



WISCONSIN LEGISLATIVE COUNCIL STUDY COMMITTEE MEMORANDUM

TO: MEMBERS OF THE STUDY COMMITTEE ON PROPERTY TAX ASSESSMENT PRACTICES

FROM: Scott Grosz, Principal Attorney, and Anna Henning, Senior Staff Attorney

RE: Topics for Committee Discussion

DATE: August 30, 2018

This memorandum summarizes potential topics of discussion for the September 6, 2018, meeting of the Study Committee on Property Tax Assessment Practices. The memorandum provides a preliminary, non-exhaustive list of topics, compiled from issues raised by presenters and committee members during the study committee's August 7, 2018, meeting.

CHALLENGES OF FINDING COMPARABLE PROPERTIES FOR "SPECIAL PURPOSE" OR "BUILD-TO-SUIT" IMPROVEMENTS

Generally, Wisconsin property tax assessors must use a three-step "*Markarian* approach," when assessing property. Briefly, the approach requires an assessor to base an assessment on the following data, applied in stepwise order: (1) recent, arm's-length sales of the subject property; (2) recent, arm's-length sales of reasonably comparable properties; and (3) other factors. [s. 70.32, Stats.; *Nestlé USA, Inc. v. Wisconsin Department of Revenue*, 2011 WI 4, ¶¶ 25-30; *State ex rel. Markarian v. City of Cudahy*, 45 Wis. 2d 683 (1970).]

With respect to the second step of the approach, locating comparable sales has created unique challenges in the context of commercial buildings designed to suit a particular company's business model. Taxpayers for special purpose properties might argue that there is no "market" for their particular special purpose property; rather, a broader market – e.g., for vacant commercial buildings in the relevant area – should be used when assessing special purpose properties in step two of the *Markarian* approach. For example, if a building constructed to hold a Walgreens store is arguably only suitable for a Walgreens store, and no other business enterprise, then it can be argued that the building is worth no more, and perhaps even less, than a vacant building would be worth in a similar location.

The Wisconsin Supreme Court arguably rejected that argument in *Nestlé USA, Inc. v. Department of Revenue*, 2011 WI 4. In that case, a state assessor considered whether to use the sales comparison approach or move to step three of the *Markarian* approach with respect to a

newly constructed manufacturing facility for powdered infant formula. Noting that the facility had “a number of expensive features which made it specially suited to produce powdered infant formula,” the assessor concluded that: (1) the facility’s highest and best use was as a powdered infant formula facility; and (2) no comparable sales of powdered infant formula facilities existed in the United States. For that reason, the assessor concluded that there were no recent, comparable sales in the powdered infant formula market, and therefore the assessment must turn to step three of the *Markarian* approach. The Wisconsin Supreme Court agreed, rejecting Nestle USA, Inc.’s argument that there was no “market” for powdered infant formula facilities and, therefore, that the appropriate market to be used was a broader market for general food manufacturing facilities.

The committee could consider whether the second step of the *Markarian* approach – assessment based on comparable sales – is being fairly interpreted by the courts, and, if not, whether it could be modified to account for the unique nature of special purpose properties, or whether it should be disregarded entirely for such properties. Relatedly, the committee could consider whether any statutory requirements should be created regarding when the second step of the *Markarian* approach must be used, for example by codifying or overturning the Wisconsin Supreme Court’s holding in *Nestle*.

INCOME- VERSUS COST-BASED ASSESSMENT IN STEP THREE OF MARKARIAN APPROACH

An assessor reaches the third step of the *Markarian* approach, discussed above, only if sales data is not available for the first two steps. Two step-three assessment methods recognized by the Wisconsin Property Assessment Manual (WPAM) include the “cost approach” and the “income approach.” The cost approach considers the value of the land, plus the cost of the improvements, minus any depreciation. The income approach estimates a property’s value based on the income generating potential of the property. The WPAM states that the income approach is preferred approach in step three. [WPAM at 13-15.]

The committee could discuss whether there are instances in which a cost-based approach would be preferable to an income-based approach in step three of *Markarian* assessment. Alternatively, or in addition, the committee could discuss whether the income approach should be refined (see below).

CHALLENGES OF INCOME-BASED ASSESSMENT AS APPLIED TO SPECIAL PURPOSE PROPERTIES AND TRIPLE-NET LEASES

As mentioned, an income assessment approach aims to estimate a property’s value based on the property’s income generating potential. Wisconsin statutes define “real property” to include not only the land and physical improvements, but also all “rights and privileges appertaining thereto.” [s. 70.03, Stats.] In the absence of reliable sales data, the value of a rental lease provides one estimate of a property’s value in the applicable real estate market.

However, in some cases, Wisconsin courts have held that a lease is not a reliable indicator of property value when a lease includes “above market” value. [See especially, *Walgreen Co. v. City of Madison*, 2008 WI 80.] In other words, while a market rate lease may be a reliable

indication of a property's income generating potential, some leases are structured to incorporate items, including, for example, the value of a creditworthy tenant, that arguably make the lease "above market."

The committee could discuss whether the income-based approach to assessment could be modified to avoid including above market items. For example, are there situations in which revenues or other evidence could be used to estimate income, rather than a lease? If the committee considers creating special approaches for entities subject to triple-net leases or other creative financing arrangements, it will need to bear in mind the constraints of the Uniformity Clause of the Wisconsin Constitution.

IMPACT OF FEDERAL TAX LAW INCENTIVES

During the August 7, 2018, meeting of the study committee, some committee members mentioned the effects of certain federal tax requirements on real estate financing, and the relevance of those effects with respect to the manner in which real estate leases and sales are structured. For example, a real estate deal may be structured so as to ensure a maximum amount of capital gains taxes may be deferred under Section 1031 of the Internal Revenue Code. Similarly, if a real estate purchaser is a real estate investment trust (REIT), there may be an incentive to characterize a great number of elements in a sale as a real estate investment to comply with federal law requiring a REIT to invest a minimum amount in real estate.

The committee may wish to discuss whether any state tax assessment policy could be created to account for those federal tax incentives, or, stated another way, whether federal tax filings could be used to determine real estate value in complex commercial transactions.

TRAINING REQUIREMENTS FOR ASSESSORS

At the August 7, 2018, meeting, the Department of Revenue (DOR) presented information and answered committee members' questions regarding the certification, training, and oversight of local tax assessors. Committee members also noted that a relatively large number of local assessors are contractors rather than municipal employees.

The committee could discuss whether any new, statutory training requirements should be added for property tax assessors.

POTENTIAL STATE OR COUNTY ROLE FOR COMPLEX COMMERCIAL ASSESSMENTS

Currently, DOR conducts assessment for the following categories of property: manufacturing, telecommunications, power companies, air carriers, railroads, pipelines, and municipal electric. All other property tax assessment is conducted by local assessors.

The committee could discuss whether any types of complex commercial property assessments might be better conducted at the state or county level than at the local level. Alternatively, or in addition, the committee could discuss whether the administration or cost of appeals and litigation relating to local property tax assessments could be shared or redistributed.

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