AD VALOREM PROPERTY TAX ABATEMENT

Introduction

Like many states throughout the country, Georgia offers ad valorem property tax abatements to entice new and expanding companies to select Georgia as the location of their investment. Cities and counties do not have the power to give ad valorem property tax exemptions directly to companies.[1] Accordingly, ad valorem property tax abatements are given to companies indirectly through development authorities. Georgia has developed a relatively complicated sale-leaseback structure which requires the issuance and validation of revenue bonds by development authorities in order to provide property tax abatement. The underlying concept requires that the company transfer legal title to the property to the development authority and enter into a lease agreement with the authority. Because the laws creating development authorities in Georgia exempt property owned by the authority from ad valorem property taxes,[2] all or a portion of the company's interest in the property will be exempt from taxation,[3] as more fully described below.

Transaction Structure

An ad valorem property tax abatement can be structured in one of two ways: (1) a "sale-leaseback bond issue"[4] or (2) a "direct lease." In each case, the property tax abatement is

[1] Article VII, Section II, Paragraph I of the Georgia Constitution of 1983 (the "Georgia Constitution") states that "[e]xcept as authorized in or pursuant to this Constitution, all laws exempting property from ad valorem taxation are void." Article VII, Section II, Paragraph II of the Georgia Constitution states that "[e]xcept as otherwise provided in this Constitution, no property shall be exempted from ad valorem taxation unless the exemption is approved by two-thirds of the members elected to each branch of the General Assembly in a roll-call vote and by a majority of the qualified electors of the state voting in a referendum thereon."

[2] See O.C.G.A. §§ 36-62-3 or 36-42-13 or the local constitutional amendment creating the development authority.

[3] O.C.G.A. § 48-5-3 states that taxable property includes "[a]ll real property including, but not limited to, leaseholds, interests less than fee, and all personal property ...."

[4] Some people refer to these transactions as "bonds for title" because the company transfers title to the property to the authority in exchange for a bond or bonds as described below.

derived from the fact that the property is owned by the development authority and leased to the company.

Sale-leaseback Bond Issue. In the event that the company has the money it needs to construct and/or acquire the property, or a bank is making a conventional loan to the company (and not through the development authority), sale-leaseback bonds are issued. They are called sale-leaseback bonds because it is a zero-sum transaction (i.e., no money changes hands). The authority issues its revenue bonds and enters into a lease with the company pursuant to which the company agrees to pay debt service on the bonds. The bonds are not sold to investors or a third party, they are "sold" to the company.[5] The company uses its own money or money from a conventional loan to construct and/or acquire the property and titles the property in the name of the authority in accordance with the lease. Because the company is the beneficiary of the bond issue, the lessee and the owner of the bonds, no money is required to change hands.

Direct lease. We are often asked if we really need to go to the trouble and incur the expenses of issuing the sale-leaseback bonds. Some lawyers are of the view that the issuance of the sale-leaseback bonds is not required and simply have the authority and the company enter into a direct lease. This is especially true if the authority is created by local constitutional amendment as more fully described below. However, the more common practice is to issue sale-leaseback bonds and to validate the issuance of the bonds.

The issuance and validation of the bonds provide additional assurances that the intended ad valorem property tax abatement will be honored. Once an issue has been validated by a court, it is "forever conclusive."[6] In order to ensure that the ad valorem property tax abatement is

[5] The Company does not actually pay for the bonds; the company agrees to convey title of the property to the authority in exchange for the bonds.

[6] Article IX, Section VI, Paragraph I of the Georgia Constitution provides that "[t]he General Assembly shall provide for the validation of any revenue bonds authorized and shall provide that such validation shall thereafter be

covered by the validation order, it is imperative that the petition and complaint include the leasehold valuation methodology and state that the company's willingness to enter into the lease and the feasibility of the project are based in part on the leasehold valuation methodology.[7]

Amount of the Abatement

The amount of the abatement is a function of the total value of the property (i.e., both the fee and the leasehold interest) as determined by the tax assessor from time to time, the type of development authority involved, the length of the lease and whether the lease is deemed to be an estate for years or a usufruct.[8]

Total Value of the Property. The fact that the property is subject to a lease does not mean that it is exempt from re-evaluation or depreciation. The total value of the real property subject to the lease must be reappraised at the same time other properties in the county are reappraised, and the personal property subject to the lease must be depreciated in accordance with normal depreciation schedules. The value of the abatement will therefore increase if the value of the real property increases and will decrease if the value of the real property decreases or as the personal property is depreciated.

Type of Authority. There are two types of development authorities: those created by a local constitutional amendment and those created by a general law (i.e., the Development

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incontestable and conclusive." O.C.G.A. Section 36-82-78 provides that "[i]f no appeal is filed within the time prescribed by law or if an appeal is filed and the judgment is affirmed on appeal, the judgment of the superior court confirming and validating the issuance of the bonds and the security therefor shall be forever conclusive against the governmental body upon the validity of such bonds and the security thereof."

[7] See Sherman v. Fulton County Bd. of Assessors, 288 Ga. 88, 94, 701 S.E.2d 472, 477 (2010) ("However, the restriction on challenging matters addressed in bond validation proceedings only attaches to those matters that are referenced and adjudicated in those proceedings.") See also Sherman v. Dev. Auth. of Fulton County, 320 Ga. App. 689, 740 S.E.2d 663 (2013) and related cases for other procedural requirements.

[8] Throughout this paper, we refer to usufructs. This term applies to real property, not personal property. If the lease relates to personal property and is deemed not to create an estate for years, there is a bailment of the personal property. For ease of discussion, this paper will only refer to usufructs.

Authorities Law or the Downtown Development Authorities Law).[9] If the development authority is created by local constitutional amendment, the company's leasehold interest may be exempt from ad valorem property taxes altogether. The Supreme Court of Georgia has ruled that if the development authority is created by local constitutional amendment, the development authority's interest in the property and the company's leasehold interest are exempt from ad valorem property taxes *unless the local constitutional amendment specifically states that the exemption shall not extend to the authority's tenants and lessees*.[10] Therefore, if the development authority was created by local constitutional amendment and the law creating the authority provides that the property of such authority will have the same immunity from taxation as the property of the county (or municipality), the company's leasehold interest will be exempt from all property taxes (i.e., a 100% abatement).

If the development authority and the taxing entities do not want this result and want the company to pay some taxes, the company must be required to make payments in lieu of taxes "pilot payments"). Any pilot payments should be specified in the lease.

Who is entitled to the pilot payments? Because the lease is between the development authority and the company (i.e., the taxing entities are not parties), the authority may specify in the lease that it shall be the beneficiary of the pilot payments. If your county has a constitutionally created development authority, make sure that any tax abatement policy and abatement documents require that the pilot payments be made to the appropriate taxing entities if the authority is not to receive them directly. In addition, it is imperative that the company and

[9] O.C.G.A. § 36-62-1, *et seq.* and O.C.G.A. § 36-42-1, *et seq.*

[10] See Hart County Board of Tax v. Dunlop Tire, 252 Ga. 479, 314 S.E.2d 188 (1984) and McMillan v. Jacobs, 249 Ga. 117, 288 S.E.2d 211 (1982). These are the types of authorities that typically use "direct leases" as opposed to sale-leaseback bonds.

the tax assessor/commissioner work together to determine the amount of the pilot payments, collect the pilot payments and distribute them to the appropriate taxing entities.

If the development authority is created by general law (or the local constitutional amendment states that the exemption shall not extend to the authority's tenants and lessees), the company's leasehold interest will not be totally exempt from ad valorem property taxes, and the company will have to pay taxes based upon the fair market value of its leasehold interest.[11] The value depends on whether the lease will be deemed an estate for years or a usufruct.

Estate for Years v. Usufruct. If the company is granted the right simply to possess the property (i.e., a license to use the property), the company will have a usufruct, not a taxable interest in the property.[12] If the company is granted an estate for years, the leasehold interest will have a value to the company, and the company will have a tax liability based upon the value of the leasehold interest.[13] Usufructs are discussed in O.C.G.A. § 44-7-1, which provides as follows:

> The relationship of a landlord and tenant is created when the owner of real estate grants to another person, who accepts such grant, the right simply to possess and enjoy the use of such real estate either for a fixed time or at the will of the grantor. In such a case, no estate passes out of the landlord and the tenant has only a usufruct which may not be conveyed except by the landlord's consent and which is not subject to levy and sale.

Estates for years are discussed in O.C.G.A. §§ 44-6-101 and 44-6-103, which provide in part as follows:

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[11] O.C.G.A. § 48-5-3; see also Sherman v. Fulton County Bd. of Assessors, 288 Ga. 88, 93, 701 S.E.2d 472, 476 (2010) (holding that the valuation method used by the county board of tax assessors must be non-arbitrary and reasonable); accord Coweta County Bd. of Tax Assessors v. EGO Products, Inc., 241 Ga. App. 85, 88, 526 S.E.2d 133, 135 (1999).

[12] See Camp v. Delta Air Lines, Inc., 232 Ga. 37, 39, 205 S.E.2d 194, 195 (1974) ("An estate for years is a taxable estate. [Cit.] On the other hand, a mere usufruct, sometimes referred to as a license to use, is not a taxable estate.")

[13] Id.

> As applied to personalty, an estate for years differs from a contract of hiring, which is a bailment conveying no interest in the property to the bailee but merely the right of use. As applied to realty, an estate for years does not involve the relationship of landlord and tenant, in which relationship the tenant has no estate but merely has a right of use which is very similar to the right of a hirer of personalty.
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> An estate for years carries with it the right to use the property in as absolute a manner as may be done with a greater estate ….

When does a lease create a usufruct (as opposed to an estate for years) in the company? A lease for less than five years is presumed to create a usufruct.[14] A lease for five years or more is presumed to create an estate for years. A company may be able to overcome the presumption that a lease with a term of five years or more creates an estate for years (and avoid ad valorem property taxes) if the lease substantially restricts the lessee's use of the property.[15] As noted above, a usufruct creates a landlord-tenant relationship. An estate for years gives the lessee the unfettered right to use the property in any manner it desires. If the lease substantially restricts the lessee's use of the property, Georgia courts have held in some limited circumstances that a usufruct is created.[16] It is important to note that the intent of the parties will not control[17] and

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[14] O.C.G.A. § 44-7-1.

[15] A court may also look at other factors such as whether or not the lessor has to provide "services" normally performed by a typical landlord. See Fulton County Board of Assessors v. McKinsey & Company, Inc., 224 Ga. App.593, 481 S.E.2d 580 (1997) and Huntingdon II v. Board of Tax Assessors, 207 Ga. App. 466, 428 S.E.2d 605 (1993). However, the most important factor appears to be the amount of control retained by the lessor over the property and business operations/use restrictions.

[16] See City of College Park v. Paradies-Atlanta, LLC), 346 Ga. App. 63, 815 S.E.2d 246 (2018); Diversified Golf, LLC v. Hart County Board of Tax Assessors, 267 Ga. App. 8, 598 S.E.2d 791 (2004); Macon-Bibb County v, Atlanta S.E. Airlines, 262 Ga. 119, 414 S.E.2d 635 (1992); Richmond County Board of Tax Assessors v. Richmond Bonded Warehouse Corporation, 173 Ga. App. 278, 325 S.E.2d 891 (1985); Eastern Air Lines, Inc. v. Joint City-County Board of Tax Assessors, 253 Ga. 18, 315 S.E.2d 890 (1984); Clayton County Board of Tax Assessors v. City of Atlanta, 164 Ga. App. 864, 298 S.E.2d 544 (1982); Allright Parking of Georgia. Inc. v. Joint City-County Board of Tax Assessors, 244 Ga. 378, 260 S.E.2d 315 (1979); and Camp v. Delta Air Lines, Inc., 232 Ga. 37, 40, 205 S.E.2d 194, 196 (1974).

[17] See Jekyll Dev. Associates, L.P. v. Glynn County Bd. of Tax Assessors, 240 Ga. App. 273, 274–75, 523 S.E.2d 370, 372 (1999) ("[A]ll provisions of the lease must be scrutinized objectively to determine whether the legal effect of the agreement is to grant an estate in the property or merely a right of use. An estate for years may be encumbered or somewhat limited without being reduced to a usufruct.") and Huntingdon II v. Board of Tax Assessors, 207 Ga. App. 466, 428 S.E.2d 605 (1993).

that in a number of cases Georgia courts have found that a lease created an estate for years in the lessee even though the lease contained restrictions on the lessee's use of the property.[18] It is also important to note that in all of the cited cases holding that a usufruct was created the following two facts were present: (1) the property was owned by a governmental entity before the lease was executed, and the property was owned by a governmental entity after the lease expired (i.e., it was exempt property before the lease was executed, and it will be exempt after the end of the lease) and (2) the lessee did not have an option to purchase the property. This is typically not the case in tax abatement transactions. Many times the title to the property is owned by a non-governmental entity prior to the lease, and the company typically has a bargain purchase option in the lease or one of the related documents. Furthermore, in the one case that involved a typical tax abatement transaction (W.C. Harris) and lease terms (including a purchase option), the court ruled that the lease created an estate for years. We urge caution when attempting to structure a tax abatement transaction as a usufruct as opposed to an estate for years. At a minimum, we suggest that the issues be fully vetted with the tax assessor and that the court be fully briefed in the validation proceedings.[19]

Valuation Methodology. There is no statute governing the methodology for valuing a leasehold interest, and Georgia courts have provided very little guidance regarding the methodology for valuing a leasehold interest. Generally, the tax assessor's methodology for

[18] See Warehouses, Inc. v. Wetherbee, 203 Ga. 483, 490–91, 46 S.E.2d 894, 899 (1948) ("[E]ven though some of the provisions of the instant lease might result in imposing liabilities upon the lessor which are usually incident to the relationship of landlord and tenant, and even if it could be said that certain of the provisions might be construed to impose limitations upon the use of the premises—yet, a contract which ordinarily would be construed to create an estate for years, is not reduced to a mere usufruct because certain limitations are put upon its use."); DeKalb County Board of Tax Assessors v. W.C. Harris & Co., 248 Ga. 277, 282 S.E.2d 880 (1981); and Buoy v. Chatham County Board of Tax Assessors, 142 Ga. App. 172, 235 S.E.2d 556 (1977). Also, keep an eye on Love et al. v. Fulton County Board of Tax Assessors, 348 Ga. App. 309, 821 S.E.2nd 575 (2018) in which taxpayers claim that the Falcons have an estate for years not a usufruct.

[19] By fully briefed, we mean that briefs in support and against are filed in the validation proceedings. It is not enough to simply plead that the lease is a usufruct.

determining the fair market value of the leasehold interest will not be set aside provided that the methodology is not arbitrary or unreasonable.[20] Many different methodologies are used throughout the State.[21] One methodology is the "straight-line method." Using this methodology, the fair market value of the entire property is determined and the leasehold interest is then assigned a predetermined percentage in the entire value of the property. This percentage increases over time. One variation of the straight-line method was upheld by the Georgia Supreme Court in Sherman and is routinely used in the metro area.[22]

An example of the straight-line methodology and corresponding taxes and abatement are set forth below. The example assumes a ten-year lease, that the property value increases every three years and that the millage rate is 30 mills.

Year	Fair Market Value of Property	Total Assessed Value	Percentage of Value Assigned to Fee	Percentage of Value Assigned to Leasehold	Assessed Value of Leasehold	Company Taxes	Abatement
1	$10,000,000	$4,000,000	100%	0%	$ 0	$ 0	$120,000
2	10,000,000	4,000,000	90	10	400,000	12,000	108,000
3	10,000,000	4,000,000	80	20	800,000	24,000	96,000
4	12,000,000	4,800,000	70	30	1,440,000	43,200	100,800
5	12,000,000	4,800,000	60	40	1,920,000	57,600	86,400
6	12,000,000	4,800,000	50	50	2,400,000	72,000	72,000
7	14,000,000	5,600,000	40	60	3,360,000	100,800	67,200
8	14,000,000	5,600,000	30	70	3,920,000	117,600	50,400
9	14,000,000	5,600,000	20	80	4,480,000	134,400	33,600
10	16,000,000	6,400,000	10	90	5,760,000	172,800	19,200

While the straight-line method seems reasonable and is easy to understand, many approaches are not. Authorities may open themselves up to political scrutiny and legal

[20] See Sherman v. Fulton County Bd. of Assessors, 288 Ga. 88, 93, 701 S.E.2d 472, 476 (2010); DeKalb County Board of Tax Assessors v. W Harris & Co., 248 Ga. 277, 282 S.E.2d 880 (1981); Delta Air Lines. Inc. v. Coleman, 219 Ga. 12, 131 S.E.2d 768 (1963) cert. denied.

[21] This may create a problem in the long-run because communities are pitted against each other.

[22] The leasehold interest was valued as 50% of the fee in year one, and it increased in value 5% each year for the next ten years.

challenges if the methodology is not reasonable or consistently applied.[23] For example, in some instances the parties claim that the company's leasehold interest in the property will remain at 25% of the total value of the property throughout the term of the lease. In other instances, the parties value similar leasehold interests in the same county differently.

Policy. Ideally, the valuation methodology used to provide a tax abatement will be part of a policy that is approved by the development authority, the tax assessor and all the taxing entities (the "Policy"). It could create local political issues for a development authority to offer a tax exemption that has not been approved by all the taxing entities.

Once the Policy is established by the development authority, the tax assessor and all taxing entities, the Policy must be consistently applied.[24] If it is not consistently applied, the Policy may be declared unconstitutional.

What should be included in a tax abatement policy? The tax abatement policy should cover at a minimum the following issues: (1) Should the abatement be offered at all?[25] (2) How much abatement should be offered? (3) Will the authority allow usufructs? (If so, what are the terms and conditions needed in the lease?) (4) What is the leasehold valuation methodology for leasehold estates? (5) Should the company be required to rebate all or a portion of the abatement under certain circumstances? (6) Whether and under what conditions the company (or its assigns

[23] This may create a problem in the long run given that Georgia law generally requires uniform taxation. Article VII, Section I, Paragraph III of the Georgia Constitution provides that all taxation shall be uniform upon the same class of property. Although valuation methods may be varied, Dougherty County Bd. of Tax Assessors v. Burt Realty Co., 250 Ga. 467, 468, 298 S.E.2d 475, 476 (1983), the valuation methods must be designed to determine the true fair market value of property. If valuation methods vary with respect to similarly situated properties, it raises doubt as to whether the valuation method was employed to fairly value the property or if it was merely a pretense to achieve the desired level of taxation.

[24] Id.

[25] Some counties run a fiscal impact analysis.

or successors) will be permitted to appeal the base tax value determined by the county board of tax assessors.

Valuation Agreement. To ensure that a tax exemption offered to a company is acceptable to the tax assessor and the taxing entities and is consistent with the Policy, we routinely recommend that the interested parties enter into a valuation agreement. We also recommend that the valuation agreement be included in the validation proceedings. This may help establish the validity of the valuation agreement if it is challenged.

Rebate/Clawbacks

The abatement is normally predicated upon a certain level of capital expenditure and/or the creation of a certain number of jobs. What happens if the company doesn't spend the amount committed, the jobs aren't created or the company moves? Is the company required to rebate all or a portion of the taxes that were abated? The answer to that question depends on the established Policy. We recommend that certain clawbacks be built into the tax abatement documents when negotiating a tax abatement. In other words, the company should be required to rebate all or a portion of the tax abatement if the economic goals are not satisfied.

To evidence compliance with the economic goals, many authorities require that the company prepare and submit an annual compliance certificate. We recommend that the taxing entities be alerted if the compliance certificate is not submitted or it indicates that the economic goals are not satisfied.

Best Practices

1. Having an abatement policy approved by the authority, the tax assessor and all taxing entities.
2. Applying the policy consistently.
3. Rethinking the way that economic developers are incentivized and evaluated (don't base incentives on number of transactions closed; base them on projects relocated to the community or retained in the community without giving incentives).
4. Fully briefing the court if a usufruct is being used.
5. Having the company rebate all or a portion of the tax abatement if economic goals are not achieved.
6. Having processes in place to monitor economic goals, recapture or end the abatement (if necessary), and to collect and distribute any pilot payments.
7. Having a clear understanding of the amount of the tax abatement and when it ends.