. Tax assessors for towns, villages, cities, and counties must be certified by DOR before they may assume office. [s. 70.05 (1), Stats.] An assessor must annually assess all real and personal property within the assessor's jurisdiction.

Submission and Objections

An assessor must complete assessments by the first Monday in April and deliver the assessment roll (to the city, village, or town clerk the list of all taxable property and its assessed value) by the first Monday in May. [s. 70.50, Stats.] In populous cities, which may have a board of assessors to process objections to property tax assessments, assessments must be finally completed before the first Monday in April. [s. 70.10, Stats.]

After assessments are completed, the relevant municipal clerk notifies property owners, generally by newspaper publication, of when the assessment roll will be open for public inspection. The period when the assessment roll is open for public inspection is generally known as "open book." Property owners may discuss their assessments with assessors during the open book period.

A property owner may contest an assessment by filing an objection with the local board of review.⁵ A board of review may raise or lower an assessment in light of relevant evidence. DOR may also review an assessment in certain circumstances. A taxpayer may then appeal a final tax assessment decision in circuit court. [ss. 70.47 and 70.85, Stats.]

Calculation of Tax

Calculation of individual property tax bills begins with computation of local mill rates, determined by dividing a taxing jurisdiction's total tax levy by the total value of its assessed property. For an individual property subject to property tax, the total tax due is calculated by applying the mill rate of each taxing jurisdiction to the assessed value of the property. In recent years, most political subdivisions have been subject to a statutory "levy limit." Under that limit, with certain exceptions, a political subdivision may not increase its levy by a percentage that exceeds the political subdivision's valuation factor for the year.⁶ [s. 66.0602 (2), Stats.] As a result, a political

⁴ However, DOR assesses manufacturing property. [s. 70.995, Stats.]

⁵ In cities and villages other than the City of Milwaukee, a board of review consists of the mayor or president of the village board, the municipal clerk, and any other municipal officials as determined by city or village ordinance. In towns, the town board supervisors and town clerk comprise the membership of the board of review. Property tax assessors may not be members of the board of review. [s. 70.46, Stats.]

⁶ A political subdivision's "valuation factor" is the greater of either: (a) the percentage change in equalized value due to new construction less improvements removed between the previous year and the current year; or (b) zero percent. [s. 66.0602 (1) (d) and (2), Stats.]

subdivision may only increase its levy limit from one year to the next if it experiences a net increase in equalized value or if the increase is approved by referendum.

Assessment

Reliance on Wisconsin Property Assessment Manual

The Wisconsin statutes require tax assessors to value real property in the manner specified in the Wisconsin Property Assessment Manual (WPAM) developed by DOR. The WPAM must “discuss and illustrate accepted assessment methods, techniques and practices with a view to more nearly uniform and more consistent assessments of property at the local level.” [ss. 73.03 (2a) and 70.32 (1), Stats.]

Assessment Based on “Full Value” at “Highest and Best Use”

For residential and commercial property, an assessment must reflect “the full value which could ordinarily be obtained therefor at private sale.”⁷ [s. 70.32 (1), Stats.] The WPAM defines “full value” to mean “the value at 100% of the value standard.” For residential and commercial property, the value standard is the same as market value. [See, WPAM at 9-7 (2018).]

In determining market value, an assessor must consider all of the following criteria:

- Any recent arm’s-length⁸ sales of the property to be assessed, if, according to professionally acceptable appraisal practices, those sales conform to recent arm’s-length sales of reasonably comparable property.
- Recent arm’s length sales of reasonably comparable property.
- The effect on the value of the property of a shore land zoning ordinance, conservation easement, or federal conservation restriction.
- The impairment of the value of the property because of the presence of a solid or hazardous waste disposal facility or because of environmental pollution.
- All other factors that, according to professionally acceptable appraisal practices, affect the value of the property to be assessed.

[s. 70.32 (1), (1g), and (1m), Stats.]

Interpreting Wisconsin case law, the WPAM specifies that for land valuation, land must be “valued as if available for development to its highest and best use – that most probable, legal use which will yield the greatest net return” The WPAM further specifies that the “use must be acceptable to the market and must conform to existing zoning and land use ordinances,” and that “[i]f an existing building cannot generate a return sufficient to support the land, the cost of demolition of the building must be deducted from the value of the land.” [WPAM at 13-7 and 13-8.]

⁷ Certain other classes of property, including agricultural land, agricultural forest land, and undeveloped land, are assessed at less than full value. [s. 70.32 (2r) and (4), Stats.]

⁸ An “arm’s-length” transaction is a sale in the open market between an owner willing but not obliged to sell and a buyer willing but not obliged to buy. [*Darcel, Inc. v. Board of Review*, 137 Wis. 2d 623, 627 (1987).]

Three-Step Process

Assessors must use a three-step process, sometimes referred to as the “*Markarian* approach,” when assessing a property to determine its full value at its highest and best use. [See, generally, s. 70.32, Stats.; *Nestlé USA, Inc. v. Wisconsin Department of Revenue*, 2011 WI 4, ¶¶ 25-30; and *State ex rel. Markarian v. City of Cudahy*, 45 Wis. 2d 683 (1970).] The first step in the process is to base the assessment on any recent arm’s-length sale of the subject property.

If the subject property has not been recently sold, an assessor must next consider sales of reasonably comparable properties. When arms-length sales of comparable property have occurred in the market, this “sales comparison approach” is theoretically the best method of approximating a property’s market value. In practice, identifying which sales are sufficiently “comparable” as to provide a fair estimation of market value can be difficult. (See, for example, the situation in the *BonStores* case, discussed in Part II.) The WPAM also includes this warning: “when using the sales comparison approach with leased properties, it is important to know the income and expenses of each property. A property that appears to be comparable may in fact not be if the income and/or expenses are not at market levels due to differences in the bundle of rights being transferred.” [WPAM at 13-13.]

If an assessor determines that no comparable sales are present, an assessor may turn to step three - a “cost” or “income” assessment approach. The cost approach is “the value of the land plus the cost of the improvements minus any depreciation.” Such depreciation must account for any “functional obsolescence.” The income assessment approach aims to estimate a property’s value based on the income generating potential of the property. The WPAM states that the income approach is the preferred approach if an assessor must reach the third step in the assessment process. [WPAM at 13-15.]

Accounting for Special Financing Arrangements

Special financing arrangements, such as above-market leases, can complicate the third step of the assessment process, described above. The WPAM cautions assessors to remove “the effects of ... creative or atypical financing,” whether positive or negative, and identifies examples of instances when “contract rent” might not be a reliable measure of “market rent” for purposes of the income assessment approach, including when leases include items not related to the real property. [WPAM at 13-16 and 13-17.] Wisconsin courts have addressed that issue in various cases, including certain cases discussed in Part II.

PART II – RELEVANT CASE LAW

Various Wisconsin court decisions – both published and unpublished – may be relevant to the study committee’s discussion. Generally, an unpublished opinion is only binding as to the particular case it addresses; it is not law with precedential effect. However, certain unpublished opinions issued after July 1, 2009 may be cited as persuasive in future cases. [s. 809.23 (3) (b), Stats.]

DECISIONS RELATING TO FINANCING TERMS AND LEASES

Flood v. Board of Review

In a 1990 decision, *Flood v. Board of Review*, the Wisconsin Supreme Court held that the Wisconsin statutes prohibit assessing real property in excess of market value. In the case, a village board of review sustained an assessment of a mobile home park based on the sale price in an arms-length transaction. The owner appealed the board’s decision in circuit court, arguing that the sale price was higher than the property’s market value because it reflected the value of favorable financing terms. The Wisconsin Supreme Court agreed with the plaintiff (owner) in the case, holding that s. 70.31 (1), Stats., requires an assessor to consider whether financing terms affect a property’s sale price. [153 Wis.2d 428 (1990).]

Darcel, Metropolitan Holding, and West Bend

In a trio of cases in the late 1980s and early 1990s, the Wisconsin Supreme Court and the Wisconsin Court of Appeals addressed the effect of below-market leases and other financial encumbrances on commercial property tax assessments. In different factual circumstances, the courts in all three cases held that below-market leases and other financial encumbrances should be taken into account when assessing a real property’s market value. [*Darcel, Inc. v. Board of Review*, 137 Wis.2d 623 (1987); *Metropolitan Holding Co. v. Board of Review*, 173 Wis.2d 626 (1993); *City of West Bend v. Continental IV Fund Limited Partnership*, 193 Wis.2d 481 (Ct. App. 1995).]

Waste Management v. Kenosha County Review Board

In a 1994 case, *Waste Management v. Kenosha County Review Board*, an assessor used the income approach to assess the value of a landfill. The question in the case was whether the business value of the landfill should be included in the assessment of real estate value. The Wisconsin Supreme Court answered that question affirmatively, holding that the value of the landfill business was “inextricably intertwined” with the land. [184 Wis.2d 541 (1994).] However, courts have distinguished the *Waste Management* decision in some more recent decisions involving specialty retail properties.

Walgreen Corporation v. City of Madison

In *Walgreen Co. v. City of Madison*, 2008 WI 80, the Wisconsin Supreme Court considered the role of leases, actual rent, and “creative financing arrangements” on assessment. While the *Walgreen* Court noted the legislative authority to determine the appropriate methods for valuing

property for tax purposes, the Court discussed prior cases and the distinction between valuation of real property and valuation of a business concern as applied to leased property. Specifically, the court distinguished an above-market lease, at issue in *Walgreen Co.* from the below-market lease and other financial encumbrances at issue in *Metropolitan Holding, West Bend, and Darcel*. The Court held that leased property must be assessed under the income approach in terms of market rent, rather than actual rent, unless the actual rent is lower than market rent. The Court also cited the strict construction of tax statutes to hold that “creative financing arrangements” such as sale-leaseback transactions should be distinguished from other “ordinary” transactions for purposes of establishing property value under the applicable law. [2008 WI 80, at ¶¶ 19, 54-75, and 82-85.]

Walgreen Corporation v. City of Oshkosh

The Wisconsin Court of Appeals characterized a 2014 unpublished opinion, *Walgreen Co. v. City of Oshkosh*, as examining “one skirmish in the war between Walgreen Co. and tax assessors throughout Wisconsin over how real property taxes are assessed against the national drugstore giant.” In the opinion, the court held that the City of Oshkosh had failed to adhere to the 2008 Walgreen decision, because the city’s assessments relied on sale prices and leases that included contractual rights that inflated the properties’ value. The court held that the city had improperly confined the “market” for comparable properties to other “investment-grade” real estate, rather than basing its market value determination on the “broader retail market.” [2014 WI APP 54, ¶ 1-2.]

CVS Pharmacy, Inc. v. City of Appleton

Like the previous case, *CVS Pharmacy, Inc. v. City of Appleton* is an unpublished opinion relating to the assessment of a national drugstore property that included an above-market rental agreement. Also applying the 2008 Walgreen decision, the Wisconsin Court of Appeals held that the city should not have taken an above-market lease into account when assessing the value of the property. [2015 WI APP 76.]

DECISIONS RELATING TO COMPARABLE PROPERTIES

Nestle USA, Inc. v. Wisconsin Department of Revenue

In a 2011 decision, *Nestle USA, Inc. v. DOR*, the Wisconsin Supreme Court considered the assessment of an infant formula manufacturing facility, and discussed concepts relating to the specific market in which a property may be situated, as well as the assessor’s national search for comparable properties in upholding the assessor’s decision. DOR’s assessor noted that the facility had “a number of expensive features which made it specially suited to produce powdered infant formula.” Because the assessor could not locate any other powdered infant formula facilities in the United States that had been sold to a purchaser who planned to continue to use the facility to produce powdered infant formula, the assessor concluded that there were no comparable properties, requiring him to use the cost assessment method rather than the comparable sales method.

The Court noted that an absence of recent sales does not necessarily indicate the absence of a specific market; in this case, a market specifically for infant formula manufacturing facilities relative to the market for general food manufacturing facilities. The Court also held that a property's "highest and best use must be legal, complementary, not highly speculative, and marketable for that use." [2011 WI 4.]

Bonstores Realty One, LLC v. City of Wauwatosa

In a 2013 decision, *Bonstores Realty One, LLC v. City of Wauwatosa*, the Wisconsin Court of Appeals affirmed a Milwaukee County Circuit Court decision relating to the assessment of the Boston Store at Mayfair Mall. In its decision, the Court of Appeals specifically stated that it was not error for the circuit court to deem reliance on comparison to "dark" stores to be unreliable with regard to assessment of a property that itself was not dark. [2013 WI APP 131, ¶ 22; see also, WPAM at 13-12 and 13-13.]

PART III – RECENT LEGISLATION

Two sets of companion bills introduced during the 2017 Legislative Session relate to the study committee’s charge: (1) 2017 Senate Bill 291 and 2017 Assembly Bill 386 (“lease bill”); and (2) 2017 Senate Bill 292 and 2017 Assembly Bill 387 (“comparable sales bill”). The lead authors for both bills were Representative Robert Brooks and Senate President Roger Roth. Both bills received public hearings in their respective Senate and Assembly committees, but no action was taken on the bills by the full Assembly or Senate.

LEASE BILL

As introduced, the lease bill revises certain definitions and makes other changes to general assessment practices. Specifically, it does all of the following:

- Revises statutory definitions of “real property,” “real estate,” and “land” to include leases and other assets that cannot be taxed separately as real property, but are inextricably intertwined with the real property, enable the real property to achieve its highest and best use, and are transferable to future owners. The bill defines “lease” to mean a right in real estate that is related primarily to the property and not to the labor, skill, or business acumen of the property owner or tenant.
- Specifies that real property must be valued by the assessor in the manner specified by the property assessment manual **at its highest and best use**.
- Defines “highest and best use” for the above provision and the definition of “real property,” “real estate,” and “land” to mean the specific current use of the property or a higher use to which the property can be expected to be put in the immediate future, if the use is legally permissible, physically possible, and financially feasible and provides the highest net return. When the current use of a property is the highest and best use, the bill specifies that the value in the current use equals full market value.
- Defines “arm’s-length sale” for purposes of determining value under s. 70.32 (1), Stats., to mean a sale between a willing buyer and willing seller, neither being under compulsion to buy or sell and each being familiar with the attributes of the property sold.
- In determining the value of leased real property, specifies that an assessor must consider lease provisions and actual rent pertaining to a property and affecting its value, including sale and leaseback provisions, if all such lease provisions and rent are the result of an arm’s-length transaction involving persons who are not related under Section 267 of the Internal Revenue Code for the year of the transaction. The bill defines “arm’s-length transaction” to mean an agreement between willing parties, neither being under the compulsion to act and each being familiar with the attributes of the property.

During the legislative process, the Senate Committee on Revenue, Financial Institutions, and Rural Issues voted to recommend an amendment to the bill. **As amended** by the committee, the bill

defines “highest and best use” to mean the “use of the property as of the current assessment date,” rather than the “current use of the property” under the bill as introduced. Similarly, the amended bill modifies the timeframe in which a property is expected to be put to a higher use to “before the next assessment date,” rather than “in the immediate future” under the bill as introduced. The amendment also clarifies that “legally permissible” use does not include a conditional use that has not been granted as of the assessment date. Finally, the amendment clarifies that “highest and best use” does not include highly speculative uses. That last change mirrors general recommendations in the WPAM, which are in turn informed by the Wisconsin Supreme Court’s decision in *Nestle U.S.A.*, described above.

COMPARABLE SALES BILL

Under current law, assessors must use the three-step process, discussed in Part I, above, to determine a property’s full value at its highest and best use.

As introduced, the comparable sales bill specifies new property tax assessment practices applicable to the determination of the value of property using generally accepted appraisal methods. In particular, the bill specifies that an assessor must consider the following as comparable to the property being assessed:

- Sales or rentals exhibiting the same or similar highest and best use as the property being assessed, with placement in the same real estate market segment. The bill defines “real estate market segment” to mean a pool of potential buyers and sellers that typically trade in properties similar to the property being assessed, including buyers who are investors or owner-occupants. The bill also specifies that the pool of potential buyers may be found locally, regionally, nationally, or internationally. The bill defines “highest and best use” to mean a use that is legally permissible, physically possible, and financially feasible and that provides the highest net return.
- Sales or rentals of property that are similar to the property being assessed with regard to age, condition, use, type of construction, location, design, physical features, and economic characteristics, including similarities in occupancy and the ability to generate income. The bill specifies that such properties may be found locally, regionally, or nationally.

Additionally, the bill specifies that a property may not be considered as comparable if any of the following conditions apply:

- At or before the time of sale, the seller placed any deed restriction that changes the highest and best use of the property so that it is no longer comparable.
- At or before the time of sale, the seller placed a deed restriction that substantially impairs the property’s marketability.
- The property is dark property, if the property being assessed is not dark property. The bill defines “dark property” to mean property that is vacant or unoccupied beyond the

normal period for property in the same real estate market segment and specifies that the consideration of whether a property is vacant or unoccupied beyond the normal period may vary depending on the property location.

For purposes of the bill, the bill defines “highest and best use” as “a use that is legally permissible, physically possible, and financially feasible and that provides the highest net return.”

The Senate Committee on Revenue, Financial Institutions, and Rural Issues voted to recommend an amendment to the bill. Specifically, the committee modified the definition of “highest and best use,” with changes similar to the definitional changes made to the lease bill. **As amended** by the committee, the bill defines “highest and best use” as “the specific use of the property as of the current assessment date or a higher use to which the property can be expected to be put in before the next assessment date, if the use is legally permissible, physically possible, not highly speculative, and financially feasible and provides the highest financial return.” The bill, as amended, specified that when the current use of a property is the highest and best use of that property, value in the current use equals full market value. The bill, as amended, also clarified that “legally permissible” does not include a conditional use that has not been granted as of the assessment date.” Finally, the bill, as amended, clarifies that a property subject to a deed restriction that prohibits competition is not comparable with a property that does not have such a restriction.

PART IV – POTENTIAL QUESTIONS FOR CONSIDERATION

The Wisconsin Supreme Court has noted that “the power to determine the appropriate methodology for valuing property for taxation purposes lies with the Legislature. [*Walgreen Co. v. City of Madison*, 2008 WI 80 at ¶ 19.] Informed by recent case law, the study committee’s charge prompts difficult questions for consideration. With respect to certain questions, the study committee may also wish to consider whether to recommend or disregard approaches in the legislative proposals discussed in Part III.

Below is a nonexhaustive discussion of preliminary questions the study committee may wish to consider as part of its charge.

GENERAL CLARIFICATION OF TERMS AND CRITERIA

Litigants and other interested parties from various perspectives have advocated a need for general clarification of terms in the statutes or the WPAM. For example, some parties have argued that the WPAM inadequately describes the role of income-based valuations in the three-step *Markarian* approach to tax assessment. The study committee may wish to consider whether general terms or instructions need to be clarified.

CREATIVE FINANCING TOOLS

The study committee may wish to consider how, if at all, existing statutes should be modified to account for the presence of creative financing tools, including certain types of above-market leases, on market value. As part of that discussion, the study committee may wish to address whether the approach under the 2008 *Walgreen Co.* decision should be confirmed or modified. The study committee may also wish to consider whether a single approach should apply to all above-market leases, or whether a more nuanced approach could be developed.

COMPARABLE PROPERTIES

The study committee may wish to consider how, if at all, property tax assessment practices should be modified or clarified to account for the unique real property needs of large retailers. In doing so, the study committee might consider whether any aspect of the approach taken in recent, unpublished judicial opinions should be confirmed or modified.