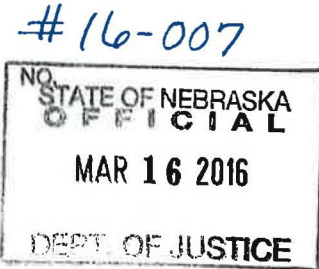




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**DOUGLAS J. PETERSON**  
ATTORNEY GENERAL



**SUBJECT:** Constitutionality of LB 717 – Use of 2015 Assessed Values of Real Property for the 2016 Tax Year, Amendment of the Definition of “Actual Value”, and the Establishment of Statutory Criteria for the Measure of Central Tendency Used to Determine Acceptable Levels of Assessment for Real Property.

**REQUESTED BY:** Senator Mike Groene  
Nebraska Legislature

**WRITTEN BY:** Douglas J. Peterson, Attorney General  
L. Jay Bartel, Assistant Attorney General

### INTRODUCTION

LB 717 contains several provisions relating to property taxation. Section 1 of the bill amends the definition of “actual value” of real property for tax purposes by eliminating specific reference to this term meaning the “market value of real property in the ordinary course of trade.” LB 717, § 1. Section 2, as amended by AM1842, would provide that, for the real property “assessment occurring as of January 1, 2016, the assessed value shall be based on the physical characteristics of the property, to include land use, as of January 1, 2016, and reflect the value the property had, or would have had, on January 1, 2015.” LB 717, § 2. Section 3 amends Neb. Rev. Stat. § 77-1327 (Cum. Supp. 2014), the statute providing for the development of a sales file by the Property Tax Administrator [“PTA”] and development of assessment ratio studies by the PTA based on the sales file by removing reference to those studies being used to analyze the level “of value” for purposes of §§ 77-5017 and 79-1016, leaving their use only to analyze the “level and

quality of assessment” for those purposes. LB 717, § 3. Section 4 of LB 717 amends Neb. Rev. Stat. § 77-5023, the statute providing for adjustments by the Tax Equalization and Review Commission [“TERC”] increasing or decreasing the value of a class or subclass of property so all property falls within the acceptable range for statewide equalization purposes. Specifically, § 4 proposes to amend § 77-5023(2), under which “[a]n acceptable range is the percentage of variation from a standard of valuation as measured by an established indicator of central tendency.” This subsection would be amended by adding that “[t]he measure of central tendency shall be determined using sales under subsection (2) of section 77-1327 occurring five years preceding the assessment date, excluding the sales which constitute the lowest twenty percent of assessment ratios, for all classes or subclasses of real property.” LB 717, § 4. The language establishing the acceptable ranges of value for agricultural and horticultural land, land receiving special valuation, or all other real property, would be altered to refer to ranges for the “level of assessment”, eliminating current language referring to the percentage “of actual value” or “special valuation”. *Id.* Subsections (3) through (5) of § 77-5023 would be amended to eliminate references to increases or decreases to the “level of value” to the midpoint of an acceptable range, replacing the term “value” with “assessment.” *Id.* Sections 5 and 6, which amend § 77-5026 concerning TERC’s notice of proposed adjustments and § 77-5027 relating to annual reports prepared by the PTA and provided to the TERC, similarly replace references to the level of “value” with the term “level of assessment”. LB 717, §§ 5, 6.

In your request letter, you state that “LB 717 puts in statute that all classes of property would be assessed uniformly over a five year history of comparable sales allowing for a larger statistically accurate sample size, replacing the present method, found in Department of Revenue rules, based on a three year history for agricultural and commercial properties and two years for residential sales.” You further state that “the bill trims the 20% sales with the lowest valuation to sale price ratio (present assessment over sale price) to proportionally reflect the definition of value as ‘assessment’ as defined in LB 717.” You state “[t]his trim also balances the currently ongoing trimming of high valuation to sales price ratio, occurring when county assessors trim certain transactions not considered at arm’s length such as between family members or neighbors.” Noting the requirement of uniform and proportionate taxation of real property in Neb. Const. art. VIII, §1(1), and the authorization for the Legislature to “prescribe standards and methods for the determination of the value of real property at uniform and proportionate values” in Neb. Const. art. VIII, § 1(6), you assert that “LB 717 redefines in statute the legislative definition of value by striking ‘market value’ which at present cannot accurately be determined by the present system...”, and that “LB 717 gives an accurate definition of value as a product of an assessment.” You ask for our opinion as to whether LB 717 complies with the requirement of uniform and proportionate taxation of property in art. VIII, § 1.

## ANALYSIS

### I. Constitutional and Statutory Provisions.

Neb. Const. art. VIII, § 1(1) provides: “Taxes shall be levied by valuation uniformly and proportionately upon all real property and franchise as defined by the Legislature except as otherwise provided in or permitted by this Constitution;....”<sup>1</sup> Subsection (4) of art. VIII, § 1, provides:

[T]he Legislature may provide that agricultural land and horticultural land, as defined by the Legislature, shall constitute a separate and distinct class of property for purposes of taxation and may provide for a different method of taxing agricultural and horticultural land which results in values that are not uniform and proportionate with all other real property and franchises but which results in values that are uniform and proportionate upon all property within the class of agricultural land and horticultural land;.... Neb. Const. art. VIII, § 1(4).<sup>2</sup>

In addition, “the Legislature may prescribe standards and methods for the determination of the value of real property at uniform and proportionate values.” Neb. Const. art. VIII, § 1(6).

Neb. Rev. Stat. § 77-201(1) (2009) provides that, except for agricultural land and horticultural land, agricultural land and horticultural land subject to special valuation, and historically significant real property, “all real property in this state, not expressly exempt therefrom, shall be subject to taxation and shall be valued at its actual value.” Agricultural land and horticultural land, as well as agricultural land and horticultural land qualifying for special valuation, is “subject to taxation, and shall be valued at seventy-five percent” of its actual or special value. Neb. Rev. Stat. § 77-202(2) and (3) (2009). “Actual value” is defined in Neb. Rev. Stat. § 77-112 (2009), which provides:

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<sup>1</sup> Prior to 1992, art. VIII, § 1, required uniform taxation of “all tangible property and franchises.” A constitutional amendment approved by the voters in 1992 replaced this requirement with the current language requiring taxes to be “levied by valuation uniformly and proportionately upon all real property and franchise....” Neb. Const. art. VIII, § 1 (1), as amended by 1992 Neb. Laws, LR 219 CA, § 1.

<sup>2</sup> The Legislature also is authorized to “enact laws to provide that the value of land actively devoted to agricultural or horticultural use shall for property tax purposes be that value which such land has for agricultural or horticultural use without regard to any value which such land might have for other purposes or uses.” Neb. Const. art. VIII, § 1(5). Pursuant to this so-called “Greenbelt amendment”, the Legislature has exercised this power by providing for the special valuation of certain lands used for agricultural or horticultural purposes. Neb. Rev. Stat. §§ 77-1344 to 77-1347.01 (2009 and Cum. Supp. 2014).

Actual value of real property for purposes of taxation means the market value of real property in the ordinary course of trade. Actual value may be determined using professionally accepted mass appraisal methods, including, but not limited to, the (1) sales comparison approach using the guidelines in section 77-1371, (2) income approach, and (3) cost approach. Actual value is the most probable price expressed in terms of money that a property will bring if exposed for sale in the open market, or in an arm's length transaction, between a willing buyer and willing seller, both of whom are knowledgeable concerning all the uses to which the real property is adapted and for which the real property is capable of being used. In analyzing the uses and restrictions applicable to real property, the analysis shall include a consideration of the full description of the physical characteristics of the real property and an identification of the property rights being valued.

With respect to assessment of real property taxes, Neb. Rev. Stat. § 77-1301(1) (Cum. Supp. 2014) provides: "All real property in this state subject to taxation shall be assessed as of January 1 at 12:01 a.m., which assessment shall be used as a basis of taxation until the next assessment."

## **II. Nebraska Case Law Discussing the Constitutional Requirement of Uniform and Proportionate Taxation.**

"The object of the uniformity clause is accomplished 'if all of the property within the taxing jurisdiction is assessed and taxed at a uniform standard of value.'" *Constructors, Inc. v. Cass County Bd. of Equal.*, 258 Neb. 866, 873, 606 N.W.2d 786, 792 (2000) (quoting *County of Gage v. State Bd. of Equal.*, 185 Neb. 749, 755, 178 N.W.2d 759, 764 (1970)). "The Legislature may prescribe standards and methods for the determination of the value of real...property at uniform and proportionate values." *Carpenter v. State Bd. of Equal.*, 178 Neb. 611, 615, 134 N.W.2d 272, 276 (1965) ["*Carpenter*"]. "The uniform method for valuing property which the Legislature has provided is to tax property at its 'actual value.'" *Xerox Corp. v. Karnes*, 217 Neb. 728, 732, 350 N.W.2d 566, 569 (1984) (citing Neb. Rev. Stat. §§ 77-201 and 77-112)). "There is no longer a constitutional requirement for the value of agricultural and horticultural land to be uniform and proportionate with the value of other real property." *Krings v. Garfield Cty. Bd. of Equal.*, 286 Neb. 352, 362, 835 N.W.2d 750, 757 (2013). The constitution, however, "still requires uniformity within" the class of agricultural and horticultural land. *Id.* at 361, 835 N.W.2d at 756.

"While absolute uniformity of approach may not be possible, there must be a reasonable attempt at uniformity." *County of Sarpy v. State Bd. of Equal.*, 185 Neb. 760, 765, 178 N.W.2d 765, 769 (1970). "[I]n dealing with the intangible concepts of valuation and uniformity", a "mathematically precise result" can never be reached. *Carpenter*, 178 Neb. at 619, 134 N.W.2d at 278. "Approximation, both as to value and uniformity, is all that can be accomplished." *Id.* "[S]ubstantial compliance with the requirements of equality and uniformity in taxation laid down by the federal and State Constitutions is all that is required and...such provisions are satisfied when designed and manifest departures from the rule are avoided." *Id.* (emphasis in original).



### III. Potential Uniformity Clause Violations Created by LB 717.

In analyzing whether LB 717 contains provisions which may violate the uniformity clause, three principal areas of concern arise. The first is the “freezing” of 2016 assessed values at the level of assessed value for 2015. The second is the apparent attempt to redefine “actual value” to mean something different than “market value”. The third is establishment of statutory criteria for determining if classes of property fall within the acceptable range of value by requiring use of a measure of central tendency based on five years of sales data with exclusion of the lowest twenty percent of assessment ratios.

#### A. *“Freeze” of 2016 Assessed Values at the 2015 Level.*

Section 2, as amended by AM1842, would provide that, for the real property “assessment occurring as of January 1, 2016, the assessed value shall be based on the physical characteristics of the property, to include land use, as of January 1, 2016, and reflect the value the property had, or would have had, on January 1, 2015.” LB 717, § 2. The bill originally proposed using the assessed value of real property on January 1, 2015, as the assessed value for January 1, 2016. AM1842, by providing that assessed value as of January 1, 2016, is to be based on the physical characteristics of the property, including land use, as of that date, while reflecting the value the property had or would have had on January 1, 2015, is intended to address the issue of non-uniform valuation created by the original subsection 2, which precluded the ability to change assessed values based on changes occurring to property subsequent to January 1, 2015, such as the addition of improvements.

Another uniformity issue, however, remains. If assessed values for 2016 are held to the assessed values used for 2015, no increase or decrease can be made which would reflect any changes in the actual value of real property during 2015 (other than those resulting from physical changes). Property within the same class or subclass may increase or decrease in value during the year, to varying degrees. Other property in the same class may remain at relatively the same value. By holding values, similar property in the same class may end up being under-valued or over-valued relative to other property. While the limited one-year period may reduce this effect, a lack of uniform and proportionate treatment of similar properties in the same class may result from holding values for 2016 at the 2015 level. Limiting the period to a single year may not be facially unconstitutional, but could, as applied, lead to non-uniform taxation as to particular classes or subclasses of property. *See Clifton v. Allegheny County*, 600 Pa. 662, 969 A.2d 1197 (Pa. Sup. Ct. 2009) (Statutes permitting indefinite use of a base year method of valuation for property tax purposes did not facially violate Uniformity Clause of the State Constitution, but statutes violated Uniformity Clause as applied in county).

#### B. *Amendment to the Definition of “Actual Value”.*

In addition, it appears the bill, by striking the language “market value of real property in the ordinary course of trade” from the definition of “actual value” in § 77-112, somehow intends to remove consideration of “market value” as the standard of value for

real property assessment. Even with this language stricken from § 77-112, the definition of “actual value” retains “market value” as the standard. The definition continues to define actual value as the “value determined using professional accepted mass appraisal methods, including, but not limited to, the (1) sales comparison approach using the guidelines in section 77-1371, (2) income approach, and (3) cost approach.” LB 717, § 2. Further, it retains the language in § 77-112 providing that “[a]ctual value is the most probable price expressed in terms of money that a property will bring if exposed for sale in the open market, or in an arm’s length transaction, between a willing buyer and willing seller, both of whom are knowledgeable concerning all the uses to which the real property is adapted and for which the real property is capable of being used.” *Id.* This language is the quintessential definition of “market” or “fair market” value. See, e.g., *Tech One Associates v. Board of Property Assessment, Appeals and Review*, 617 Pa. 439, 465, 53 A.2d 685, 700 (Pa. 2012) (“Market value is ‘a price which a purchaser, willing but not obliged to buy, would pay an owner willing, but not obligated to sell, taking into consideration all use[s] to which the property is adapted and might in reason be applied.’” (quoting *Deitch Co. v. Board of Property Assessment, Appeals and Review*, 417 Pa. 213, 217-18, 209 A.2d 397, 400 (1965))); *Cascade Court Ltd. Partnership v. Noble*, 105 Wash. App. 563, 567, 20 P.3d 997, 1000 (Wash. Ct. App. 2001) (“Market value means the amount of money which a purchaser willing, but not obliged, to buy would pay an owner willing, but not obligated, to sell, taking into consideration all uses to which the property is adapted and might in reason be applied.” (quoting *Mason Cty. Overtaxed, Inc. v. Mason Cty.*, 62 Wash.2d 677, 683-84, 384 P.2d 352 (Wash. 1963))).

The Nebraska Supreme Court has consistently recognized that “[f]or purposes of taxation, the terms actual value, market value, and fair market value mean the same thing.” *Richards v. Thayer Cty. Bd. of Equal.*, 178 Neb. 537, 540, 134 N.W.2d 56, 58 (1965). *Accord Xerox Corp. v. Karnes*, 217 Neb. 728, 732-33, 350 N.W.2d 566, 569 (1984); *Gage Cty. v. State Bd. of Equal.*, 185 Neb. 749, 751, 178 N.W.2d 759, 762 (1970). This is consistent with the generally recognized rule that “[t]rue or actual value of property has been defined as its market value.” 84 C.J.S. *Taxation* § 571 (2015). An earlier version of § 77-112 defining “actual value” listed “market value in the ordinary course of trade” as an element of a “formula” for determining actual value, which Justice McCown noted was “not an element but essentially the same as the ‘actual value’ which is to be determined.” *Carpenter*, 178 Neb. at 631, 134 N.W.2d at 284 (McCown, J., dissenting).

Accordingly, in our view, LB 717 does not change the standard of value in § 77-112, and the standard still equates to “market value”. The Constitution does permit the Legislature to “prescribe standards and methods for the determination of the value of real property at uniform and proportionate values.” Neb. Const. art. VIII, § 1(6). This language authorizes the establishment of standards and methods to determine value, which historically has been interpreted to be actual value, which means the same as market value or fair market value. The Legislature may certainly adopt methods to achieve that standard, and has done so in § 77-112. The statement of intent for LB 717 indicates the bill “would strike confusing language defining valuation as Market value and thus allow the legislature to define valuations over a period of time instead of a single date in time.” Committee Records on LB 717, 104<sup>th</sup> Leg., 2<sup>nd</sup> Sess., Introducer’s Statement of Intent 2

(Feb. 4, 2016). Enforcement of the uniform and proportionate requirement depends on adherence to an ascertainable standard of value. Historically, actual value has been understood to be the equivalent of market value or fair market value, and has served as the standard to judge compliance with the uniformity clause. To the extent § 2 of LB 717 represents an attempt to undo that understanding, we question if it can be squared with the constitutional mandate that real property be taxed “by valuation uniformly and proportionately.”<sup>3</sup>

*C. Requiring Use of Five Years of Sales Data and Exclusion of the Twenty Percent of Sales With the Lowest Assessment Ratio in Calculating the Measure of Central Tendency Used to Determine Whether Values Fall Within the Acceptable Range.*

Section 4 of LB 717 amends § 77-5023, the statute providing for adjustments by the TERC increasing or decreasing the value of a class or subclass of property so all property falls within the acceptable range for statewide equalization purposes. Section 4 proposes to amend § 77-5023(2), under which “[a]n acceptable range is the percentage of variation from a standard of valuation as measured by an established indicator of central tendency.” This subsection would be amended by adding that “[t]he measure of central tendency shall be determined using sales under subsection (2) of section 77-1327 occurring five years preceding the assessment date, excluding the sales which constitute the lowest twenty percent of assessment ratios, for all classes or subclasses of real property.” LB 717, § 4.

As noted in your request letter, the Department of Revenue [“Department”] has adopted regulations regarding calculation of “the measures of central tendency and other statistical indicators of the quality of assessment, such as the coefficient of dispersion and price related differential, of all or a class or subclass of property.” 350 N.A.C. § 12.003.07. The regulations establish a study period of two years for residential property, and three years for commercial property and agricultural and horticultural land. 350 N.A.C. § 12.003.07A(1)-(3). A longer or shorter study period may be used when the data developed for these periods does not “accurately reflect the value for a county and where the change in the length of the study period will enhance the Department’s ability

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<sup>3</sup> That is not to suggest that the Legislature may not establish a particular method to value a class of property other than market value which may be appropriate for that classification. For example, we have concluded the Legislature could provide that the value of agricultural land and horticultural land be determined on the basis of its earning capacity rather than as a percentage of market value. Op. Att’y Gen. No. 01013 (April 5, 2001). Our conclusion was based on the separate classification of agricultural land and horticultural land authorized under Neb. Const. art. VIII, § 1(4), and the rational basis to employ an earning capacity method of value for the taxation of agricultural land and horticultural land, provided it resulted in uniform and proportionate valuation within the class of agricultural land and horticultural land. LB 717, however, proposes no such alternative valuation for the class of agricultural land and horticultural land.

to determine a county's level of value." 350 N.A.C. § 12.003.07A(4). "To the extent possible, sales outside the established time period will be adjusted to the mid-point of the established time period." 350 N.A.C. § 12.003.08.

The Department's regulations are consistent with recognized standards for ratio studies. The standards generally recognize that the period from which sales are drawn "should be as short as possible, no more than one year." International Association of Assessing Officers, Standard on Ratio Studies at 10 ¶ 4.4 (April 2013) ["IAAO Standard"]. The IAAO Standard recognizes, however, that "[a] longer period may be required to produce a representative sample...." *Id.* "To develop an adequate sample size, the sales used in a ratio can span a period of as long as five years provided there have been no significant economic shifts or changes to property characteristics and sales prices have been adjusted for time as necessary." *Id.* The two and three year periods adopted in the Department's regulations are consistent with the IAAO Standard, and are no doubt based on a determination that these time periods are appropriate to provide a representative sample of sales for the various property classes throughout the state.

The IAAO Standard also address the "trimming" of "outlier ratios." IAAO Standard at 12 ¶ 5.2. "Outlier ratios are very low or very high ratios as compared with other ratios in the sample." *Id.* If outlier ratios are identified, they should be removed or "trimmed" in developing the sample. IAAO Standard Appendix B. Outlier Trimming Guidelines at 53 ¶ B.3. "However, trimming of outliers using arbitrary limits, for example, eliminating all ratios less than 50 percent or greater than 150 percent, tends to distort results and should not be employed." *Id.*

The use of five years of sales data under § 4 of LB 717 may be questionable, as it is not apparent that use of data for this length of time is necessary to provide a representative sample of sales. The IAAO Standard, however, indicates a five year sales period can be appropriate, which may depend on the type or class of property to which it is applied. The Department's regulations currently permit deviation from the two and three year sales data periods when necessary to accurately determine the level of value. If five years of sales data is used, however, the IAAO Standard provides time adjustments of the sales data may be necessary.

While the five year sales period alone may not be unreasonable, requiring that the lowest twenty percent of ratios be excluded is more problematic. The IAAO Standard provides that "outlier" ratios should be trimmed, but the lowest ratios are not necessarily "outliers".<sup>4</sup> There appears to be no sound basis to automatically remove the lowest twenty percent of ratios.

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<sup>4</sup> Section 77-1327, which provides for development of the sales file by the PTA, provides a county assessor's determination regarding the qualification of a sales will not be overturned unless, after Department review, it is determined by county assessor's decision is incorrect. Neb. Rev. Stat. § 77-1327(2) (Cum. Supp. 2014). The Department has adopted regulations regarding the inclusion of sales in the sales file, including review of a county assessor's determination "whether the sale is qualified or non-qualified for



It thus appears that the use of five years of sales, when combined with elimination of the lowest twenty percent of ratios, will create a lack of uniformity among property in the various classes in relation to market value. The values of residential, commercial, and agricultural property will necessarily increase or decrease at different rates, and ultimately the use of the extended period of sales and removal of low ratio sales will create disparities in the valuation and assessment of property in the same class relative to market value.

This disparity can be illustrated using the data provided by the Department attached to your opinion request. For example, the data related to dryland shows a 2016 projected change increasing the statewide average by 4.12 percent to bring the average to 75 percent, the level of value for the agricultural land class. Utilizing the 2016 five year sales data and twenty percent trim for 2016, however, results in a 25.42 percent decrease in the statewide average. This would effectively reduce the statewide average level of value for this subclass to approximately 54 percent. The data related to grassland shows a 2016 projected change increasing the statewide average by 18.43 percent to bring the average to 75 percent. Utilizing the 2016 five year sales data and twenty percent trim, however, results in a 31.61 percent decrease in the statewide average, effectively reducing the statewide average level of value for this subclass to approximately 42 percent. The resulting disparity in average values between these subclasses of agricultural land indicates a lack of uniformity relative to actual or market value between these subclasses, when all agricultural land must be valued uniformly and proportionately.

“Real property taxes may not be equalized by merely classifying property and then arbitrarily applying a given value to all properties of that classification.” *Warner v. Bd. of Equal.*, 214 Neb. 730, 733, 335 N.W.2d 556, 577-58 (1983). “The mere fact that a formula is devised, by which property is nonuniformly and disproportionately assessed, does not satisfy the constitutional requirements.” *Id.*, 335 N.W.2d at 558. *See also Carpenter*, 178 Neb. at 632, 134 N.W.2d at 284 (“[T]he Legislature cannot set an arbitrary formula or standard which does not reasonably reflect ‘actual value’ or ‘fair market value.’” (McCown, J., dissenting)). The formula prescribed in LB 717 would appear to arbitrarily value property and would likely result in nonuniform and disproportionate taxation of property in the same class, in violation of art. VIII, § 1.

## CONCLUSION

We conclude that the “freeze” of 2016 assessed values of real property at 2015 levels may result in a lack of uniformity among property in the same class in violation of Neb. Const. art. VIII, § 1. Further, the bill does not alter the definition of “actual value” in § 77-112 as “market value”, and we question whether, if that is the intent, an ascertainable standard or method of value is established consistent with Neb. Const. art. VIII, § 1(6),

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inclusion in the sales file as an arm’s length transaction.” 350 N.A.C. § 12.003.03C. Sales that are not based on arms-length transactions are to be excluded from the sales file.

given the historic understanding that "actual value" and "market value" are synonymous. Finally, establishment of a five year sales period, when combined with exclusion of the lowest twenty percent of ratios for purposes of determining the measure of central tendency under § 77-5023(2), would appear to result in property within the same class being assessed at values that are not uniform and proportionate relative to their market value. Accordingly, it is our opinion that these provisions of LB 717 are likely unconstitutional.

Very truly yours,

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Attorney General



L. Jay Bartel  
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Approved by:

  
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pc Patrick J. O'Donnell  
Clerk of the Nebraska Legislature

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