Avoiding Procedural Quagmires in Property Tax Appeals—Kentucky Case Studies

Jennifer S. Smart, Esq.

Property tax appeal procedures are often complex, and they may involve traps for the unwary taxpayer/property owner or for the taxpayer's legal counsel. Some states, such as Kentucky, have more complicated procedural requirements in place for real property taxes than for tangible personal property taxes. Experience and expertise regarding these specific procedural steps are necessary in order to perfect all types of property tax appeals. Such experience and expertise are important in order to avoid missteps that may prove fatal to the successful property tax appeal.

Introduction

To state the obvious, state and local property taxes are a significant cost of owning property, whether real estate or tangible personal property. For example, in Kentucky, a business owning real or tangible personal property valued at $50 million would likely be assessed $600,000 in property taxes, assuming a property tax rate of $1.20 per $100 of value.

To add insult to injury, real property is frequently over-assessed, especially in a depressed economy. Nonetheless, real property assessments can often be significantly reduced after a taxpayer challenge. Even tangible personal property assessments may be challenged if the property is overvalued or misclassified.

For example, in Kentucky, many taxpayers have been successful in challenging tangible personal property tax assessments regarding various misclassification issues.

If property is exempt from tax, a successful challenge can reduce the invalid assessment to zero. Similarly, if a taxpayer has inadvertently overpaid its property tax, then all the proper procedural steps should be carefully followed. And, the timely filing of a refund claim is particularly important.

This discussion describes the complex procedures involved in challenging property tax assessments and in obtaining refunds. This discussion focuses on recent Kentucky court decisions.

Taxpayer Required to Hold PVA Conference in Year in which Assessment Issued in Real Property Case

The first judicial decision was issued after years of litigation. In that case, the Kentucky Supreme Court unanimously held that, in order to appeal a tax assessment on real property, a taxpayer must request a conference with the Property Valuation Administrator (PVA).

The conference must be requested during the two-week open inspection period in the specific year that the tax assessment was made. Otherwise, the taxpayer may never dispute that tax year's assessment again. This decision was reached in *Cromwell Louisville Associates, LP v. Commonwealth of Kentucky, Jefferson County Property Valuation Administrator*.[1]

The facts of this case are as follows. Cromwell Louisville Associates, LP ("Cromwell") owned two parcels of property in Jefferson County, Kentucky. The Jefferson County PVA assessed both parcels as of January 1, 2001, for the 2001 tax year,

increasing the combined assessment of value by nearly $5,000,000 from the prior tax year.

The PVA later assessed these parcels in both 2002 and 2003 at the same value it used for 2001.

In May 2002, Cromwell contested both the 2001 and 2002 assessments to the PVA during the 2002 inspection period. After no adjustment, Cromwell then appealed both assessments to the Jefferson County Board of Assessment Appeals (BAA).

The BAA reassessed the value of the parcels for the 2002 tax year but declined to address the 2001 assessment. Cromwell then appealed both the 2001 and 2002 assessments to the Kentucky Board of Tax Appeals (KBTA).

The KBTA held that Cromwell's appeal of the 2001 assessment was untimely. This is because the appeal was not challenged before the PVA in a conference during the two-week inspection period in 2001. Therefore, the KBTA dismissed the appeal.

Cromwell then appealed the KBTA decision to Jefferson Circuit Court, claiming that the KBTA erroneously determined that the appeal of the 2001 assessment was untimely. The Circuit Court held that the 2001 appeal *was* timely. This was because, in the Circuit Court's view, the statutes concerning challenges to property tax assessments did not contain specific language. That specific language required that the appeal to the PVA must occur within the inspection period *of the same year* as the challenged tax assessment.

The PVA then appealed the Circuit Court's decision to the Kentucky Court of Appeals. The Court of Appeals reversed the Circuit Court and remanded the case for dismissal. Cromwell then sought discretionary review with the Kentucky Supreme Court.

After the appeal was pending for months, the Supreme Court granted review.

As in most states, Kentucky provides taxpayers a statutory right to inspect the real property tax rolls during a certain time period each year. In Kentucky, the inspection period is the first 13 days of May each year.[2]

Additionally, as in most other states, a taxpayer may appeal a real property tax assessment only after it requests a conference with the PVA "prior to or during the inspection period provided for in KRS 133.045."[3]

Cromwell argued (1) that this "inspection period" restricts only the period of days and (2) that it does not restrict the taxpayer to the year of the assessment. Cromwell also argued that an initial conference and subsequent appeal challenging the property assessment could properly occur under the statutory procedural scheme.

Cromwell's position was that the conference was timely because the requested the initial conference (KRS 133.120(1)(a)) within the first 13 days of May (KRS 133.045(1)) and within two years of payment of the taxes under the controlling tax refund statute (KRS 134.590)(2)(6).

Therefore, Cromwell contended that, by requesting a conference the year after the property tax assessment, it complied with all of these statutes. Cromwell further argued that if the Supreme Court did not reverse the Court of Appeals, taxpayers would only have 13 days during the inspection period to challenge improper property tax assessments.

In its response, the PVA adopted the reasoning of the Court of Appeals. The PVA argued that the only reasonable reading of the assessment appeal procedures defined in KRS 133.120, which references KRS 133.045's current year language, requires that each tax year must stand on its own.

Further, the PVA argued that KRS 134.590, the refund statute, is not a substitute for KRS 133.120 and that Cromwell's failure to perfect its appeal by holding a conference with the PVA during the same tax year as the assessment was fatal to the taxpayer's position.

The Kentucky Supreme Court agreed with the PVA position. The Supreme Court began by quoting Benjamin Franklin, "in this world nothing can be said to be certain, except death and taxes." The Supreme Court then noted that what was less certain was the applicable time period each taxpayer has each year to challenge annual property tax assessments.

The Supreme Court then reviewed statutory construction maxims and determined that the Supreme Court's primary objectives were to review the applicable statutes in accordance with their plain language in order to effectuate legislative intent and to avoid absurd results.

The Supreme Court concluded that the legislature's intent in enacting Kentucky's property tax appeals system was to limit taxpayers' appeals of unresolved property tax assessments to the current tax year. The Supreme Court held that KRS 133.045(1) mandates the time and length of an open inspection period of the real property tax roll and limits such to the "current year."

The Supreme Court further opined that pursuant to KRS 133.120(1), a taxpayer who wishes to appeal an assessment must request a conference with the PVA to be held during the inspection period provided in KRS 133.045 for that specific year.

The Supreme Court also held that were it to interpret the applicable statute without a year limit, a taxpayer could theoretically request a conference with the PVA years after the assessment in question, so long as it was within the inspection period of the first 13 days of May.

The Supreme Court concluded that to construe the statute's time frame for the conference to a period of days without a limitation to the current year would produce an absurd result. That result would be in violation of long-standing authority, which the Supreme Court declined to abandon.

The Supreme Court next reviewed Cromwell's contention that KRS 133.120 does not restrict taxpayers' right to a PVA conference to the current tax year because KRS 134.590, the refund statute, allows a two-year statute of limitations.

The Supreme Court held that KRS 133.120 and KRS 134.590:[4]

> . . . apply to patently different situations; the former is applicable to administrative proceedings for challenging the PVA's *assessment* of property value, while the latter provides for refunds of ad valorem or unconstitutional taxes. We recognize the fundamental distinction between a statute elucidating all mandatory administrative procedures relating to the *initial* assessment and the statute of limitations for applying for a refund, the ultimate *remedy*. Consequently, we decline Appellant's invitation to misconstrue the administrative procedures relating to the assessment statute.

The Supreme Court noted that "the references to KRS 133.120 within KRS 134.590(2) and (6) do not change the analysis; rather, it merely establishes a prerequisite to applying for a refund, insuring taxpayers do not circumvent the administrative procedures."[5]

The Supreme Court further noted that KRS 133.120(1) does not refer to KRS 134.590(2) or (6) for the time period to request a conference and appeal. However, KRS 133.120(1) "does explicitly reference KRS 133.045 for the applicable time frame, which, as previously stated, unambiguously applies a current year framework to the inspection period."[6]

The Supreme Court concluded by holding that the Supreme Court is "not at liberty to add or subtract from the legislative enactment," and ultimately held that the two-year period set forth in KRS 134.590 was inapplicable in determining the time period for a PVA conference regarding a challenge to a property tax assessment.[7]

The Supreme Court next reviewed Cromwell's contention that it was deprived of due process under *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*[8] and *Reich v. Collins*,[9] as it was denied the right to file a claim for a refund. The Supreme Court stated that there could be no deprivation of due process for taxes not yet paid. In addition, no "bait and switch" had occurred, such as in *Reich* where Georgia reconfigured its tax scheme in midcourse to prevent taxpayers from receiving refunds of disputed taxes.

The Supreme Court rejected Cromwell's claim of violation of due process, holding that it was "disingenuous." The Supreme Court concluded by holding that the statutory language of KRS 134.590 clearly required the exhaustion of administrative remedies before a taxpayer could apply for a refund.

The *Cromwell* decision confirms that in Kentucky real property tax cases, one misstep can be fatal to the appeal. In Kentucky, as in many states, an elaborate system for contesting real property tax assessments has been statutorily created, which oftentimes is a trap for the unwary.

Therefore, it is very important to carefully review the timing requirements regarding contesting assessments,

"In Kentucky, as in many states, an elaborate system for contesting real property tax assessments has been statutorily created, which oftentimes is a trap for the unwary."

"The Circuit Court found that . . . 'requiring a taxpayer to pay taxes under protest as a mandatory pre-condition of asserting a refund claim later simply erects unnecessary procedural obstacles to obtaining a refund.'"

meetings or conferences with PVAs, appeals to local boards of review, and secondary appeals to state boards of review when faced with a real property tax assessment.

Taxpayer Not Required to File Protest Prior to Filing Refund Claim in Tangible Personal Property Case

The *Cromwell* decision addressed critical procedural steps and missteps involved in a real property tax case. In the second decision, the Kentucky Court of Appeals held that a taxpayer was not required to first protest a tax assessment prior to paying taxes and filing a refund claim in a tangible personal property tax case.[10]

The facts of this case are straightforward, undisputed, and easily digested. The Kentucky Department of Revenue conducted a tangible personal property tax audit of Cox Interior, Inc. ("Cox Interior") for the periods 2001 through 2004. At the conclusion of the audit, the Department of Revenue issued tangible personal property tax bills to Cox Interior in the amount of $151,943.51.

In March of 2006, Cox Interior paid the entire balance of the assessments, and the protest period expired. On July 10, 2007, Cox Interior filed refund claims pursuant to KRS 134.590 to recover $44,717.00 in tangible personal property taxes that Cox Interior contended were erroneously paid by it after the audit. This was because the Department of Revenue had incorrectly placed manufacturing machinery (which is subject to a favorable tax rate in Kentucky and exempt from all local taxation) on the nonmanufacturing schedule of the tangible return.

On August 17, 2007, the Department of Revenue denied Cox Interior's refund claim on procedural grounds without addressing the merits of the claim; specifically, the Department of Revenue determined that the Cox Interior refund claims were disallowed by KRS 134.590 because Cox Interior had paid the assessments without filing a protest.

Cox Interior then protested the denial of the refund claim on August 28, 2007, within the 45-day Kentucky statutory period for filing a protest as set forth in KRS 131.110.

The Department of Revenue issued a final ruling letter upholding its denial of the refund claim. Cox Interior appealed the final ruling letter to the KBTA, arguing that its refund claim was timely filed because it was filed within two years of payment of the taxes, as required by KRS 134.590(2).

Cox Interior further asserted that simply because it did not protest the original assessments made at the conclusion of the audit did not later preclude it from filing a refund claim if it later discovered that it had overpaid its property taxes.

Finally, Cox Interior argued that it had properly protested the Department's denial of the refund claims, and had accordingly exhausted its administrative remedies. The KBTA issued an order concluding that Cox Interior had timely filed its refund claim, and thereafter timely filed its Protest of the Department's denial of its refund claims.

The KBTA also found that Cox Interior did not lose its ability to file for a refund under KRS 134.590 by paying the tax first and failing to file a Protest.

The KBTA reasoned that the two-year statute of limitations for refunds did not disappear merely because the taxpayer paid the tax assessed without first filing a Protest.

The Department of Revenue appealed the KBTA decision to the Franklin Circuit Court, which affirmed the decision of the KBTA.

The Circuit Court found that the interpretation of KRS 134.590 asserted by the Department would create "a procedural minefield of obstacles" that would defeat the claims of taxpayers seeking to exercise their legitimate right to make refund claims.

Specifically, the Circuit Court stated:

> [R]equiring a taxpayer to pay taxes under protest as a mandatory pre-condition of asserting a refund claim later simply erects unnecessary procedural obstacles to obtaining a refund. When a taxpayer protests the denial of a refund claim under the procedure of KRS 131.110, Revenue has a full and fair opportunity to address the merits of the refund claim. That is all the doctrine of exhaustion of remedies can or should require."[11]

The Circuit Court determined that the same procedural protest and refund principles that govern sales and use tax, income tax, and other types of tax refunds should also apply to property tax refunds. Specifically, the Circuit Court held that its previous decision in *Revenue Cabinet v. Castleton, Inc.*,[12] was applicable in a tangible personal property tax context. The *Castleton* decision involved a sales tax matter where the Circuit Court held that it was not necessary for a taxpayer to first protest taxes prior to payment as a mandatory condition in order to subsequently request a refund.

The Circuit Court noted that although KRS 134.590 was amended subsequent to *Castleton* to condition a property tax refund on the exhaustion of administrative remedies, it did not find that such an amendment altered the applicability of that decision's holding in a tangible personal property tax setting.

The Circuit Court agreed with the KBTA and the Circuit Court previous decisions that the Department of Revenue's interpretation would effectively require the exhaustion of two administrative remedies rather than one.

Indeed, the Circuit Court opined, "requiring a taxpayer to protest taxes prior to payment as a mandatory condition in order to later request a refund creates unnecessary and inefficient procedural obstacles for the taxpayer. We cannot presume that the legislature intended such a result."

The Circuit Court further noted that all that KRS 134.590 requires is that taxpayers must exhaust their administrative remedies before a refund may be obtained. The Circuit Court determined that Cox Interior fully exhausted its administrative remedies by submitting its refund claim well within the two-year statute of limitations provided by KRS 134.590.

The Circuit Court also determined that it was undisputed that upon the Department's denial of the refund, Cox Interior timely protested that denial in accordance with KRS 131.110. The Circuit Court held that Cox Interior therefore exhausted all available administrative remedies, and therefore upheld the decisions of the KBTA and the Circuit Court awarding Cox Interior its refund claim. This was because it was timely filed even though no protest was filed.

The Department of Revenue filed a motion for discretionary review on December 6, 2010. On November 16, 2011, the Kentucky Supreme Court granted the Department's motion..

The Cox Interior decision confirmed what many Kentucky tax practitioners have long believed and argued. The Cox Interior decision is not only legally correct, but it makes practical sense. A taxpayer should not be required to take the absurd, almost futile position of having to protest every tax assessment before payment or waive its right to pursue a refund claim.

The *Cromwell* and *Cox Interior* Decisions Are Not in Conflict

The Department of Revenue contends in its motion for discretionary review before the Kentucky Supreme Court in the *Cox Interior* case that the Court of Appeals opinion in *Cox Interior* contradicts the *Cromwell* decision. However, as noted, *Cromwell* involved a taxpayer's obvious failure to properly exhaust its administrative remedies.

As noted, in *Cromwell*, the taxpayer failed to follow the real property tax appeal procedures and to hold a conference to contest the real property tax assessment before the local PVA, as specifically required by KRS 133.120.

Therefore, the Court rejected *Cromwell*'s arguments that it could avoid appearing before the PVA, and held that KRS 133.120 requires that the taxpayer request a conference with the PVA during the annual inspection period of the year in which the tax assessment was issued.

"It is also important to review the applicable statutes and cases to determine the specific timing requirements. . . ."

Because Cromwell did not have a conference with the PVA during the same year as the tax assessment, it was prohibited from pursuing its appeal rights.

Although the *Cromwell* decision refers to KRS 134.590, there, the Court held that the two-year refund statute was inapplicable in an assessment case. This was because the taxpayer had clearly failed to exhaust its administrative remedies by meeting with the PVA and pursuing its appeal rights. In contrast, in *Cox Interior*, the taxpayer fully exhausted its administrative remedies pursuant to KRS 134.590(2) and KRS 131.110.

There was no step that the taxpayer in *Cox Interior* failed to take in appealing its assessments, unlike the situation in *Cromwell*. Cox Interior exhausted its administrative remedies by timely filing a refund claim in writing within two years of paying tangible personal property tax. Moreover, when the Department of Revenue denied the Cox Interior refund claim, the taxpayer filed a timely protest in accordance with KRS 131.110, which was later appealed to the KBTA.

Essentially, there is no requirement in Kentucky law that a taxpayer must first protest a tax matter prior to filing a refund claim of overpaid taxes. But, there is a statutory requirement that taxpayers must meet with the PVA during the tax year of real property tax assessments.

Because the decisions involved different legal issues, they should not be considered to be in conflict.

Additionally, the cases are significantly different in their factual background. This is because *Cox Interior* is a tangible personal property tax case and *Cromwell* is a real property tax case. In Kentucky, tangible property taxes are centrally administered by the Department of Revenue.

In Kentucky, the Department of Revenue, not the local PVA, is responsible for assessing and handling protests and appeals of tangible personal property tax assessments, pursuant to KRS 132.486(1).

In tangible personal property tax cases, the taxpayer is not obligated to take action with the PVA or the local Board of Assessments and may file refunds directly with the Department of Revenue, which is solely responsible for administering the tax.

In contrast, real property tax appeal procedures involve 120 counties, are more complex, and require that specific steps be taken at the local level. Therefore, it appears that Cox Interior fully exhausted its administrative remedies in a tangible personal property case, whereas Cromwell failed to comply with a necessary and critical step in perfecting its real property appeal.

Summary and Conclusion

These case studies are obviously Kentucky-based. Nonetheless, in all appeals of property tax assessments, it is important to know and understand the requirements in your state for property tax protests and appeals.

It is also important to review the applicable statutes and cases to determine the specific timing requirements for (1) filing of notices contesting assessments, (2) any required conferences with local tax officials, and (3) protests and filing of appeals with local and state boards of review.

Notes:

1. *Cromwell Louisville Associates, LP v. Commonwealth of Kentucky*, Jefferson County Property Valuation Administrator, 323 S.W.3d 1 (Ky. 2010).
2. See KRS 133.045(1).
3. See KRS 133.120(1)(a).
4. 323 S.W.3d at 5 (f.n. omitted) (emphasis in original).
5. Id.
6. Id.
7. Id. (citation omitted).
8. *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1990).
9. *Reich v. Collins*, 513 U.S. 106 (1994).
10. *Dept. of Revenue v. Cox Interior, Inc.*, __ S.W.3d __, 2010 WL 4366351 (Ky. App.), *Motion for Discretionary Review granted*, No. 2010-SC-794-D (Ky. Nov. 16, 2011).
11. *Cox Interior, Inc.*, 2010 WL 4366351 p. 5, quoting from Franklin Circuit Court Opinion and Order p. 3.
12. *Revenue Cabinet v. Castleton, Inc.*, 826 S.W.2d 334 (Ky. App. 1992).

Jennifer Smart, Esq., is an attorney with the law firm of Greenebaum Doll & McDonald PLLC in Lexington, Kentucky. Jennifer's practice focuses on state and local tax, administrative law and governmental affairs. She counsels clients on a wide variety of state and local tax and related matters and is licensed to practice law in Kentucky, Tennessee, and Louisiana. She routinely appears before the Kentucky Department of Revenue, Kentucky Board of Tax Appeals, and the appellate courts of Kentucky. She can be reached at (859) 288-4672 or at jss3@gdm.com.