Matthew G. Bevin
Governor

William M. Landrum III
Secretary

COMMONWEALTH OF KENTUCKY
FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE
LEGAL SERVICES FOR REVENUE
P.O. BOX 423
FRANKFORT, KENTUCKY 40602-0423
Phone (502) 564-9581

Daniel Bork
Commissioner

Gwen R. Pinson
Office of General
Counsel

June 6, 2016

Mr. David O'Neill, PVA
Office of the Fayette County PVA
101 East Vine Street, Suite 600
Lexington, Kentucky 40507

Dear David:

This letter is in response to your letter of March 1, 2016 (copy attached at Tab A), in which you requested the assistance of David Gordon, Executive Director, Office of Property Valuation ("OPV"), Kentucky Department of Revenue ("Revenue"), in determining the meaning and applicability of several sections of KRS Chapter 132 relating to the "agricultural use" valuation for real property in Kentucky.

By prior agreement, Revenue deferred responding to your legal opinion request until after the adjournment of the 2016 General Assembly, in deference to the legislature's consideration of HB 576, filed by Rep. Palumbo on March 1, 2016 and co-sponsored by Rep. Flood. As you know, that bill was not enacted, but it is anticipated that the same or similar legislation may be filed for consideration by the 2017 General Assembly. The responses to your questions are based on the law as it exists on the date indicated above.

Ad valorem tax assessment of real property at "agricultural value" or "horticultural value" is authorized by Ky. Const. §172A, which provides as follows:

> Notwithstanding contrary provisions of Sections 171, 172, or 174 of this Constitution—
>
> The General Assembly shall provide by general law for the assessment for ad valorem tax purposes of agricultural and horticultural land according to the land's value for agricultural or horticultural use. The General Assembly may provide that any

> change in land use from agricultural or horticultural to another use shall require the levy of an additional tax not to exceed the additional amount that would have been owing had the land been assessed under Section 172 of this Constitution for the current year and the two next preceding years. The General Assembly may provide for reasonable differences in the rate of ad valorem taxation within different areas of the same taxing districts on that class of property which includes the surface of the land. Those differences shall relate directly to differences between nonrevenue-producing governmental services and benefits giving land urban character which are furnished in one or several areas in contrast to other areas of the taxing district.

This 1969 amendment to the Kentucky Constitution has been implemented through several provisions of KRS Chapter 132—i.e., KRS 132.010(9), (10), and (11); 132.450; and 132.454. For your convenience, copies of those statutes are attached hereto at Tab B.

You indicated that your questions arose out of public concern highlighted in a series of newspaper articles by the Lexington Herald-Leader. Copies of those articles dated February 18, 2016, through May 12, 2016, including your February 25, 2016 op-ed article, are attached hereto at Tab C. Revenue personnel, some of whom are quoted in the articles, have read these articles with interest and have also participated in the public discourse regarding this issue, having attended the public meeting you organized and facilitated at the Lexington Public Library on March 3, 2016, and the Lexington Forum meeting at Keeneland on April 7, 2016, where David Gordon participated with you and David Beck of the Kentucky Farm Bureau as part of the three-person panel facilitated by Tom Martin. Revenue also assisted the Legislative Research Commission staff in the drafting of HB 576.

Clearly, this issue has captured the public's attention, and there are certainly areas of concern with how the "agricultural valuation program" has been administered since the passage of HB 585 in 1992 (copy attached hereto at Tab D). HB 585 amended KRS 132.010(9) and (10) and KRS 132.450, removing all of the language requiring a landowner to provide proof of income from agricultural or horticultural activities on his or her property in order for the property to qualify for valuation as agricultural or horticultural land. Without such proof of income-producing activities from the properties they value and assess, the PVAs have been left with slim legal footing from which to refute a landowner's claims that their property has the "potential" to be used for agricultural or horticultural purposes, even when no such activities are likely to occur.

HB 585 also removed the "clawback" provisions of KRS 132.450(f) and 132.454. These requirements provided that when property valued and taxed as agricultural or horticultural land was converted to any other use, then the portion of the land upon which the use was changed was

subject to deferred taxes for the prior two tax years. The current version of KRS 134.454, which was last amended in 1994, provides only that the "portion of the land upon which the use is changed shall be subject to tax for the *succeeding* tax year at its fair cash value." (Emphasis added). Moreover, KRS 132.450(2)(b) provides that:

> Land devoted to agricultural or horticultural use, where the owner or owners have petitioned for, and been granted, a zoning classification other than for agricultural or horticultural purposes qualifies for the agricultural or horticultural assessment until such time as the land changes from agricultural or horticultural use to the use granted by the zoning classification.

The Summit at Fritz Farm development on Nicholasville Road and Man O' War Blvd. in Lexington, Kentucky, has been highlighted in the Herald-Leader articles as an example of abuse of the "agricultural valuation program." However, it is Revenue's opinion that your office has handled the valuation of that property in precisely the manner required by current law, as work at the development site did not start until July of 2015. Under KRS 132.450 and 132.454, the value of the property was properly determined based on the agricultural or horticultural use of the land on January 1, 2015. Now that construction has been undertaken on the property, you have indicated in your public discussions that your office's valuation of the property for the January 1, 2016 assessment will be $19 million. That appears to be exactly what the legislature intended with its modifications to the statutes in 1992 and 1994.

The more pressing concern is the fact that for many years, when responding to questions from PVAs as to whether certain parcels qualify for an agricultural value, Revenue has not given full, critical consideration to how the ten-acre minimum mandated by KRS 132.010(9) is impacted by the requirements of KRS 132.450(2). In various situations Revenue has advised PVAs that the agricultural value *can* apply to ten-acre parcels that include a house and other improvements. However, in determining the minimum acreage under KRS 132.010(9), KRS 132.450(2)(a) specifically mandates that the acreage devoted to certain land usages associated with a "dwelling house" must be *excluded*. After examining more closely how these statutory provisions appear to work in tandem—in the context of this public discussion—we believe that the correct interpretation is that in determining whether a parcel qualifies as "agricultural land," the acreage associated with the dwelling house cannot be included in the ten-acre minimum under KRS 132.010(9). KRS 132.450(2)(a) provides, in pertinent part, that:

> In determining the total area of land devoted to agricultural or horticultural use, there shall be included the area of all land under farm buildings, greenhouses and like structures, lakes, ponds, streams, irrigation ditches and similar facilities, and garden plots devoted to growth of products for on-farm personal consumption but

> there shall be excluded, land used in connection with dwelling houses including, but not limited to, lawns, drives, flower gardens, swimming pools, or other areas devoted to family recreation....

Thus, a property consisting of only 10 contiguous acres (5 contiguous acres in the case of commercial aquaculture or horticulture) cannot qualify for valuation as agricultural or horticultural land if it contains a dwelling house or any property used in connection with a dwelling house, as described in the statute. However, most PVAs throughout the Commonwealth have not undertaken the process described in the statute to determine whether a particular parcel may qualify for the agricultural or horticultural use value once the acreage used in connection with the dwelling is removed.

In your February 25, 2016 op-ed article, you also announced your intention to "grandfather-in" all properties that have been assessed under the agricultural or horticultural use value for the past five years, pursuant to KRS 132.450(3) ("Land that has been assessed as agriculture and owned by the same person for five or more years will retain the agricultural classification until it changes ownership.") However, it is not clear that is permissible in all instances.

KRS 132.450(3) provides as follows:

> When land which has been valued and taxed as agricultural land for five (5) or more consecutive years under the same ownership fails to qualify for the classification through no other action on the part of the owner or owners **other than ceasing to farm the land**, the land shall retain its agricultural classification for assessment and taxation purposes. Classification as agricultural land shall expire upon change of use by the owner or owners or upon conveyance of the property to a person other than a surviving spouse. (Emphasis added).

This portion of the statute is intended to preserve the agricultural valuation for property owned by a farmer who retires from actively farming the property and who does not sell or devise the property to a new owner. Therefore, if the agricultural designation is removed from properties which should never have qualified for the agricultural valuation in the first place, due to their failure to meet the 10-acre minimum after removal of the acreage for portions of the land indicated in KRS 132.450(3), the property should not be allowed to qualify for the designation going forward, unless sufficient additional acreage is added to the parcel.

Responses to Questions

It is the opinion of the Department of Revenue that real property which has not been actively engaged in an agricultural, horticultural, or commercial aquaculture use, or which has not been "devoted to and meeting the requirements and qualifications for payments pursuant to

agriculture programs under an agreement with the state or federal government," does not meet the requirements for agricultural or horticultural valuation under KRS 132.010(9)-(11).

The language of the applicable sections and paragraphs of KRS 132.010(9)-(10) speaks to a current and active use of the property for the indicated activities:

> (9) "Agricultural land" means:
>
> (a) Any tract of land, including all income-producing improvements, of at least ten (10) contiguous acres in area **used for** the production of livestock, livestock products, poultry, poultry products and/or the growing of tobacco and/or other crops including timber;
> (b) Any tract of land, including all income-producing improvements, of at least five (5) contiguous acres in area commercially **used for** aquaculture; or
> (c) Any tract of land **devoted to and meeting** the requirements and qualifications for payments pursuant to agriculture programs under an agreement with the state or federal government;
>
> (10) "Horticultural land" means any tract of land, including all income-producing improvements, of at least five (5) contiguous acres in area commercially **used for** the cultivation of a garden, orchard, or the raising of fruits or nuts, vegetables, flowers, or ornamental plants. (Emphasis added).

This statutory requirement that the land be "used for" agricultural, horticultural, or aquacultural purposes has become confused with the no longer extant requirement of active *income production*. In a number of recent Kentucky Board of Tax Appeals ("KBTA") cases, the issue of agricultural valuation has only involved the question of whether the property in question was actually producing income from the alleged agricultural activities. As the KBTA properly observed in those cases, that question was mooted by the legislature's 1992 amendments:

> Nowhere in the statutory definition of agricultural land is there a requirement that the land actually be producing income, before it qualifies for the classification. There were income-producing

> requirements previously in the statute, but they were removed by the legislature in 1992. Subsequent to that 1992 amendment, and to current date, the statute requires only that the land have an "income-producing capability."

Hai and Muoi Le, Appellants v. McCreary County Property Valuation Administrator, Appellee, 2013 WL 5880135, at *2. See also Christopher and Jennifer Reeder, Appellants v. McCreary County Property Valuation Administrator, Appellee, 2013 WL 5880124, at *2; and Jamie Claire Corum, Appellant v. Harlan County Property Valuation Administrator, Appellee, 2015 WL 3444481, at *3 (attached hereto at Tab F).

The statute requires that the land be "used for" agricultural, horticultural, or aquaculture purposes, and there is no case law or KBTA ruling stating otherwise. Therefore, the response to your first question, to wit:

> 1. **Is a property required to have active agricultural "use" in order to qualify for an agricultural classification or only that the land has an "income producing capability?"**

is that the property must be actively used for agricultural or horticultural purposes in order to qualify as agricultural or horticultural land under KRS 132.010(9) or (10).

Your second question is:

> 2. **What qualifies as "used for the production of" as the term is applied in KRS §132.010(9)?**

There is no statutory definition of "used" or "production" in KRS 132.010. And, where there is no statutory definition of a particular term in a statute, "[a]ll words and phrases in [the] statute shall be construed according to the common and approved usage of language such as found in a common dictionary." Louisville & N. R. Co. v. Department of Revenue, 551 S.W.2d 259, 261 (Ky. App. 1977) (*citing* KRS 446.080(4)). Thus, the definition of "used" is, as found in Webster's II New College Dictionary, "[t]o bring or put into service or action," and the definition of "production" is "an act or process of producing," or "[c]reation of value or wealth by producing goods and services." Therefore, the phrase "used in production," as it is used in KRS 132.010(9), may mean either: "to have brought or put into service in the act or process of producing agricultural goods or services" or "to have brought or put into service in the creation of value by producing agricultural goods or services."

From the standpoint of fairly administering the "agricultural valuation program" it may be better to adopt the latter interpretation of the phrase, as the "creation of value" aspect could aid the PVAs in determining whether claimed agricultural activities on a particular piece of property are,

in fact, legitimate (an activity which creates something of value or service to the owner) or merely a pretext for claiming the right to the agricultural valuation of the property for non-valuable activities (such as riding a tractor around the property without actually tilling the soil or doing anything aiding in the production of any crops or livestock). Note that something which has "value" to the owner would not necessarily have to produce income or any kind of profit.

Your third question asks:

> **3. What is meant by the phrase "in area used" for the production of agriculture contained in KRS §132.010(9)? Is this on the same tract or simply in an area where neighboring tracts use their land in that manner?**

The phrase pointed to, "in area used," is actually part of two phrases within the statutory definition of "agricultural land." One phrase is "ten (10) contiguous acres in area," and the other is "used for the production of," which is explained *supra*. The words "in area" refer to the area of measurement immediately preceding them—10 contiguous acres—an acre being a common unit of land measurement in the U.S. Customary System. See Webster's II New College Dictionary at 10.

It also means on the same tract of land, because "contiguous" means "sharing a boundary or edge, touching." Id. at 243. See also Parsons v. Dils, 172 Ky. 774, 189 S.W. 1158, 1159 (1916), in which Kentucky's highest court, in the only case examining the meaning of "contiguous," and noting the apparent "divergence of opinion as to the exact meaning" of the word, stated that it was "inclined to adopt that meaning which would make two tracts of land contiguous where they have a common corner, and which would make it possible to step from one to the other without crossing any other tract of land."

In your fourth question, you ask:

> **4. What is meant by the phrase "in area commercially used" in the definition of horticultural land in KRS§132.010(10)? How does this differ from "in area used" in KRS §132.010(9)?**

As with the response to your third question, the phrase pointed to is, again, part of two phrases in the statutory definition of "horticultural land." And, like the words "in area" in KRS 132.010(9)(a), the same words in KRS 132.010(10) refer to the area of measurement immediately preceding them—5 contiguous acres.

The term "commercial" in KRS 132.010(10) has no statutory definition. Therefore, as explained above, the term is given its common and approved usage. KRS 446.080(4). Again,

referencing Webster's II New College Dictionary, the common and approved definition of "commercial" is "[e]ngaged in commerce." The word "commerce" is, in turn, defined as "[t]he buying and selling of goods, esp. on a large scale: Business." The term "commercial" is also defined as "[h]aving profit as a primary aim." Therefore, it appears that "horticultural land" must be used for horticulture aimed at making a profit in order to qualify for horticultural valuation—but that does not necessarily mean that the owner must demonstrate a profit every year from his or her activities on the property.

Your fifth question is:

> **5. If a 10 acre tract includes a house used as the owner's primary residence, but the property is otherwise used in the production of agriculture, can the property qualify for an agricultural classification even though excluding the area under the house would cause the tract to fall short of the 10 acre minimum?**

As explained above, pursuant to KRS 132.450(2)(a), "[i]n determining the total area of land devoted to agricultural or horticultural use… there shall be excluded, land used in connection with dwelling houses including, but not limited to, lawns, drives, flower gardens, swimming pools, or other areas devoted to family recreation."

A property owner's primary residence is considered the "dwelling house," and the acreage upon which the house is built is "land used in connection with" the dwelling house—the dwelling is, after all, *connected* to the ground. Therefore, under current law, a 10-acre lot cannot qualify as "agricultural land" if the owner's residence—i.e., "dwelling house"—is located on the lot, as the 10-acre minimum under KRS 132.010(9)(a) cannot be demonstrated under the exclusions proscribed by KRS 132.450(2)(a). Note that this does not apply to housing located on farm property occupied by a non-owner and used in income-producing activity of the farm as dwellings for tenant farmers and farm workers. Dolan v. Land, 667 S.W.2d 684, 687 (Ky. 1984).

Your sixth question concerns commercial development of formerly agricultural land:

> **6. When a property planned for development in KRS §132.450(2)(b) ceases to be used in the production of agriculture, but rather is mostly dormant while awaiting final approval of a development plan and necessary zoning change, when should the agricultural classification be removed?**

The answer to this question is not completely clear, as explained below. However, it appears from our analysis that the proper answer is that the agricultural classification should be

removed when the agricultural activity on the property ceases and the new classification use begins.

KRS 132.450(2)(b) provides that:

> Land devoted to agricultural or horticultural use, where the owner or owners have petitioned for, and been granted, a zoning classification other than for agricultural or horticultural purposes qualifies for the agricultural or horticultural assessment until such time as the land changes from agricultural or horticultural use to the use granted by the zoning classification. (Emphasis added).

You have indicated that your office's policy is to treat such property as agricultural or horticultural land until such time as a final plat approved by the Lexington-Fayette Urban County Planning Commission has been recorded in the office of the county clerk—regardless of whether this filing coincides with the first day of earth moving or construction activities on the re-zoned site. The question, then, is whether, in and of itself, the filing of a plat changes the "use" of the land

The statutory language at issue is "changes…to the use granted by the zoning classification." The question, therefore, is when the "use" of land "changes" following the granting of a change in a zoning classification. As noted in 82 Am. Jur. §156, "the term 'use,' as employed in the context of zoning, is generally described as a word of art denoting the purpose for which a parcel of land or building is utilized." Courts in other jurisdictions have noted that the term can be somewhat "amorphous" in its meaning:

> This Court recognizes the term "use" has amorphous meanings in the realm of zoning. Municipal Elec. Auth. of *409 Ga. v. 2100 Riveredge Assocs., 180 Ga.App. 326, 348 S.E.2d 890 (1986). In addition to the interpretation that "use" describes the actual purpose of a property, the word is also sometimes employed to refer to the types of activities, practices, and operations conducted in connection with the property's purpose. *See* Recovery House VI v. City of Eugene, 156 Or.App. 509, 965 P.2d 488, 512 n.2 (1998) ("We … note … that the word "use" has two different meanings, depending on the context. It sometimes refers to the actual activity that is conducted on or proposed for … property, and sometimes to types of activities and operations that are or are not permissible in an area under zoning regulations.").

Heilker v. Zoning Bd. of Appeals for City of Beaufort, 346 S.C. 401, 408-09, 552 S.E.2d 42, 46 (Ct. App. 2001). Unfortunately, there is no Kentucky case law examining exactly what "use" means in the context of KRS 132.450(2)(b), as the reference to "zoning classification" in the statute confuses the matter to some degree.

If the intent of the legislature was to frame the term "agricultural or horticultural use" within the context of planning and zoning concepts, that does make for strange bedfellows, because, as the Court of Appeals has noted, the "agricultural supremacy clause" of KRS 100.203(4) "does not simply make a farm a legal nonconforming use but takes it outside the zoning ordinances' jurisdiction, although not outside the master or comprehensive plan." Grannis v. Schroder, 978 S.W.2d 328, 330 (Ky. App. 1997). Even when a zoning classification is changed from agricultural to another more dense use, such as commercial or residential, the agricultural or horticultural activity would still be allowed to continue as a non-conforming use. The change in classification by the planning commission would not, in and of itself, change the agricultural use of the property.

Under Kentucky's planning and zoning statutes, "agricultural use" is defined as "*the use of*: … [a] tract of at least five (5) contiguous acres for the production of agricultural or horticultural crops, including but not limited to livestock, livestock products, poultry, poultry products, grain, hay, pastures, soybeans, tobacco, timber, orchard fruits, vegetables, flowers, or ornamental plants…." KRS 100.111(2)(a). (Emphasis added). If we employ that definition in our attempt to parse the meaning of KRS 132.450(2)(b), then the language in question would mean: "until such time as the land changes from [the use of the land for the production of agricultural or horticultural crops…] to the use granted by the zoning classification."

If that is the proper interpretation of the statute, it would appear that, under KRS 132.450(2)(b) the land in question would continue to qualify for the agricultural or horticultural use valuation as long as the agricultural or horticultural activities on the property are being actively undertaken. If the land is simply sitting empty and unused, as far as can be objectively discerned from available evidence and observation, then a PVA would be justified in removing the agricultural or horticultural designation of the property pursuant to his authority under KRS 132.450(2)(d) and valuing it at fair cash value when the new classification use begins.

On the other hand, it might be argued that the filing of the final plat by the land owner is an act sufficient in and of itself, to change the "land use" *designation* of the property sufficiently to justify the removal of the agricultural designation under KRS 132.450(2)(b). However, taken in context with the rest of the language in that section, it appears that the legislature intended to allow the agricultural or horticultural designation to remain with the land for some period of time after the zoning change has "been granted" and "until such time as the land changes from agricultural or horticultural use to the use granted by the zoning classification." So, it is unlikely that argument would prevail. It appears that the proper interpretation of the statute is to remove the agricultural

or horticultural designation after the agricultural or horticultural activity ceases and the new classification use begins.

If the property in question was entitled to an agricultural or horticultural designation and was conveyed to a developer more than five (5) years prior to the current tax year, and the developer has maintained the agricultural activities on the property since that time, and the designation has not been subject to any change over that period of time, then the designation cannot be removed if the developer ceases the agricultural or horticultural activity, due to the operation of the "retired farmer" provision of KRS 132.450(3):

> When land which has been valued and taxed as agricultural land for five (5) or more consecutive years under the same ownership fails to qualify for the classification through no other action on the part of the owner or owners other than ceasing to farm the land, the land shall retain its agricultural classification for assessment and taxation purposes. Classification as agricultural land shall expire upon change of use by the owner or owners or upon conveyance of the property to a person other than a surviving spouse. (Emphasis added).

However, as explained above, if no agricultural or horticultural activity has been maintained on the property after the prior conveyance, then the designation can be removed, because the developer is not the owner who ceased farming the land. The prior owner ceased farming the land, and the prior owner conveyed the property to someone other than a surviving spouse.

Your final question, or series of questions, is as follows:

> **7. What is meant by "Election by owner" in the title of KRS §132.450? What is meant by "listed by the taxpayer" in KRS § 132.450(4)? What is meant by "property schedule" in KRS §132.450(5)? Do any of these phrases imply that agricultural classifications should only be approved at the taxpayer's request? Can the PVA require the taxpayer to request the classification before considering the qualifications?**

The words "[e]lection by owner," in the title of KRS 132.450 have no meaning. As the Kentucky Supreme Court has noted:

> "Title heads, chapter heads, section and subsection heads or titles[ ] ... in the Kentucky Revised Statutes, do not constitute any part of the law[.]" KRS 446.140. The titles of sections and subsections in the statutes, vis-a-vis the titles of Acts, are often renamed and inserted

> by the reviser of the statutes after the enactment of the statute, *See* KRS 7.136(1) ("The [reviser of the statutes] ... shall not alter the sense, meaning, or effect of any act of the General Assembly, but may: ... (b) Change the wording of headnotes[.]"), and therefore, are not part of the legislature's deliberations and debate. For that reason, unlike *an Act's* title, *see infra* note 11, the title of any *statute,* including KRS 371.065, should not be used as an aid in its interpretation.

Wheeler & Clevenger Oil Co., Inc. v. Washburn, 127 S.W.3d 609, 613 fn. 10 (Ky. 2004).

The phrase "listed by the taxpayer" in KRS 132.450(4) refers to the duty of all owners of property in Kentucky to list their property with the PVA for assessment as of January 1 of each year under KRS 132.220.

The phrase "property schedule" in KRS 132.450(5) is an older term no longer in common use. It referred to the individual property record card that a property owner could sign to show the property had been properly listed. However, it is important to note that KRS 132.450(5) does not apply to agricultural or horticultural land. It applies to property that the owner "does not consider to be subject to taxation." Those types of property are described in Ky. Const. § 170, and include public property used for public purposes, and real and personal property owned by institutions of religion, institutions of purely public charity, and institutions of education. Agricultural and horticultural land is not exempt from taxation, it is subject to taxation—just at a lower assessment than the fair cash value standard mandated by Ky. Const. § 172.

And, finally, a PVA *can* require a taxpayer to request the agricultural or horticultural classification for his or her property before the PVA considers whether the property qualifies for either of those designations, because KRS 132.220(2) provides that, "if requested in writing by the property valuation administrator or by the department, any real property owner shall submit a property tax return to verify existing information or to provide additional information for assessment purposes." That information requested could include verification that agricultural or horticultural activities are being actively pursued on the property. However, the agricultural or horticultural classification does not have to be approved only at the taxpayer's request. If the PVA knows that the property is being used for agricultural or horticultural purposes, he or she could continue to assess the land as such unless and until presented with evidence to the contrary.

I hope that the above analysis and advice will prove helpful to you. We are going to make a copy of this letter available on Revenue's website, and are also sending a copy to Mack Bushart, Executive Director of the Kentucky PVA's Association, for distribution to other PVAs throughout the state.

Please let me know if you have any questions regarding this letter or the subjects addressed herein. Thank you for your inquiry and for the work that you do for the citizens of Fayette County.

Sincerely,

Richard W. Bertelson, III
Staff Attorney III, Office of Legal Services for Revenue