

PUBLICATION

Spotlight on Tennessee: Attorney General Questions Property Tax Valuation for Certain Facilities

November 7, 2012

On November 1, 2012, the Tennessee Attorney General and Reporter issued Opinion No. 12-102 (OAG 12-102) which concludes that the statutory authority for valuing certain machinery and equipment is of doubtful constitutionality. The focus of OAG 12-102 is purportedly upon Subsection (d) of Tennessee Code Annotated, Section 67-5-604, which establishes the value of machinery and equipment used to produce electricity in a "certified green energy production facility" -- that is, geothermal, hydrogen, solar and wind energy production sources.

Constitutional Requirements

The Tennessee Constitution, at Article II, Section 28, directs that all "real, personal or mixed" property shall be subject to taxation, and provides subclassifications and assessment percentages for purposes of establishing property values. Article II, Section 28, further states in part that the ratio of assessment to value of property in each class or subclass shall be equal and uniform throughout the state, with "...the value and definition of property in each class or subclass to be ascertained in such a manner as the Legislature shall direct."

The Attorney General, in Opinion No. 03-068 dated May 27, 2003 (OAG 03-068), recognized that the Legislature has very broad discretion in determining the value and definition of property in each classification or subclassification. Nevertheless, as opined by the Attorney General in that OAG 03-068, the Legislature cannot exercise that power in such a way as to render meaningless the other constitutional provisions relating to the classification and assessment of property. Similarly, the Attorney General in OAG 12-102 states, "[w]hile the General Assembly has broad powers to establish methods to ascertain the value of property for ad valorem tax purposes, those methods must have as their goal the determination of actual value of the property."

Section 67-5-604

In 1985, the Tennessee Legislature enacted Tennessee Code Annotated, Section 67-5-604, which directed that "pollution control equipment" shall be valued for property tax purposes at the salvage value of such equipment, which according to that Section "... shall never exceed one-half (1/2) percent of the acquisition value of such equipment." In 1986, the Attorney General issued Opinion No. 86-142 dated August 12, 1986 (OAG 86-142) declaring Section 67-5-604 to be of "doubtful constitutionality." The Attorney General reasoned in OAG 86-142 that such Section attempts to limit the value of pollution control equipment to a definition of "salvage value" and, further, effects the practical equivalent of an exemption from property taxation, which cannot be justified under Article II, Section 28, of the Tennessee Constitution.

Following the issuance of OAG 86-142, the Legislature deleted and restated Section 67-5-604 in 1991. The 1991 reinstatement amended the wording of the 1985 original enactment in several ways, including changing "pollution control equipment" to "pollution control facilities" -- which was defined in essence to mean any system, method, improvement, structure, device or appliance appurtenant thereto used or intended for the primary purpose of eliminating, preventing or reducing air or water pollution or for the primary purpose of treating, among other activities, hazardous or toxic waste created as a result of fabricating or processing and that, if released without such treatment or other activities, might be harmful to the public.

At the time of its 1985 enactment as well as its 1991 reinstatement, Section 67-5-604 contained only Subsections (a) through (c). Under both versions of Section 67-5-604, the Legislature's authorization of this special pollution control valuation has been (and is now) contingent upon certification being issued through the Tennessee Department of Environment and Conservation (or by a designated county board of health) in order for the salvage value to be utilized by the facility for property tax purposes.

In 2010, the Legislature added Subsection (d) to Section 67-5-604. Subsection (d) provides in part that the valuation applied to pollution control facilities under Section 67-5-604 shall also apply to machinery and equipment used to produce electricity in a "certified green energy production facility." That term is defined in Tennessee Code Annotated, Section 67-4-2004, to be a facility certified by the Department of Environment and Conservation as producing electricity for use and consumption off the premises using clean energy technology -- meaning technology used to generate energy from geothermal, hydrogen, solar and wind sources.

OAG 12-102

In OAG 12-102 issued last Thursday, the Attorney General states that "[a]s there have been no legal developments since 1986 to change this Office's analysis, the extension of Tenn. Code Ann. § 67-5-604 to limit valuation of certified green energy production facilities in the same manner as valuation of pollution control facilities would be subject to the same concern." The Attorney General's analysis in OAG 12-102 is similar to the analysis set forth in OAG 86-142, declaring that there is no basis to presume that all machinery and equipment used to produce electricity in a certified green energy production facility is of negligible value. The Attorney General observed that "[t]he statute contains no findings that would support this valuation method, and it requires property assessors to cap the property's value at 0.5% regardless of whether this amount has any relation to the property's true value."

In contrast to Section 67-4-2004, the Attorney General in OAG 12-102 referenced OAG 03-068 (issued in 2003) as being an analysis of a statutory property tax valuation that is "constitutionally defensible." In OAG 03-068, the Attorney General analyzed Subsection (e) of Section 67-5-601, which provides a property tax valuation for property that generates electricity using wind as its energy source, and noted the following:

The bill also provides a rationale for treating such property differently, i.e. that 'due to [such property's] dependence on the intermittent nature of wind as an energy source,' the property has an intrinsically lower value than other electricity-generating property.

One might argue that a business or utility would not install a windmill if, immediately upon completion, it is worth only one third of its cost. Thus, one could contend that the effect of the proposed bill is merely to allow a reduced, and improper, tax rate for such property. That a reasonable basis exists for treating windmills differently from other property is not sufficient to satisfy the uniform taxation clause, because under that clause, any authorized methodology must seek to reach the true value of the property, regardless of its social usefulness. In this context, the answer may, to some extent, require a factual inquiry to determine whether the methodology set forth in the bill is so divorced from reality that it becomes unconstitutional. Upon the very limited facts presented, it would appear that the bill's justification for its methodology contains at least a credible rationale. The legislature's power to determine the value of property, as recognized in the Sherwood decision (*Sherwood Co. v. Clary*, decided by the Tennessee Supreme Court in 1987), is so broad that this Office, upon the limited facts known to us, cannot say that the bill goes beyond the legislature's prerogative. (Parens supplied.)

The Attorney General then concluded that Subsection (e) of Section 67-5-601 is constitutionally defensible.

Section 67-5-601(e) vs. Section 67-5-604(d)

Subsection (e) of Section 67-5-601 does contain reasoning by the Legislature regarding the valuation authorized by that Subsection; whereas, Subsection (d) of Subsection 67-5-604 does not itself contain similar reasoning. However, it is troubling that this difference justifies a "doubtful constitutionality" as compared to a "constitutionally defensible" characterization. Unlike Subsection (e), Subsection (d) expressly requires (just like the original 1985 as well as the 1991 reinstatement of Section 67-5-604) a facility certification by a governmental agency before that particular property tax valuation is allowed. Such governmental certification should, in and of itself, be indicative of restricted use -- and restrictive use can be a proper basis for providing a specific property tax valuation methodology according to OAG 12-102.

In addition, and although purportedly not the focus of OAG 12-102, the combination of governmental certification with the apparent restricted use of pollution control facilities (as addressed in Subsections (a) through (c) of Section 67-5-604), together with the Legislature's reinstatement of the pollution control facilities valuation in 1991 following the issuance of OAG 86-142 in 1986, would hopefully now be sufficient to negate the earlier "doubtful constitutionality" characterization.

Regardless, the Legislature may be asked in 2013 to provide supporting justification for the questioned property tax valuations.

Summary

In the past, the Legislature has been on record supporting certified green energy production facilities — that is, geothermal, hydrogen, solar and wind source energy production facilities. In addition to the property tax valuation discussed above, the Legislature has previously provided to such facilities an exemption from the minimum base of the franchise tax, as well as the availability of a sales/use tax credit. OAG 12-102 must be viewed as a competitive step backwards for the geothermal, hydrogen, solar and wind industries.

Should you have any questions regarding the property tax issue discussed in this Alert, or wish to discuss any other state or local tax issues, please do not hesitate to contact one of the attorneys in the Firm's Tax Department.