Defining and Valuing the Base of the Property Tax

Joan M. Youngman
DEFINING AND VALUING THE BASE OF THE PROPERTY TAX

Joan M. Youngman*

I. INTRODUCTION .......................... 715

II. VALUATION OF PROPERTY SUBJECT TO A LONG-TERM LEASE 718
   A. "Contract" Versus "Fair Market" Rent 718
   B. The Effect of Statutory Language 721
   C. Reasoning from the Nature and Purposes of the Tax 725
      1. Taxing All Interests in Property 725
      2. Horizontal Equity 727
      3. Taxing the Capacity for Income 728
      4. Taxing the "Property Itself" 720
      5. Administrative Considerations 730
      6. Maximizing the Tax Base 732
   D. Analogous Valuation Problems 733
      1. Condemnation Awards 733
      2. Valuation Under Rent Control 739
      3. The State of the Owner's Title 740
      4. Property Subject to a Mortgage 741
      5. Property Subject to a Favorable Long-Term Lease 744
   E. The Long-Term Lease: Conclusions 745

III. VALUATION OF SPECIALTY PROPERTY 746
   A. Value to the Owner and Value to the Market 746
   B. Measuring Value to the Owner 749
   C. Depression Cases: What Is a "Market"? 751
   D. Extension to Income-Producing Property 755
   E. Extension to "Prestige" Structures 759
   F. The Question of Highest and Best Use 764
   G. Summary: The Cost Approach and Its Alternatives 767
      1. Horizontal Equity 767
      2. Imperfect Markets 769
      3. Realizable Sale Price as a Tax Base 770
   H. Specialty Valuation: Conclusions 773

IV. VALUATION OF PROPERTY SUBJECT TO EASEMENTS AND SIMILAR LEGAL RESTRICTIONS 774
   A. The Problem of Easements That Reduce Market Value 774
      1. Development of the Majority Position 775
      2. Application to Restrictive Covenants 782
      3. Mills, Golf Courses, and Low-Income Housing 788

---

* Associate, Hale and Dorr, Boston; Research Associate, Harvard Law School International Tax Program; A.B., 1973, Harvard College; J.D., 1977, Harvard Law School. Research for this article was supported by the Harvard Law School International Tax Program and the Lincoln Institute of Land Policy. I would like to thank Professor Oliver Oldman, Mary Miles Teachout, and Will Knedlik for their comments on earlier drafts of this article.
I. INTRODUCTION

The local tax on real property in the United States is generally an ad valorem levy, measured as a specified percentage of the fair market value of taxable land and improvements. The need to assign a market value to each taxable parcel (and even to nontaxable parcels, if the revenue lost by their exemption is to be calculated) offers fertile ground for dispute. The resulting case law provides some unexpected insights into the nature of the tax itself.

Valuation decisions set the tax that a given property owner must pay. A decision involving one owner may affect other taxpayers in the jurisdiction as well because the size of the aggregate property tax base, together with the revenue needs of the district, determines the tax rate. But certain valuation decisions are of even more general significance, for their solution implies an answer to the difficult and little-addressed issue of what exactly constitutes the property value subject to tax. While lawyers are familiar with definitions of "property" as a set of legal interests, popular association of that term with the object of those interests—here, the real estate itself—has had a clear effect upon valuation decisions. Moreover, even a definition of "property" as a set of legal interests leaves the exact components of that set unspecified. This is a central problem in the valua-

1. A recent listing of the statutory language defining the basis for assessed valuation in each state may be found in the ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, SIGNIFICANT FEATURES OF FISCAL FEDERALISM 1979-80, at 142-44 [hereinafter cited as ACIR]. Almost all states use some variation of "fair market value" as their statutory criterion. Assessments may, however, be made against a given fraction of that figure, a device which permits a given nominal tax rate to produce differing effective tax rates for various classes of property. California is a notable exception to the general rule of assessment at "fair market value." California's "Proposition 13" amended the state constitution to define "full cash value" as either the 1975-76 value of property or the "appraised value," i.e., fair market value, of property on the date of a later change in ownership or new construction, with a maximum 2% annual inflation adjustment. CALIF. CONST. art. XIII A, § 2. While this article deals primarily with the taxation of real property, many of the valuation principles discussed here are applicable to the taxation of personal property as well. A listing of each state's statutory criteria for the assessment of personal property may be found in ACIR, supra, at 145-46.

2. This procedure is subject to constitutional or statutory limitations upon the tax rate. E.g., CAL. CONST. art. XIII A, § 1 (limit of 1%); MASS. ANN. LAWS ch. 59, § 21(C)(1)(b), (e) (Michie/Law. Co-op. Supp. 1983) (general limit of 2½%, unless increased by two-thirds vote in a local referendum); WASH. CONST. amend. 55 (limit of 1% upon local and state aggregate levies).

3. See, e.g., RESTATMENT OF PROPERTY § 8 (1936) ("real property" used in RESTATMENT to mean specific interests in land). In this article, the term "legal interests" is used generally to denote judicially enforceable interests, without distinguishing between legal and equitable interests in land. Cf. id. § 6 (legal interests developed by principles, standards, and rules of courts of law; equitable interests by courts of chancery).

4. See infra notes 60-61. Statutes including physical objects within the definition of "property" for tax purposes include, for example, CAL. REV. & TAX CODE § 103 (West 1970) ("property includes "all matters and things" capable of private ownership); N.Y. REAL PROP. TAX LAW § 102(12)(a), (b) (McKinney 1972) ("property includes "land itself" and "buildings and other articles and structures" affixed to it).
tion of parcels subject to divided legal interests, where the value of the rights retained by the owner may be far below the value of the undivided fee.

In practice, courts have generally relied upon one of three alternative views of "property" in such cases, each with a corresponding definition of "value." First, property may be equated with the rights held by the owner, however circumscribed by public regulation and private agreement, with a concomitant definition of value as the actual sale price the owner could realize for his interest. Alternatively, property may be considered the unencumbered fee, permitting "value" to exceed the amount which the holder of a restricted interest could command in an actual sale. Finally, property may be identified with the physical land and improvements, entailing a corresponding search for "real" or "intrinsic" values. A choice among these approaches is rarely the topic of extensive judicial scrutiny. Yet resolution of this issue is crucial, not only for routine computational chores of the assessor and the valuation tribunal, but also for a general understanding of the operation of the tax itself.

In the absence of direct answers, this definitional question may be approached through examination of valuation disputes offering a choice among clear yet mutually exclusive definitions of "property" and "value." This article examines cases in three such categories. The first concerns property subject to a long-term lease unfavorable to the lessor. In this situation "property" may be equated with either of two quantities. It may be defined as the owner's interest, and its value measured by the sale price of the parcel as encumbered by the lease. Alternatively, it may be viewed as the sum of the owner's and lessee's interests, and valued by the hypothetical sale price of the unencumbered fee. In cases presenting this question of law, the definitional issue must be addressed, even if indirectly.

A second area concerns what has been termed "specialty" property. Specialty property consists of buildings of particular and sometimes unique value to their owners which is not reflected in the market prices these structures would command if offered for sale to others. An early such case involved the New York Stock Exchange.5 The Exchange's owners claimed that no other party would view it as anything but a "teardown proposition," a useless structure which actually reduced the market value of the bare land. In such a case, a statutory standard of "market value" as the basis for the tax may be interpreted in two ways. It may be held to require a nominal or even a negative valuation, reflecting the actual sale price realizable by the owner. Or value to the owner, as demon-

Property Tax

Stratified by the investment, may be considered to justify a cost-based valuation. The difficult choice thus presented between what often appears to be an outrageously low assessment of useful and costly improvements on the one hand and, on the other, a rejection of the literal terms of the statute further illuminates the difficulties in the valuation process. Where the lease decisions require a definition of the legal interests constituting the "property" to be valued, the specialty decisions direct similar attention to the meaning of "market value." Together, these two components determine the base of the property tax.

The third area concerns property subject to various types of legal restrictions upon the owner's use. Decisions concerning these restrictions, from zoning ordinances to easements, offer a similar set of alternative definitions of the tax base. The unrestricted value corresponding to the sum of all parties' interests in the real estate may be in fact unattainable by the owner in the market. Yet the amount realizable for the owner's remaining interests may reflect private, non-arm's-length and profit-motivated arrangements that produce a deliberate reduction in sale price. Here again, two alternatives are available, each with its own drawbacks. A court may tax a purely hypothetical "market value," although this requires contrary-to-fact speculation as to price. On the other hand, it may adopt the actual sale price of the parcel as its "value" for tax purposes, although this will allow the owner's unilateral and self-interested actions to diminish the jurisdiction's tax base.

These inquiries usually arise as discrete and isolated questions, but when taken together they offer a means of investigating the definition of the tax base itself. This article will examine the implications of the definitions of "property" and "market value" employed in the long-term lease and specialty cases for the valuation of land and improvements subject to easements and similar legal restrictions. A definition of "property" as the sum of all legal interests in a given parcel has permitted a workable resolution of the long-term lease problem. This approach is clearly superior to its alternatives and has been adopted in a majority of those jurisdictions that have considered the issue. The valuation decisions considering specialty property have produced no similar clarity of analysis, but they do serve a useful function by demonstrating that realizable sale price sets no universal ceiling upon "fair market value."

This article will consider the applicability of the "summation-of-interests" definition of property to the easement question generally, and will conclude that it is preferable to its alternatives in that context as well. The "summation-of-interests" definition in the easement context contradicts precedent established early in this century and accepted by a majority of jurisdictions. However, this precedent is based upon a number of logical
errors: it equates property rights with property value, assumes that “property” must be defined as the rights retained by the owner of the fee, and sets the realizable sale price of the owner’s interest as an upper limit upon “fair market value” for tax purposes. Finally, a concluding section will consider briefly the actual steps in the valuation process by which a new approach to the assessment of restricted property might be initiated.

More than forty years ago, James Bonbright surveyed the property tax as part of his landmark treatise on valuation, and determined that the field so lacked intellectual coherence as to make inquiries into its general principles useless. 6 The present investigation reaches a more optimistic conclusion. The tax is sufficiently rational to permit a critical comparison of alternative approaches to specific valuation questions, and to allow application of methods derived from the better-reasoned cases to other contexts presenting analogous difficulties. Although a surprising number of basic issues and principles concerning the property tax have never been resolved, the analysis found in a century of case law provides a basis upon which those tasks may begin.

II. VALUATION OF PROPERTY SUBJECT TO A LONG-TERM LEASE

A. “Contract” Versus “Fair Market” Rent

Valuation of property burdened by an unfavorable long-term lease often presents difficult factual issues as to the rent it could command if unencumbered, but the legal question posed is straightforward. Consider property subject to a forty-year lease written twenty years ago, calling for level annual rent far below the amount it could command if a new lease were written today. Should the assessment be based upon the actual sale price of the owner’s interest, limited as it is by twenty more years of the low return specified in the lease, the “contract” rent, or should it be based upon the sale price that would be offered if no lease existed? The latter figure reflects the full potential income a prospective purchaser could expect under a new lease.

A clear majority of the decided cases favor assessment on the basis of

---


The confusion as to the meaning and measure of value that one finds in the administrative practice and in the judicial rulings on real-estate assessment is not the type of confusion that can ever be cleared up by the professional appraiser or by the value theorist. The trouble lies far too deep to be cured by either of these economic skin specialists. It lies in the absence of any valid philosophy for the general property tax or for the general real-estate tax.

Id. at 508.
fair market rent, relying heavily upon the reasoning of early decisions in Massachusetts and New York. Courts there found that capitalization of contract rent erroneously equated the value of the landlord’s interest with the value of the property subject to the tax. In a 1923 opinion, Donovan v. Haverhill, the Massachusetts Supreme Judicial Court wrote, “The tax whether assessed to the owner of the fee or to the person in possession is a tax upon the whole land and not merely on the interest of the person taxed.” The New York Appellate Division accepted and expanded this reasoning in a 1962 decision, People ex rel. Gale v. Tax Commission:

[A] division of ownership or the independent holding of separate legal interests in taxable property will not affect the mode of assessment. For instance, mortgagor and mortgagee interests, vendor and vendee interests, landlord and tenant interests, life tenant and remainder interests and cotenant interests are not separately assessed.

Consequently, it is clear that, notwithstanding real property is subject to a long-term lease, there should be but a single assessment of the property without a separation of the interests of the lessor and lessee.

While this view has been accepted by a majority of the courts confronting the question, the attraction of actual, realizable sale price—a measure based upon leases in effect at the time of valuation—as the basis for assessment has produced several contrary decisions. The Vermont Su-


The very weight of judicial authority favoring this position has now become a factor exerting independent influence over more recent decisions. See, e.g., Crossroads Center, Inc. v. Commissioner of Taxation, 286 Minn. 440, 176 N.W.2d 530, 535 (1970):

[T]he taxpayers argue that since the property is burdened with an unprofitable lease the property value is considerably lower than it would otherwise be. However, the majority of cases provide that an unprofitable lease should not be used to determine value for property tax purposes. Rather, the fair rental value should be used.

8. 247 Mass. 69, 141 N.E. 564 (1923).
9. 141 N.E. at 565.
11. Ort Children Trust Four v. Supervisor of Assessments, No. 81 (Md. T.C. Jan. 23, 1981);
Supreme Court, for example, simply noted in 1976 that the tax was to be proportioned to the "fair market value" of the property, and concluded, "It is obvious that the presence of a lease/option agreement concerning a parcel of property is an element which enters into giving a saleable or market value to the property." The Michigan Supreme Court went even further in *C.A.F. Investment Co. v. Township of Saginaw*:

[T]rue cash value must equal the fair market value of the property to the owner . . . . [T]o equate economic income with hypothetical income in every situation where actual rent under a long-term lease is less than the prevailing market rental would be to ignore the effect of the lease on a prospective investor's judgment regarding the fair market value of the property.

The symmetrical opposition of these views is somewhat misleading. An apparently unambiguous determination by a state's highest court may dissolve in confusion when applied at a lower level—a fate experienced on both sides of this issue. In a case involving a one-year lease, the effect of which upon sale price would be minimal under either approach because of its short duration, the Michigan Court of Appeals nevertheless offered a restrictive interpretation of the state supreme court's utilization of contract rent in assessment, holding: "The requirement of using actual rental income . . . was limited to the facts of that case." Similarly, a 1972 trial court decision in New York began with an acknowledgment of the decade-old authority for capitalization of fair market rent, but immediately added language of exactly the opposite import:

[W]ith the traditional test of "market value," what investor will purchase real property without primary concern for the "bottom line"? The prudent investor's first concern is with his return now and in the foreseeable future—not what his bundle of rights may be many years hence . . . .

In the tradition of many valuation opinions, the court set compromise figures, leaving its own position on the long-term lease question unresolved. A number of courts have made similar attempts to settle specific long-term lease cases without reference to any general rule. Sometimes the
question is declared to be one of fact;\textsuperscript{17} sometimes general but circular declarations of principle are employed, such as a directive that actual rental income may be disregarded only when that figure does not reflect the "true value" of the property.\textsuperscript{18} Such decisions offer no aid in resolving the definitional issues underlying the valuation controversy itself.

B. The Effect of Statutory Language

Most constitutional and statutory language prescribing the legal basis for assessment has little impact upon the long-term lease question. Such enactments invariably employ phrases such as "fair market value," "actual cash value," "full and fair cash value," "just value," or "true and fair value," to name but a few.\textsuperscript{19} These terms do not address the question of what exactly constitutes the property to be valued; rather, they suggest the existence of a straightforward, nonhypothetical measure rendering that inquiry unnecessary. The Vermont Supreme Court was responding to such a suggestion when it found it "obvious" that contract rent under a long-term lease must control valuation for property tax purposes.\textsuperscript{20} The Connecticut Supreme Court adopted the same attitude in a 1978 decision, although it failed to adopt a general rule for dealing with such situations:

\begin{itemize}
  \item \textsuperscript{17} E.g., Wynwood Apartments, Inc. v. Board of Revision, 59 Ohio St. 2d 34, 391 N.E.2d 346 (1979) (long-term lease question a factual determination, therefore reviewable only for lawfulness and reasonableness). Yet in the Wynwood case, the county board of revision had specifically framed the issue in terms of a general legal principle:

  The problem confronted by the board herein was expressed as follows: "In a situation like this, where there is income producing property which is under lease and the contract rent is lower than the economic rent, should contract rent or economic rent be relied upon in pursuit of establishing the fair market value of the property?"

  391 N.E.2d at 347. The term "economic rent" is sometimes used in property tax cases such as this as a synonym for "fair market rent." This usage, of course, is distinct from the economist's definition of "economic rent" as the return to a factor of production with fixed supply, e.g., P. SAMUELSON, ECONOMICS 527, 557 (11th ed. 1980). See Commonwealth Edison Co. v. Montana, 453 U.S. 609, 629 (1981) (appellants defined "economic rent" as the difference between cost of production and market price).


  "We do not mean to suggest that consideration of actual income is improper in all cases. We hold only that, where the actual income from long-term leases does not reflect the true value of the property because the leases were made in a time of boom or depression or as a result of poor management, the board may reject or give little weight to the capitalization of actual net income method.

  Cf. State v. Cook, 60 N.J.L. 70, 36 A. 892, 893 (1897) (assessment of mining property; "yearly rental of the premises may also be taken into consideration as an element in the ascertainmet of true value, where the property is so situated that the yearly rental reflects upon true value").

  19. For a listing of the legal basis for assessed valuation in each state, see ACIR, supra note 1.

Since "fair market value" is generally said to be "the value that would be fixed in fair negotiations between a desirous buyer and a willing seller, neither under any undue compulsion to make a deal"; it cannot be said, either in law or logic, that the actual income accruing to [the lessor] under the particular facts of this case is not a significant factor to be considered in determining what a third party would pay to acquire the property in question.21

Yet if the "property in question" comprises the interests of both the lessor and lessee, a third party would not consider what arrangement might have existed between those two, but rather what rent he could expect to receive when offering the property anew on the market. Failure to define explicitly the "property in question" leaves the choice between these alternatives unresolved.

A set of Massachusetts decisions predating that state's decision on the long-term lease illustrates how little aid a standard such as "fair cash value" provides.22 At one time the Massachusetts Supreme Judicial Court found the "fair cash value" criterion as unambiguous as the Vermont court finds it today. For example, Judge Holmes in a Massachusetts opinion gave a characteristically terse definition of the "cash value" of property as "the amount of cash for which it will exchange in fact."23 This nonhypothetical, "in-fact" standard was weakened, however, when in 1919 the Massachusetts court addressed the problem of specialty valuation. In a confusing opinion,24 the court approved two contradictory rulings: one limiting valuation to "the sum which the owner after reasonable effort could, at the date as of which the assessment is made, obtain for it in cash";25 the other equating "cash value" with value "in the hands of any owner, including the present owners."26 This illustrates the problem of valuing unmarketable property—which may have a low sale price and a high value to its owner—but offers no solution. This unsatisfactory decision may have given the court an appreciation for the definitional problems contained within the deceptively simple statutory language when it approached the long-term lease question four years later. In

25. 124 N.E. at 28.
26. Id. at 28.
any event, the later opinion was explicitly based upon a concept of property which embraced both the lessor’s and lessee’s interests.27

Courts have found little aid in statutory guidance because property tax legislation generally does not address these definitional problems. For example, the Michigan “true cash value” standard28 and the Massachusetts “fair cash value” standard29 do not explain the divergent results of C.A.F.30 and Donovan31—especially when the Michigan statute calls for consideration of “economic income,” defined by the court as contract rent.32 Neither do Arizona’s “full cash value”33 and Vermont’s “fair market value”34 standards illuminate those states’ contradictory positions on the long-term lease.35 Such formulas are usually amplified by the “willing buyer-willing seller” criterion.36 Yet this merely strengthens the impression that a realizable sale price is to be found, without clarifying what is to be sold.37

37. Consider the reasoning of the New York Appellate Division in the 1961 Lincoln Square eminent domain decision.

While it is a fair presumption that a willing buyer would project his offer on the basis of what return he could obtain rather than on what the seller was receiving, it would be contrary to general experience to believe that he would ignore existing leases which had an appreciable period to run, with the consequent effect that the return he expected would not be realized for some years.
The Georgia and Vermont long-term lease decisions illustrate the malleability of such standards. In *Martin v. Liberty County Board of Tax Assessors*,38 the Georgia Court of Appeals interpreted a statute requiring that assessments reflect both the current use of property and any covenants or restrictions burdening it.39 On the other hand, in *Townsend v. Town of Middlebury*,40 the court dealt with a Vermont statute limiting such consideration to "state or local law or regulation affecting use of the land."41 It might seem, then, that the Georgia legislature intended private restrictions and agreements to affect property tax assessments, while the Vermont legislature took a contrary position. The respective courts took exactly the opposite approach, however, concluding that contract rent should govern valuation in Vermont but not in Georgia. The Georgia court defined "property" as the sum of all interests in the land and improvements: "Assuming . . . that the lease results in a decreased value of appellant's interest in the property, there would be a proportional increase in the 'fair market value' of the leasehold. The 'fair market value' of the estates merge to establish the 'fair market value' of the fee."42 The Vermont court, however, defined the "property" at issue as the owner's interest in the taxable realty, and found the extension of the legislature's recognition of public restraints to private agreements "not contrary to the logic of the statute."43

Because neither statute addressed the definitional issue, the outcome of these decisions could not be predicted by reference to legislation. In fact, any such effort would probably have forecast opposite results in each case. If certainty as to the amount to be paid is a primary goal for any

---

39. At the time of the *Martin* decision, the statutory requirement that the assessor "consider" covenants or deed restrictions dedicating land to a particular use, or "any other factors deemed pertinent in arriving at fair market value," was contained in *GA CODE § 92-5702* (1975). It is now found in *GA CODE ANN § 48-5-2(1)(B)* (1982).
42. *Martin*, 262 S.E.2d at 611.
43. *Townsend*, 365 A.2d at 516. This reinforces Llewellyn's contention that there exist "two opposing canons on almost every point" of statutory interpretation—here, while "expression of one thing excludes another," nonetheless "the language may fairly comprehend many different cases where some only are expressly mentioned by way of example." Llewellyn, *Remarks on the Theory of Appellate Decision*, 3 *VAND. L. REV* 395, 401, 405 (1950).
system of taxation, these cases are a poor reflection upon the performance of the courts and legislatures.

C. Reasoning from the Nature and Purposes of the Tax

Given the minimal guidance provided by statutes, the development of the majority approach—valuation based upon fair market rent, rather than below-market contract rent—has drawn heavily upon the courts' sense, not always explicit, of the aims and attributes of the tax. Prominent among such considerations in long-term lease cases have been the goals of taxing all interests in the property, however divided; of achieving horizontal equity, with the concomitant need to determine which taxpayers or parcels are to be considered similarly situated; of assessing property at its highest and best use; of taxing the "property itself"; of easing the burden of tax administration; and even of maximizing the tax base. Each of these issues sheds some light upon the long-term lease problem, but only the first provides a solution rather than a provocative rephrasing of the question, because it alone attempts to define the "property" subject to tax. An examination of principles involved in the cases dealing with the long-term lease confirms the superiority of the majority approach.

I. Taxing All Interests in Property

The most important and persuasive of these rationales interprets the tax as a levy upon all legal interests in a given parcel, one which treats realty subject to claims of both lessor and lessee in the same manner as equivalent property occupied by the owner. "[I]t is not generally proper or necessary that separate legal interests in a piece of property be independently assessed . . . . [T]here should be but a single assessment of the property without a separation of the interests of the lessor and lessee . . . ." Whatever interests constitute the "property" taxed when the owner occupies the premises continue to constitute the "property" after it is leased. A legislative decision to tax property values rather than the owner's income mandates an assessment of all interests comprising that property, whether or not the owner has reserved them for himself. Because a sale of the landlord's and tenant's interests together would permit the pre-

44. The tax which each individual is bound to pay ought to be certain, and not arbitrary . . . .
The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, . . . is not near so great an evil, as a very small degree of uncertainty.


mises to be offered for rent at current market levels, a determination that rented property should be assessed in the same manner as identical property occupied by the owner effectively answers the long-term lease question. The strength of this reasoning has been largely responsible for adoption of the summation-of-interests approach and valuations reflecting full market rents by a majority of the courts considering this issue.

Much of this analysis, however, is unique to the long-term lease context, and not transferable to consideration of divided interests in land generally. A landlord’s interest in property burdened by an unfavorable lease is diminished by reason of the encumbrance by exactly the amount of the “bonus value” enjoyed by the tenant—the present value of the difference between contract and market rent. Most other examples of divided legal interests lack this symmetry. A prohibition on construction of improvements, for example, might enormously diminish the value of the owner’s interest without necessarily enhancing any other; by contrast, an easement permitting access to a parcel of land might be responsible for almost all its market value but not significantly impair the value of the servient estate. In such situations an appraisal that simply ignored the


The decision of the court is not correct. The Michigan property tax is a tax on each item of nonexempt property, and the single annual assessment reaches all property rights and interests . . . One of the rights in property is the right to current possession. If the rent paid to the lessor for this right is less than the current market value, then the value of the right of current possession must, of necessity, be increased. When this enhanced value for the right of possession is combined with the value of the right to receive income from the property, the aggregate value of the property will reflect current economic rent . . . . Admittedly, a sale of the lessor’s interest would have reflected the unfavorable lease, but this is not enough. A sale of the lessee’s interest, conversely, would have resulted in a return disproportionately higher than his relatively low rental expense would suggest. The court should have considered the combined possible return on sale.


47. “Where the contract rent is less than the economic rent, the owner in fact transfers a portion of the land value to the user.” A. RING, THE VALUATION OF REAL ESTATE 37 (2d ed. 1970).

48. E.g., Lodge v. Inhabitants of Swampscott, 216 Mass. 260, 103 N.E. 635 (1913) (deed restrictions upon erection of improvements held to reduce “fair cash value” for tax purposes).

49. Numerous cases dealing with the taxation of property subject to an easement have ignored this possibility and simply assumed that total market value of the servient and dominant estates is conserved in this transaction. “When an easement is carved out of one property for the benefit of another, the market value of the servient estate is thereby lessened, and that of the dominant increased, practically by just the value of the easement; the respective tenements should therefore be assessed accordingly.” Tax Lien Co. v. Schultzze, 213 N.Y. 9, 106 N.E. 751, 752 (1914). This point is discussed in more detail infra at text accompanying notes 268–71.
existence of the encumbrance might seriously distort aggregate market values. While a tax on the sum of all such interests might prove equally appropriate under these circumstances, the straightforward device of disregarding the encumbrance cannot be the means of achieving that end.\textsuperscript{50}

The majority approach to the long-term lease cases does offer a pattern applicable to arrangements which, like the lease, may affect a number of persons but only one parcel of real estate—such as a mortgage or a life estate—no matter what agreement these parties may have reached among themselves as to liability for actual payment of the tax.\textsuperscript{51} When a legal restriction affects more than one unit of taxable property, the principle of taxing all interests in a given unit provides only a part of the solution to this more complex valuation problem. For the long-term lease, however, it offers a consistent and nearly complete answer.

2. \textit{Horizontal Equity}

Considerations of horizontal equity have been cited by a number of cases adopting the majority approach to the lease question. "Taxing statutes should not be construed so as to create inequalities between taxpayers who own comparable parcels of substantially the same market value but who, for a variety of reasons, receive disproportionate incomes from the lease thereof."\textsuperscript{52} This is an important argument, made more powerful by the variety of legal transactions through which an owner could diminish the realizable sale price of a parcel of property without altering either the physical situation of the property or the economic position of the owner.\textsuperscript{53} The argument is not complete in itself, however, for it requires a

50. \textit{People ex rel. Gale v. Tax Comm'n}, 17 A.D.2d 225, 233 N.Y.S.2d 501, 504–05 (1962), recognized this distinction but quoted Bonbright for the comment: "Why the easement should have received the exceptional treatment we are unable to say." 1 J. \textit{BONBRIGHT, supra} note 6, at 497.

51. \textit{Some states provide for separate taxation of leasehold interests. E.g., GA. CODE ANN. § 48-5-3 (1982) ("All real property including, but not limited to, leaseholds, interests less than fee, and all personal property shall be liable to taxation . . . ")}. Neither this statute nor its predecessor was at issue in Martin v. Liberty County Bd. of Tax Assessors, 152 Ga. App. 340, 262 S.E.2d 609 (1979), discussed \textit{supra} at note 39–43, because the lessor had agreed to pay all property taxes upon the real estate at issue in that case.

The Vermont Supreme Court suggested in Townsend v. Town of Middlebury, 134 Vt. 438, 365 A.2d 515, 517 (1976) that legislative action of this type would be necessary in order to tax the "bonus value" enjoyed by the lessee. Yet this ignores the legislative action that has been taken in establishing a system of local taxation of property. Any long-term lease decision provides at least an implicit definition of "property"; the court cannot simply await a legislative solution.


53. For example, in \textit{Martin} the lessor chose to receive a disproportionate share of the rental payments in the first four years of a 35-year lease.
prior determination as to the subject matter of the tax. Without this step, there is no way of identifying those equal properties which are to be treated equally. Are they parcels yielding equal income to their owners, those with equal realizable sale values, those with equal return to all parties holding interests in them, or those with similar physical features? Until this choice is made, appeals to horizontal equity could support any given method of valuation.

3. Taxing the Capacity for Income

The concept of "highest and best use" provides another standard for assessment: it suggests that properties of equal income-producing potential are to be treated equally, whatever the current yield to their owners. "[I]t is the capacity for earning income, rather than the income actually derived, which reflects 'fair cash value' for taxation . . . ." This is a

Under appellant's argument that the terms of the lease are to be considered in the assessment of the "fair market value" of property for tax purposes, the tax liability of one who elects, as did appellant, to receive the greater part of the consideration in the early years of the lease, would be correspondingly greater during those years. Had the board been obliged to consider "use" of the property during the first four years of the lease of appellant's property, we doubt if he would be so ardent an advocate of the argument he currently advances.

Id. This suggests that, if contract rent and thus the sale value of the owner's interest were to be the test of taxable value, an owner could take as a lump sum the present value of all payments required by the lease, leaving only the reversionary value as the basis for assessment.

54. C.A.F. Inv. Co. v. Township of Saginaw, 410 Mich. 428, 302 N.W.2d 164 (1981), illustrated this problem. The majority argued that the constitutional requirement of uniformity in taxation, MICH. CONST. art. 9, § 3, required capitalization of contract rent in assessment: "Properties encumbered by different lease terms . . . would not have the same cash value on the open market. It would be incongruous, indeed violative of the rule of uniformity, to assess two properties the same despite the fact that their usual selling prices are different." 302 N.W.2d at 173 (citations omitted). The dissent, on the other hand, reasoned that the requirement of uniformity required capitalization of fair market rent: "To allow business acumen to form the controlling basis of property tax assessment in Michigan would obliterate the principal concept of consistency. Such a conclusion would seem fundamentally unfair and would result in the doctrine of uniformity becoming a mere sham." Id. at 189-90 (Moody, J., dissenting). A requirement of uniformity, without more, cannot determine whether taxes are to be uniform between owners whose interests are of equal value, or between owners whose properties contain interests of equal total value.

55. Springfield Marine Bank v. Property Tax Appeal Bd., 44 Ill. 2d 428, 256 N.E.2d 334, 336 (1970). Accord Somers v. City of Meriden, 119 Conn. 5, 174 A. 184, 186 (1934) ("As a general principle, earning or income-producing capacity, as distinguished from actual earnings, is to be regarded as a factor in valuation for taxation purposes . . . ."); Assessors of Quincy v. Boston Consol. Gas Co., 309 Mass. 60, 34 N.E.2d 623, 626 (1941) ("The rental value of the land is competent as showing its market value, although its earning capacity rather than its actual income would seem to be more appropriate for this purpose.") (citations omitted); In re Property of Pine Raleigh Corp., 258 N.C. 398, 128 S.E.2d 855, 859 (1963):

The statute, G.S. § 105-295, in fixing the guide which assessors must use in valuating property for taxes, includes as a factor "the past income therefrom, its probable future income." But the income referred to is not necessarily actual income. The language is sufficient to include the
helpful elaboration, but one in which the definitional problem simply assumes a new form.

Under what circumstances is the property’s “capacity for earning income” to be determined? Surely some legal restrictions are to be given weight. At a minimum, those imposed by the taxing jurisdiction itself, such as zoning classification, rent control, and landmark preservation programs limiting future development, must be examined to determine their effects upon the market value of the property. These effects may largely depend upon potential purchasers’ estimates of the possibility that such restrictions could be lifted or modified in the future. Such encumbrances may be distinguished from the long-term lease, as the latter is undertaken voluntarily by the owner. Having had no part in imposing the lease, the taxing jurisdiction need not account for it in assessment. This rationale deals adequately with the lease, but demonstrates again that a solution sufficient in this area may resist easy translation to other types of encumbrances and restrictions.

4. Taxing the “Property Itself”

Some courts have attempted to answer valuation questions by charac-

---

income which could be obtained by the proper and efficient use of the property. To hold otherwise would be to penalize the competent and diligent and to reward the incompetent or indolent.

56. California requires tax assessors to take into account any enforceable restrictions upon the use of land, and establishes a rebuttable presumption that zoning restrictions are permanent. Meyers v. County of Alameda, 70 Cal. App. 3d 799, 139 Cal. Rptr. 165 (1977); CAL. REV. & TAX. CODE § 402.1 (West Supp. 1983). An even stricter view was expressed in Kensington Hills Dev. Co. v. Milford Township, 10 Mich. App. 368, 159 N.W.2d 330, 332 (1968): “Zoning restrictions are real and, during their duration, limit the use of the property as much as deed restrictions.” Contra Trinity Place Co. v. Finance Adm’r, 38 N.Y. 144, 149, 341 N.E.2d 536, 539, 379 N.Y.S.2d 16, 20 (1975) (“[T]he fact that the plaza land may not be used for other purposes without city permission is not determinative of its value . . . . What has been zoned can be rezoned.”).


58. See NEW YORK CITY ADMIN. CODE § 207-8.0 (1978), which incorporates procedures for tax exemptions and remissions into consideration of requests for alterations of landmarks and historical districts. In a major landmark preservation case involving the Grand Central Terminal, Penn Cent. Transp. Co. v. City of New York, 42 N.Y.2d 324, 331, 366 N.E.2d 1271, 1275, 397 N.Y.S.2d 914, 918 (1977), aff’d, 438 U.S. 104 (1978), the New York Court of Appeals recognized that “the value of the property necessarily depends on the return permitted or available.”

59. “[T]he advantageous leases were yielded to the three tenants with the landlord’s eyes open . . . . The county was not a party to these plans; nor was it, or is it, a coventurer who was required to share in [the taxpayer’s] good or bad fortune.” Merrick Holding Corp. v. Board of Assessors, 45 N.Y.2d 538, 545, 382 N.E.2d 1341, 1344, 410 N.Y.S.2d 565, 569 (1978). The Arizona Court of Appeals expressed a similar attitude in Caldwell v. Department of Revenue: “[T]he voluntary alienation of a leasehold interest does not destroy the comparability of the sale of other properties not similarly encumbered.” 122 Ariz. 519, 596 P.2d 45, 47 (Ct. App. 1979).
terizing the tax as a levy upon the "property itself." This resembles a
definition of "property" as the sum of all legal interests but risks serious
confusion by suggesting the tangible, physical object as the subject of the
tax. The market value of ownership rights in the land cannot be set
without reference to intangible legal attributes. "Properties may have
similar physical characteristics, but differences in economic factors will
determine the usual selling price of the properties. Properties encumbered
by different lease terms, zoning restrictions, or deed restrictions, al-
though physically similar, would not have the same cash value on the
open market." Unless a court is willing to ignore zoning, rent control,
and historic preservation restrictions, on the one hand, or to allow owner-
imposed and non-arm's-length agreements to lower an assessment on the
other, the task of distinguishing among various types of encumbrances
cannot be avoided.

5. Administrative Considerations

Concern for the efficient administration of the property tax has played a
role in long-term lease decisions, as courts adopting the majority position
and valuing property in light of its full market rent have occasionally ad-

60. E.g., Caldwell v. Department of Revenue, 122 Ariz. 519, 596 P.2d 45, 47 (Ct. App. 1979)
("It is the value of the real property itself that is to be determined . . . ."); People ex rel. Gale v. Tax
Comm'n, 17 A.D.2d 225, 233 N.Y.S.2d 501, 504 (1962) ("[R]eal property taxes are assessed on the
basis of the full value of the property itself. In all cases the assessment is against the 'real property
itself'. . . . The tax levied is a tax upon the whole land, and not merely on the interest of a particular
person therein."). Gale drew upon a statute, N.Y. REAL PROP. TAX LAW § 304(1) (McKinney Supp.
1982-83), which provides that assessments are to be "against the real property itself which shall be
liable to sale pursuant to law for any unpaid taxes or special ad valorem levies." But the question as
to whether the owner is personally liable for unpaid taxes, or whether these become simply a lien
against the property assessed, is distinct from the valuation issue as to what conditions are taken into
account in setting the "fair market value" of the real estate.

61. Bonbright contended that decisions in the early part of this century indicated a shift from
identification of "property" with a tangible object to "the newer concept of property, which centers
attention in opportunities and expectations of income rather than in physical things." 1 J. BON-
BRIGHT, supra note 6, at 109. He also stated:

Because the law of early capitalism concerned itself so largely with rights of full, undivided
ownership, and because these rights attached mainly to specific, tangible objects, like land or
chattels, the property rights in these objects were closely identified with the objects themselves.
. . . A court, no less than the layman, will sometimes refer to a tract of land or a shipment of
wheat as property, and will sometimes refer to the legal interests of people in this land or in this
shipment as property.

Id. at 100–01. Bonbright foresaw that this "process of education," id. at 109, would lead to greater
emphasis upon capitalization of income as a method of valuing "property." But the long-term lease
cases demonstrate that such capitalization can itself prove insufficiently sophisticated unless the cir-
cumstances under which the income is to be measured are explicitly identified—and that process can
shift attention from the owner's interest to the sum of all interests in the physical "land itself."

See supra text accompanying note 13.
verted to the danger that an opposite result would encourage tax evasion through mutually disadvantageous leases or other rental arrangements without economic effect. Similarly, the difficulty of evaluating the terms of all leases within a taxing jurisdiction is sometimes cited in support of a decision to capitalize fair market rent rather than contract rent.

These considerations can lend additional weight to a decision justified by independent reasoning, but cannot in themselves support a given outcome. Valuation of commercial property will of necessity involve occasional analysis of complex documents and financing arrangements. A decision to capitalize fair market rent introduces complexities of its own, substituting the assessor's computations for either a verifiable income figure or the actual sale price of the encumbered property. Courts choosing to reject the majority position and value property on the basis of below-market rent have had little trouble rationalizing the administrative consequences of their position. Given the administrative difficulties inherent

63. E.g., Clayton v. County of Los Angeles, 26 Cal. App. 3d 390, 394, 102 Cal. Rptr. 687, 690 (1972).

64. E.g., Richmond, F. & P. R.R. v. Commonwealth, 203 Va. 294, 124 S.E.2d 206, 211 (1962) ("If I own land worth $10,000 I cannot escape taxation by renting it to a friend for one dollar a year. And tax assessors cannot be expected to ascertain whether the lessee is a friend or a controlling stockholder of the lessor.").

65. E.g., Martin v. Mesquite, 590 S.W.2d 793, 798 (Tex. Ct. App. 1979) ("We cannot adopt a rule that would require the tax assessor to examine the provisions of each commercial lease, calculate the rent under various contingencies, evaluate the taxpayer's claims of legitimate expenses, and apply a capitalization factor to determine market value.").

66. A sale-leaseback, for example, requires a determination as to whether the rental payments constitute interest for the use of money in addition to payment for the use of property. E.g., Uniroyal, Inc. v. Middlebury Bd. of Tax Review, 174 Conn. 380, 389 A.2d 734 (1978); Federated Dep't Stores, Inc. v. Board of Tax Review, 162 Conn. 77, 291 A.2d 715 (1971); City of Atlantic v. County Bd. of Review, 234 N.W.2d 880 (Iowa 1975). Unless the actual lease is to be ignored, its terms must be analyzed in order to identify elements of noncash return to the lessor (such as construction of improvements) or payments by the lessee for nonoccupancy benefits (such as the use of money).

67. Considerations of this type have led the New Jersey Supreme Court, which has in a series of well-reasoned opinions rejected capitalization of below-market rent as a basis for assessment, Humble Oil & Ref. Co. v. Borough of Englewood Cliffs, 71 N.J. 401, 365 A.2d 929 (1976); City of New Brunswick v. State Div. of Tax Appeals, 39 N.J. 537, 189 A.2d 702 (1963), to require that contact rent upon large, well-managed apartment projects operating under short term leases be treated as prima facie evidence of fair rental value. Parkview Village Assocs. v. Borough of Collingswood, 62 N.J. 21, 297 A.2d 842 (1972). "A court or taxing agency should be most hesitant to find that the tenants of a residential property being operated commercially are being charged inadequate rent." 297 A.2d at 849.

68. E.g., Townsend v. Town of Middlebury, 134 Vt. 438, 365 A.2d 515, 517 (1976) ("we believe that any attempted fraud of this nature would be readily discoverable through resort to the judicial process"). The Vermont court, in fact, saw no administrative barriers to increasing the number of assessments, for it recommended that the legislature permit leases and options to be taxed to their holders if capitalization of below market rent in assessment offended the principle of horizontal equity. Id. Cf. Lodge v. Inhabitants of Swampscott, 216 Mass. 260, 103 N.E. 635, 636 (1913) (As to deed restrictions, the court held: "No doubt assessors cannot be compelled to inquire into all the
in any system of ad valorem taxation, the incremental burdens posed by various approaches to the lease question can have no decisive effect upon the long-term lease question.

6. Maximizing the Tax Base

An even more pragmatic approach to valuation has led some courts to cite the need for a stable tax base as justification for disregarding an unfavorable long-term lease. Generally, these courts have attempted to reconcile this result with the statutory standard of market value by an appeal to "true" or "intrinsic" values. This reasoning was most in evidence in the 1930's, when the cataclysmic drop in market values accompanying the Depression threatened to erode the economic support of local governments. Constitutional and statutory limitations prevented them from recovering through rate increases what they lost through diminution of the tax base. Yet even if maximization of that base were accepted as a


Stability in municipal income is a factor which must always be considered. To require owners of property which is not income-producing to pick up the deficiency resulting from reducing the tax burden of income property owners each time there is a temporary downward trend in the economy, would surely not be either feasible or equitable.

70. E.g., People ex rel. 379 Madison Ave., Inc. v. Boyland, 281 A.D. 588, 121 N.Y.S.2d 238, 241 (1953) ("There are times when property must bear a share of taxation proportionate to value even though it may then have no income, or an income inadequately focused to true value."). By contrast, Bonbright refused to draw any implication of normal or intrinsic worth from the term "value," stating that "an abnormal, or evanescent, or extortionate, or dangerously low market price represents just as true a current value as does a normal, or permanent, or fair, or reasonably high market price."

1 J. BONBRIGHT, supra note 6, at 29 n.23.

71. "The fact that property cannot be sold at a particular period of depression should not be taken as conclusive that its value has been materially reduced." Somers v. City of Meriden, 119 Conn. 174 A. 184, 186 (1934). Bonbright commented, "During a depression, therefore, assessors and judges must conspire in a gigantic legal lie about property values—a lie which is concealed by all sorts of loose talk about the stability of real values as contrasted with the collapse of mere market prices." 1 J. BONBRIGHT, supra note 6, at 471. In 1936 the United States Supreme Court took judicial notice "of the fact that late in 1929 there occurred a great collapse of values of all classes of property," and held failure to consider the effect of the Depression upon property values a violation of the fourteenth amendment. Great N. Ry. v. Weeks, 297 U.S. 135, 149, 152 (1936). Yet this decision's effect was more limited than might be expected. Assessments at "true" or "intrinsic" value continued; only complete disregard of the 1929 collapse was prohibited. This "factor" could easily be "taken into account" without necessarily having an observable effect upon the ultimate figures assigned as the property values. See, e.g., Minnesota v. Federal Reserve Bank, 25 F. Supp. 14, 20 (D. Minn. 1938) (citing Great N. Ry., upholding 1936 assessment valuing unmarketable building at $2.9 million). On the constitutional and statutory limitations preventing unlimited property tax rate increases, and their effect upon assessments during the Depression, see infra note 176.
Property Tax

proper goal for assessment, it would only suggest in the lease context that the greater of contract or fair market rent be capitalized.\textsuperscript{72} The fact that even such a principle, divorced as it is from verifiable and statutorily mandated market value criteria, may be perceived as a guide for assessment\textsuperscript{73} dramatizes the absence of clear goals for the property tax.

D. Analogous Valuation Problems

A third source of guidance is found in similar valuation controversies, especially those surrounding eminent domain proceedings and assessments of property encumbered by other types of legal restrictions.

1. Condemnation Awards

Comparison of eminent domain and property tax decisions proves again the inexactness of a "market value" standard. A number of courts declare valuation procedures for these two purposes to be identical, while others find them dissimilar.\textsuperscript{74} Decisions setting condemnation awards for the taking of property subject to a long-term lease provide special guidance for the property tax question, however, by analyzing the issue in terms of the legal interests constituting the "property" so taken.

"Just compensation" for property encumbered by a long-term lease and taken for public use\textsuperscript{75} requires valuation of both the lessor's and lessee's interests in appropriated property.\textsuperscript{76} The lessee's interest or "bonus value" is calculated as the difference between fair rental value of the premises and rent reserved in the lease.\textsuperscript{77} The lessee's award thus differs

\textsuperscript{72} Both Somers v. City of Meriden, 119 Conn. 5, 174 A. 184 (1934), and Uniroyal, Inc. v. Middlebury Bd. of Tax Review, 174 Conn. 380, 389 A.2d 734 (1978), recognized fair market rent, not contract rent, as the proper basis for valuation in property tax cases, yet both permitted the assessor to take above market leases into account. In Somers the desire to maintain pre-Depression values was explicit. The Uniroyal court professed no goal of maximizing assessments, but the result suggested such an approach.

\textsuperscript{73} E.g., Somers v. City of Meriden, 119 Conn. 5, 174 A. 184, 186 (1934) ("Was it the purpose of the statute to jeopardize the machinery of . . . [a] municipality, during a depression, or was it enacted to cover ordinary conditions existing over a period of years? To ask the question is to answer it."); Central Realty Co. v. Board of Review, 110 W. Va. 437, 158 S.E. 537, 538 (1931).

\textsuperscript{74} Compare Great N. Ry. v. Weeks, 297 U.S. 135, 139 (1936) ("The principles governing the ascertaining of value for the purposes of taxation are the same as those that control in condemnation cases, confiscation cases, and generally in controversies involving the ascertainment of just compensation."\textit{}) with Peck v. Pelcher, 55 Misc. 2d 516, 285 N.Y.S.2d 767, 769 (1967) (valuation for taxation is "a totally different concept than exists in eminent domain proceedings").

\textsuperscript{75} U.S. CONST. amend. V. Similar language can be found in almost all state constitutions. Searles, Eminent Domain: A Kaleidoscopic View, 1 REAL EST. L. REV. 226, 228 (1973).

\textsuperscript{76} E.g., Maxey v. Redevelopment Auth., 94 Wis. 2d 375, 288 N.W.2d 794 (1980); see also United States v. Petty Motor Co., 327 U.S. 372 (1946).

\textsuperscript{77} E.g., \textit{In re} Mott Haven Houses, 33 Misc. 2d 808, 227 N.Y.S.2d 858, 862 (1960), aff'd, 16
from the measure of a lessee's interest for property tax purposes. If a separate tax were imposed on the leasehold interest—as is commonly done when the lessor is a tax-exempt entity—no deduction would be made for the present value of the contract rent. For tax purposes, the leasehold would be valued at the discounted fair market rent over the lease term—what the lessee would pay a landlord, not what a prospective tenant would pay the lessee to assume the lessee's position and rent obligations. The fact that no award is due the lessee in condemnation does not mean the leasehold has no taxable value. As the California Supreme Court explained:

In eminent domain the full value of the interest must be paid for, but since the taking discharges the obligation to pay future rent, the value of that obligation to the lessor must be awarded to him. . . . It would be anomalous to hold that a possessory interest has no value [for tax purposes] merely because the lessee has agreed to pay what it is worth.

In other words, the court in an eminent domain proceeding may accept the value set for the lessee's interest for tax purposes, and yet require no payment in compensation for its loss because a rental obligation of equal magnitude was simultaneously extinguished. To the extent the lessee enjoyed no "bonus value" from below-market rent, no compensation is due, and the lessor's award should be correspondingly greater than that due the owner of a similar structure bound by an unfavorable lease.

Eminent domain decisions thus clearly value property as a summation of interests, with little of the confusion found in property tax decisions


78 Texas Co. v. County of Los Angeles, 52 Cal. 2d 55, 338 P.2d 440, 444 (1959). This case involved valuation of a possessory interest in tax-exempt property, the possessory interest alone being subject to tax. In Blinn Lumber Co. v. Los Angeles County, 216 Cal. 474, 14 P.2d 512, (1932), the court had held that a leasehold subject to separate assessment was to be taxed only upon its "bonus value," allowing a deduction for rental payments. A leasehold interest acquired for fair market value thus had no separate taxable worth. Blinn was overruled in De Luz Homes, Inc. v. County of San Diego, 45 Cal. 2d 546, 290 P.2d 544, 557 (1955) ("[T]he assessor must estimate the price a leasehold would bring on an open market . . . . No deduction is made for the cost of the lease to the present lessee . . . ."). Accord, Korzen v. American Airlines, 39 Ill. 2d 11, 233 N.E.2d 568 (1968); see K. EHRLIN & S. FLAVIN, TAXING CALIFORNIA PROPERTY ch. 18 (2d ed. 1979). The argument for an opposing rule is made in Ricks, Possessory Interests in Publicly Owned Property: Improperly Assessed, 20 NAT'L TAX J. 347, 350–51 (1967):

The court [in De Luz] expressed concern that it was possible under Blinn for a leasehold estate to have zero or negative indicated value if amortization of improvement costs plus contract rent exceeded the economic rent of the whole property . . . . But is this not equitable? If the lessee, because of market changes, remains committed to pay more for property under a lease than it can produce in the way of income, he does indeed have a net burden and therefore an interest without positive value.

734
which identify the lessor’s interest with the value of the property as a whole. Condemnation cases have recognized the lessee’s interest as a component of full value, even when the lessee is prevented by agreement with the lessor from claiming reimbursement for it. Of course, the property owner who vigorously directs the court’s attention to the summation-of-interests approach in an eminent domain proceeding is not likely to have suggested it in any earlier assessment dispute. “A certain degree of cynicism is no doubt warranted by the very general practice of landowners who have applied for [tax abatements] of putting down estimates that vary widely from the claims that they make when the property is about to be condemned.”

Eminent domain cases involving a long-term lease favorable to the landlord present some special difficulties that do not arise in property tax assessment controversies. When fair market rent exceeds contract rent, the difference may be assigned to the tenant as a leasehold bonus, with the corresponding diminution in the value of the landlord’s interest producing a constant sum. By this logic, a landlord enjoying a lease with above-market rental payments should be compensated for loss of the bonus if the property is taken during the term of the lease. Yet unless the tenant is called upon for a contribution representing the benefit received


[T]he City would have the court disregard the value of the lessee’s interest and make a total award only for the lessor’s interest despite the fact that the City is taking both interests . . . . The City’s contention that the owner could not obtain any more for the property in the market place if it were encumbered by this lease totally ignores the fact that a purchaser of the fee interest would acquire the property subject to the encumbrance of the lease. The City takes the property free and clear of all encumbrances and thus acquires the interest of both the fee owner and the lessee


As these figures cannot be reconciled, the conclusion is inescapable that one estimate or the other, and possibly both, bear little relation to the true opinion of the owner, and his statement that the estimate represents his opinion is false. But the constitution makes no provision for distinguishing the compensation to be given to an honest applicant and one who lets his desires outrun standards of common honesty. “Just” compensation does not mean compensation limited to the just. An admission of an opinion is not controlling as to the fact. The realization that the admission is not binding has been hailed in some quarters by the assertion that there is one value for condemnation and another for taxation. The genesis of such a contention is apparent—it is by Sophistry out of Greed. Value is the same regardless of the nature of the proceeding. However, the same property may have different values at different times. If a proceeding to fix value for tax purposes is sufficiently close in time to the time of taking, the adjudication would provide a standard common to both proceedings and binding on all concerned.

222 N.Y.S.2d at 795–96.
by early termination of the unfavorable lease, a condemnation award based upon the value of the undivided fee will not be sufficient for such a payment. While below-market rents are, in effect, a transfer of a portion of the property value from the lessor to the lessee, payments of above-market rents represent a type of nonproperty return to the lessor. Through luck or business acumen, the lessor has received income greater than property value alone would warrant. And since, not surprisingly, "[n]o cases have been found, and it is unlikely that any court will so decide . . . that the lessee [should] contribute or pay the negative value of his interest upon a complete taking," the only remaining alternatives are undercompensation of the landlord or payment of more than the market value of the undivided fee by the condemnor. While this specific question has been confronted only rarely in reported decisions, the general acceptance of the undivided fee concept in setting total eminent domain awards suggests that most jurisdictions would choose the former course.

The eminent domain cases support the majority approach to the lease question in the tax context: valuation reflecting fair market rent. Departure from the undivided fee rule in eminent domain cases in order to compensate the landlord fully may be likened to an assessment based upon contract rent. Each takes the realizable sale price of the lessor's interest into account, but produces a result at variance with a concept of property as a summation of all component legal interests, however divided. Each allows the contractual arrangements between lessor and lessee to work to the detriment of the taxing or condemning jurisdiction. This analogy was dramatized in a decision by the California Court of Appeals in which the court refused to capitalize below-market rent for tax purposes and criticized an earlier opinion which suggested that "just compensation" in eminent domain required consideration of a long-term lease benefiting a

81. Property subject to a long-term lease favorable to the lessor should be assessed in the same manner as if encumbered by an unfavorable lease—by capitalization of the fair market rent. For discussion of this point, see infra text accompanying notes 125-30.


83. See id.


Property Tax

landlord.\textsuperscript{87} The court in the later case found this “so questionable as a matter of condemnation doctrine” that it refused “to use it as a springboard for even more questionable taxation law.”\textsuperscript{88} Taxation of the undivided fee does not preclude, of course, an explicit legislative choice of a contrary approach in eminent domain cases. However, this could produce the administrative complexities and problems of non-arm’s-length arrangements identified in assessment decisions.\textsuperscript{89}

2. Valuation Under Rent Control

Rent control limits a landlord’s income as effectively as does a long-term lease. Unlike the lease, however, rent control does not require the landlord’s consent. This distinction negates many of the arguments in favor of capitalizing fair market rent for property tax purposes. Rent control is not “a private arrangement,”\textsuperscript{90} nor is it imposed “with the landlord’s eyes open and no doubt directed towards its own short or long-range profit.”\textsuperscript{91} Moreover, the governmental unit seeking to impose the tax usually cannot claim that it “was not a party to these plans.”\textsuperscript{92} All these considerations militate against valuing rent-controlled property on the basis of the income it could command in an unrestricted market, and such in fact has been the conclusion of most courts presented with this issue.\textsuperscript{93}

Although owners may be pleased with this result in the property tax context, they have not hesitated to take the opposite position in eminent do-

\footnotesize

\textsuperscript{87} The Lynbar court’s own discussion of the implications of its position reveals its error: If, on the other hand, the actual rental under the existing lease is less than such fair rental value, ordinarily the fair market value of the parcel taken will be reduced accordingly and the condemnor then pays less by way of just compensation. In either event the condemnor pays for what it takes in the condition the parcel was on the date of valuation or condition. 62 Cal. Rptr. at 330. The condemnor will not pay “less by way of just compensation” in this instance, for the value of the lessee’s interest will balance the reduction in the lessor’s share of the award. This negates the court’s attempt to draw a unifying principle equating “market value” with realizable sale price, and thus undercuts similar efforts with regard to assessment for property tax purposes.

\textsuperscript{88} Clayton v. County of Los Angeles, 26 Cal. App. 3d 390, 394, 102 Cal. Rptr. 687, 690 (1972).

\textsuperscript{89} See supra text accompanying notes 63–65.

\textsuperscript{90} The court in Clayton v. County of Los Angeles, 26 Cal. App. 3d 390, 393, 102 Cal. Rptr. 687, 689 (1972), characterized a long-term lease in this way.

\textsuperscript{91} Merrick Holding Corp. v. Board of Assessors, 45 N.Y.2d 538, 545, 382 N.E.2d 1341, 1344, 410 N.Y.S.2d 565, 569 (1978) (fair market rent, not rent called for in lease, to be capitalized for property tax purposes).

\textsuperscript{92} Id.


737
main proceedings. The New York Supreme Court answered such owner objections in its 1961 *Lincoln Square* opinion:

Various claimants have contested [the use of controlled rent as the guide to property value] on the ground that increases in rental have been from time to time allowed, that procedures exist for obtaining additional rentals, and that the whole system of rent controls may be abolished. Taking these arguments in reverse order, the last is such a remote possibility that it cannot be considered and no indication that purchases are made on that contingency has ever been established. While procedures do exist for increases in rent, the fact that the instant landowner has not availed himself of them is some indication that in the particular instance they would not prove fruitful. As for prior rent increases, they are reflected in the current rent roll.

One could apply the sum-of-the-interests approach to a rent control case, arguing that a legislative decision to transfer a portion of the property's value to the tenant does not foreclose an assessment upon the value of the undivided fee. But so harsh a result should require explicit legislative approval. Absent that, the tax due from the landlord should be measured by the value of the property remaining to him.

The valuation of low-income housing constructed with the aid of government subsidies combines elements of legal restrictions, rent control, and the long-term lease. The interaction of these latter two strands was well illustrated in *Knickerbocker Village, Inc. v. Boyland*, a case in-
volving property built in response to the incentives of New York’s Public Housing Law. These included low-interest loans and a twenty-year exemption from property taxes upon improvements. In return, owners were limited both in their income from the property and in the price for which they could sell it. The taxpayers in Knickerbocker Village sought to limit the assessed value of their property to the permitted sale price. The New York Appellate Division rejected this argument with reasoning similar to that employed in many long-term lease cases:

What is to be assessed is the whole of the property . . . regardless of restrictions personal to the owner . . . . The restrictions upon its sale of the real property result solely from petitioner’s ownership. The restrictions were voluntarily assumed and to a large extent induced by the advantage of a 20-year exemption in respect of the improvement.

Yet, as a dissenting opinion pointed out:

[T]he restrictions “run” with the land if that be the test . . . . [T]he restrictions here are rigorous limitations, in the classic real property sense, on the estate held by the owner. Moreover, they are all but never removable, even if unlimited moneys are available to the owner for that purpose . . . .

In part, this simply dramatizes the need for—and lack of—predictability in the property tax area. Had the developers known and planned for a tax assessment based upon fair market rent, such a payment could have been viewed as one more element in the bargain struck with the city. Beyond this, the case illustrates that the critical distinction between the rent control and long-term lease cases lies in the taxpayer’s voluntary assumption of the limitations upon income. The classification of Knickerbocker Village’s restriction as “personal to the owner” is based upon this notion of consent rather than upon a traditional property law designation, a

99. The property could be sold only to the city or to another public housing corporation:
[The property could be sold only] for a price not in excess of the cost of the said property less any amounts paid in amortization of the mortgage indebtedness and the retirement or redemption of stock, plus so much of the limited dividends on the stock . . . as shall have been unpaid, and accrued interest on the mortgage indebtedness and income debenture certificates.
226 N.Y.S.2d at 985.

100. Id. at 987. The court had previously noted that such a limit would cause the assessment to vary “inversely to its profits . . . . [A]s petitioner’s profits increase more can be applied to amortization and stock redemption with a consequent lowering of the statutory maximum sales price . . . .”
Id. at 986.

101. Id. at 990 (Breitel, J., dissenting).

102. A long-term lease may be recorded in many jurisdictions, e.g., MASS. ANN. LAWS ch. 183, § 4 (Michie/Law. Co-op. 1977); N.Y. REAL PROP. LAW § 290 (McKinney 1968); WASH. REV. CODE § 65.12.470 (1981), and enforced against subsequent purchasers of the fee, e.g., Bank of New York v. Hirschfield, 37 N.Y.2d 501, 336 N.E.2d 710, 374 N.Y.S.2d 100 (1975); N.Y. REAL PROP. LAW §§ 291, 294 (McKinney 1968). It may thus be said to “run with the land,” yet this provides little support for permitting it to reduce the property’s assessed value if it would not otherwise have that

739
concern that the tax base not be diminished through restrictions sought by the owner. The wider applications of this principle of ignoring voluntarily assumed restrictions must be approached with care.\textsuperscript{103} But it offers immediate support to the majority position on the long-term lease,\textsuperscript{104} i.e., valuation reflecting fair market rent rather than contract rent.

3. \textit{The State of the Owner’s Title}

Parcels with sale value diminished by an owner’s inability to convey clear title present another example of divided legal interests, with many similarities to the long-term lease. New Jersey courts, for example, with a strong record in support of capitalization of fair market rent,\textsuperscript{105} have held that deficiencies in the owner’s title cannot affect valuation for tax purposes. “The law requires an assessment of the value, not of the purported owner’s title, but of the land; the assessed value of the land represents the

\textsuperscript{103} In particular, it must be recognized that the voluntary, profit-motivated actions of owners can in certain instances reduce the jurisdiction’s tax base. An owner may neglect the property and maintain it poorly; an owner may also fail to construct improvements that would maximize its value. So long as the tax base is linked to that market value it will be affected by such decisions. Many cases seem to overlook this when employing a highest and best use analysis. \textit{E.g., In re Ernst, 58 Misc. 2d 504, 295 N.Y.S.2d 712, 714 (1968), aff’d mem., 33 A.D.2d 655, 306 N.Y.S.2d 672 (1969) (Upholding capitalization of fair market, not contract, rent: “Can we, for tax purposes, permit the owner of taxable property to create ‘instant economic obsolescence’ by encumbering said property with an inadequate lease agreement? And then must the taxing authority ‘bail’ him out? The Court doesn’t believe so.”)}. A potential purchaser need not continue the current use of the property, but its condition at the time of sale will affect the bid which might have been made for it.

\textsuperscript{104} This outcome did not retain its clarity long. Six years after \textit{Knickerbocker Village}, a special term decision considered the same issue and reached the opposite conclusion without mention of the earlier case. The New York Appellate Division affirmed without an opinion. The rationale was simply a rejection of hypothetical values:

This property is by law rigidly rent controlled and rigidly controlled in many other respects. Therefore I do not find much help by giving consideration to capitalization of hypothetical net income from a hypothetical building which could not legally be erected and operated under the laws applicable to this property. \textsuperscript{105} \textit{Washbridge Housing Corp. v. Tax Comm’n, 60 Misc. 2d 296, 303 N.Y.S.2d 308, 310 (1968), aff’d mem., 32 A.D.2d 899, 303 N.Y.S.2d 336 (1969). Washbridge may represent a reaction against the city’s attempt to ignore rent control as well as public housing regulation, an approach it suggested in \textit{Knickerbocker Village} as well, 226 N.Y.S.2d at 984–85, without influencing the outcome in that case. It may also represent a response to the continuing attraction of a realizable sale price standard, even in a state which has clearly adopted the majority rule that property is to be valued on the basis of fair market rent.}

\textsuperscript{105} \textit{E.g., Humble Oil & Ref. Co. v. Borough of Englewood Cliffs, 71 N.J. 401, 365 A.2d 929, 931 (1976) (Conford, P.J.A.D., concurring) (“What is theoretically wrong about the Appellate Division capitalization approach, however, is its acceptance of the actual rental income of the property instead of postulating the fair or ‘economic’ rental value. The legal criterion is always the latter.”); City of New Brunswick v. State Div. of Tax Appeals, 39 N.J. 537, 189 A.2d 702 (1963).}
value of all interests in the land." A representative 1972 opinion considered property physically equivalent to lots of $90,000 value, but recently sold for only $35,500, "subject to 'tidelands or riparian rights which might be claimed by the State of New Jersey.' The court refused to limit the assessment to the sale price:

Here both sides concede that the "value of all interests in the land" is $90,000. The sale for $35,500 does not meet the stated test; it was a sale only of the owner's title, subject to such rights as the State might have.

The difference between $90,000, the conceded value if there were not a cloud on title, and the sales price of $35,500 undoubtedly represents the buyer's estimate of the cost to it of eliminating, either through purchase or litigation, the outstanding adverse claim to title. It is understandable that a purchaser will insist on a discount from the true value of property if he buys a doubtful title, but the fact that he does so affords no justification for applying a discount in a tax valuation case.

On the strength of this reasoning a Tennessee court, citing this case, concluded that a deed restriction preventing sale of land or its lease for more than one year should not affect its assessment, despite a statute directing that "legal restrictions on use" be considered in valuation. Neither the subsidized housing cases nor decisions on restricted title can be analyzed in any but their most elementary form without consideration of the special treatment historically afforded property subject to easements and similar limitations upon use. However, the courts' willingness to disregard the realizable sale price of the owner's interest here lends definite support to such an approach in the less problematic long-term lease area.

4. Property Subject to a Mortgage

The well-settled practice of combining the interests of mortgagor and mortgagee in property assessment offers a number of useful parallels to the long-term lease. It clearly demonstrates, for example, that accepted applications of the tax bear no ready relationship to the owner's ability to pay. As Jens Jensen observed in his 1931 treatise, Property Taxation in the United States:

108. 295 A.2d at 10.
110. A discussion of cases combining these elements may be found infra at text accompanying notes 353-62.
The application of the test of ability to pay, in its proper form, to the general property tax need not detain us long. . . . [T]here is obviously no necessary, or at best only a very remote, relationship between the clear income of a taxpayer, especially if he holds property heavily encumbered with debt, and the property taxes he may be required to pay. 111

Bonbright made the same point: "What reason is there to suppose that the value of a house worth $10,000, but subject to a mortgage of $9,000, measures even crudely the taxpaying ability of the owner of the equity?" 112

At one time the distinction between a mortgage which transferred title to property and one which provided merely a lien against it was thought conclusive of its treatment for assessment purposes. 113 However, with the recognition that retention of legal title by an exempt entity does not confer immunity from taxation upon property held by a nonexempt vendee 114 or lessee, 115 the locus of legal title has lost this determinative quality. 116 Until recently, the state of Washington afforded an exception to the general rule of assessing the mortgagee’s interest together with the mortgagor’s. The Washington court in a set of cases 117 decided early in this century had, through an erroneous parallel to eminent domain awards, 118 determined that rental payments were to be deducted in valuing a leasehold for tax purposes, 119 thus taxing only the "bonus value" of the lease. The court then extended this principle to require deduction of mortgage

111. J. JENSEN, PROPERTY TAXATION IN THE UNITED STATES 84 (1931).
112. I. J. BONBRIGHT, supra note 6, at 455.
113. E.g., In re Rolater, 67 Okla. 215, 170 P. 507, 508 (1918) ("Under our Constitution and statutes property must be assessed at its fair cash value, and this without regard to the amount of mortgage liens against the property. A mortgage in this state transfers no title to real estate, but is merely a lien to secure the payment of debt.").
We think that the public policy of national development and federal tax collection justify the limitation on state taxing power . . . . We do not, however, conclude that [the] rationale [of previous decisions] leads to an exemption from state taxation of all lands in which the United States holds legal title as security for the purchase price.
115. United States v. City of Detroit, 355 U.S. 466 (1958) (leasehold interest in federal property may be subject to local taxation).
118. I.e., the distinction between the value of the leasehold and the value of the leasehold bonus is overlooked, as discussed supra at text accompanying notes 77–79.
119. Metropolitan Bldg. Co. v. King County, 62 Wash. 409, 113 P. 1114 (1911).
indebtedness when assessing tax upon mortgaged property. The Washington Supreme Court overruled these decisions in 1970, stating: "Indebtedness does not represent a burden on the leasehold. Though it may be a burden on the lessee, we have already concluded that the ad valorem tax is not on the lessee’s equity; it is on the value of the leasehold term."

Early attempts to tax the mortgagor only on his retained interest encountered administrative difficulties as well. Jensen wrote:

The privilege of dividing the tax liability between the mortgagor and mortgagee obtains in Arizona. It formerly obtained in California, Massachusetts, Nevada, and Wisconsin. But it was and is of no effect since the mortgagor invariably undertakes to pay the tax on the equity of the mortgagee as well as his own. A law could conceivably be enacted forbidding such division, but it would presumably merely raise the interest cost by the amount of the tax to the borrower.

The greatest aid these cases offer the long-term lease question is their demonstration that "fair market value" for tax purposes need not equal the net sale value realizable by the owner upon a transfer of the encumbered interest. This links the mortgage and long-term lease questions so closely as to require compatible approaches to the two areas.

120. In Metropolitan Bldg. Co. v. King County, 72 Wash. 47, 129 P. 883, 883–84 (1913), the court held:

The leasehold is burdened by a debt exceeding the value placed upon the lease by most of the witnesses. A purchaser of the lease would necessarily stand in the shoes of the respondent. He would take what it has with all its burdens, no more and no less . . . . The law of common honesty applies to the taxing power with the same force it applies to an individual . . . . [T]he leasehold interest is to be measured both by its burdens and its benefits. It cannot be otherwise.

See also Metropolitan Bldg. Co. v. King County, 64 Wash. 615, 117 P. 495 (1911).

In order to harmonize this result with WASH. REV. CODE § 84.04.080 (1981), which denies a deduction for indebtedness in valuation of real property for purposes of taxation, the court in In re Metropolitan Bldg. Co., 144 Wash. 469, 258 P. 473 (1927), characterized these deductions as an allowance for amortization of improvements.


122. 469 P.2d at 909.

123. J. Jensen, supra note 111, at 119. See also Annot., 122 A.L.R. 742 (1939).

124. The North Carolina Supreme Court recognized the support offered by the example of mortgaged property when it adopted the majority position on the long-term lease and valued property on the basis of its fair market rent in 1963:

[Petitioner] says . . . it exercised bad judgment and made a lease which does not expire for nearly twenty years; and because of its bad business judgment, the value of this property should be cut in half, and Wake County should lose its taxes. Applying this reasoning to the man who owns property, borrows money mortgaging the property as security, and invests the funds obtained in securities which become worthless, he ought to be taxed only the the value of his equity of redemption.

5. Property Subject to a Favorable Long-Term Lease

The considerations underlying capitalization of fair market rent recommend that an above-market long-term lease favorable to the lessor be disregarded in assessment as well. To the extent the landlord has secured a greater return than fair market rent, the tenant is burdened with a lease of negative market value, and the sum of these two interests should equal the value of the undivided fee. Above-market return represents by definition more than normal income to the property alone. A tax upon real estate should disregard those elements of value attributable to the owner's enterprise or good fortune.\(^{125}\)

Although the favorable lease has figured infrequently in valuation decisions, the better-reasoned cases have applied to it the principles governing below-market rent. For example, the court in *Merrick Holding Corporation v. Board of Assessors*\(^ {126}\) required that the "bonus value" of below-market leases granted to major tenants be included in the capitalized income of a shopping center, then remanded to determine whether income capitalized by the assessor included above-market rents from smaller stores. "Of course, in arriving at the value of the entire property, if Merrick’s leases with its lesser tenants were at above market rents these should be offset against the below market rentals received from the three flagship tenants."\(^{127}\) Similarly, the North Carolina Supreme Court relied upon its approach to below-market rent when called upon to value property subject to a favorable lease:

The same reasoning permits the State Board of Assessment, upon an appeal such as the present, to substitute the fair rental value of the property . . . for the actual rent payable under an existing long term lease, which present conditions show to have been improvident from the point of view of the tenant."\(^ {128}\)

The appeal of realizable sale price as an assessment standard has led several courts to allow above-market rents to enhance taxable value,\(^ {129}\)

\(^{125}\) *E.g.* California Portland Cement Co. v. State Bd. of Equalization, 67 Cal. 2d 578, 432 P.2d 700, 705, 63 Cal. Rptr. 5, 9 (1967) (citations omitted):

 When earnings are taken into account or the capitalization of income method is employed, the profitableness of property to its present owner does not provide a standard by which to arrive at its "full cash value"; rather, the net earnings to be considered or capitalized are those that would be anticipated by a prospective purchaser. Nor may income derived in large part from enterprise activity be ascribed to the property being appraised; instead, it is the earnings from the property itself or from the beneficial use thereof which are to be considered.

For further discussion of the role of enterprise income, see *infra* text accompanying notes 179–97.


\(^{127}\) *Id.* at 545, 382 N.E.2d at 1344, 410 N.Y.S.2d at 569.

\(^{128}\) *In re Property in Forsyth County,* 282 N.C. 71, 191 S.E.2d 692, 698 (1972).

\(^{129}\) *E.g.* Uniroyal, Inc. v. Middlebury Bd. of Tax Review, 174 Conn. 380, 389 A.2d 734, 738
generally upon the grounds that "leases having a long-term yet to run and reserving relatively high rents measurably appreciate present value." Once it is clear that taxable value is not uniformly equated with value to the owner, however, this position is as untenable as its counterpart in the context of below-market leases. To the extent the landlord benefits from above-market rent the tenant is burdened with a leasehold of negative value; the sum of their interests may be valued as an unencumbered fee.

E. The Long-Term Lease: Conclusions

Two aspects of the long-term lease question recommend it as the first step in an inquiry into the legal aspects of valuation for property tax purposes. Unlike most valuation disputes, the long-term lease problem presents an uneven contest between proposed solutions. When factual difficulties of determining market rents are settled and contract rent is found to be below fair market return, the summation-of-interests approach provides full justification for capitalizing the latter figure. Considerations of horizontal equity, administrative efficiency, and assessment at highest and best use reinforce this conclusion. The major arguments for a contrary result, a rejection of hypothetical values and a desire to adjust the tax to the owner's ability to pay, have only weak application to the present system of local property taxation, as cases dealing with mortgages and imperfect title demonstrate. Of course, the evidentiary difficulties of determining fair market rent frequently diminish the clarity of this isolated question. The possibility, however, of a straightforward answer to even one aspect of the problem provides a useful starting point for a more extensive inquiry.

In addition to the virtue of answerability, the long-term lease problem presents a second and equally important advantage: it cannot easily be evaded when presented for appellate review. Valuation opinions usually display an aversion to the formation of rules with general application. Instead, such decisions frequently substitute numerical findings accompanied by observations to the effect that valuation is "inherently im-


precise," 131 "not an exact science," 132 "a matter of opinion," 133 subject to "a multitude of circumstances," 134 or even "an intuition of experience which outruns analysis and sums up many unnamed and tangled impressions." 135 In its pure form, however, the long-term lease question precludes such evasive responses. A choice between figures agreed to represent fair market and contract rent cannot be made by deferring to the expertise of the appraiser, nor by referring to the totality of circumstances presented by a specific case. Even a denial that the decision has larger implications 136 cannot obscure the generality of the issue.

The majority approach to the long-term lease question also illuminates the larger problem of defining the "property" subject to tax, primarily by disproving a number of plausible generalizations that have clearly influenced courts in various assessment disputes. The "property" to be taxed is not always identified with the owner's interest, nor is its "value" always the sale price the owner could realize on the market. The actual income of the owner from the property, and thus the owner's ability to pay the tax, does not settle the valuation question, even if that income is limited by agreements which were arm's-length and not improvident when made. Beyond these negative assertions, the long-term lease cases reinforce the importance of considering "property" subject to tax as comprised of various legal interests, however divided. These considerations provide a basis for examining related issues of greater complexity which further clarify the nature of the tax.

III. VALUATION OF SPECIALTY PROPERTY

A. Value to the Owner and Value to the Market

Market value assessment presents a dilemma in the case of "specialty" property, an improvement uniquely suited to its present owner. Bonbright doubted the utility of a market value standard in this situation at all:

[T]he essence of the concept lies in its reference to the exchangeability of the property . . . .

This very characteristic of market value means that the concept has but a limited usefulness in the valuation of property. For if it were invariably ac-

---

cepted as the basis of an appraisal, it would require a finding that many properties, highly prized for the special purposes for which they are designed, are of trivial value because only the present owner is in a position to exploit them.\textsuperscript{137}

As Bonbright himself noted,\textsuperscript{138} the mere fact that value to the owner exceeds market value does not in itself favor use of either measure; the choice depends upon the purposes of the appraisal. For property tax purposes, an equation of the statutory base of "fair market value" with realizable sale price is consistent with the majority of assessments, which take no account of special utility to the owner. Yet a costly but unmarketable building could all but escape tax in this way.

While the long-term lease cases turned upon one element of the tax base, the definition of "property," the specialty cases turn upon the other component, the definition of "fair market value." Is a new and unique industrial plant, or a lavish residence of eccentric design, to be valued well below its cost, at realizable sale price, although the owner is well satisfied with it and would in fact rebuild it if it were to be destroyed or condemned? Or, conversely, is a statutory "market value" standard to be identified with cost in this instance, but with realizable sale price in almost every other? And if this latter course is chosen, as it has been by most jurisdictions considering the question, how is a "specialty" to be identified? At what point does a divergence between depreciated cost and realizable sale price grow large enough to invoke this treatment? And how is the owner's satisfaction with the property to be proven? For certainly an owner who would not rebuild, who values the unusual property as little as does the market, cannot be taxed at a figure based upon cost. The imprecise boundaries of the specialty designation attest to the difficulty of these questions.

The first major case to consider this problem involved assessment of the New York Stock Exchange building.\textsuperscript{139} The owners argued that a market value standard\textsuperscript{140} required an appraisal recognizing that it could only be sold as a "tear-down proposition," for it could be used by no

\textsuperscript{137} I. J. BONBRIGHT, supra note 6, at 66.

\textsuperscript{138} Bonbright stated:

[T]he mere fact that a given property may be worth to its owner more than its market value, does not alone compel a conclusion that the former value should be accepted and the latter value rejected . . . . [M]arket value may be a fairer basis of valuation than would value to the owner, even if the latter could be estimated with equal accuracy and convenience.

\textit{Id.} at 66–67.


\textsuperscript{140} Greater N.Y. Charter, § 889 (1925 & Supp. 1925–30) (valuation at sale price under "ordinary circumstances").
other purchaser, not even another exchange. The court rejected this. "A complete answer to this contention, however, is that section 6 of the Tax Law . . . provides: 'All real and personal property subject to taxation shall be assessed at the full value thereof.'" 141 Depreciated reproduction cost was held the proper basis for assessment.

The opinion contrasted "full value" and "market value." The court stated that "real property must be assessed at its full value, whether or not there is an ascertainable market value." 142 But what constitutes a "market"? A statutory market value standard can hardly be interpreted as requiring a "perfect" market, 143 particularly if the alternative is an assessment upon value to one party alone, the present owner. It is well settled that an actual sale of real estate constitutes important evidence of its value, 144 even if the offer of sale has elicited only a limited number of responses. 145 If "only two people, a buyer and a seller, are necessary to constitute a market, although a very 'imperfect' one," 146 a nominal or even negative market value for the New York Stock Exchange as a "tear-down proposition" appears plausible. Imputation of a requirement of cost-based assessment requires more support than simply a reference to "full value" if it is not to suggest that an insufficiently high market price will be deemed not to exist.

Similar valuation problems arise in other contexts. "Throughout the field of legal valuation, one finds the law first starting out with a false doctrinal premise that the objective of a valuation is to ascertain 'true value,' and then correcting this premise by adopting methods of valuation that necessarily reach some other objective." 147 The distinction between

141. 223 N.Y.S. at 68.
142. Id.
143. Cf. Copes, Reckoning with Imperfections in the Land Market, in THE ASSESSMENT OF LAND VALUE 55 (D. Holland ed. 1970): "The conditions for a 'perfect' market which are significant for the purpose of this discussion are, briefly: the commodity must be homogeneous and buyers and sellers must be present in large numbers and be well informed as to quality and price."
144. E.g., Lane Bryant, Inc. v. Tax Comm'n, 21 A.D.2d 669, 249 N.Y.S.2d 994 (1964), aff'd mem., 19 N.Y.2d 715, 279 N.Y.S.2d 174, 225 N.E.2d 882 (1967) (arm's-length sale of property evidence "of the highest rank" in determining taxable value); Equity Land Resources, Inc. v. Department of Revenue, 268 Or. 410, 521 P.2d 324, 325 (1974) (reversing lower court decision which had contended that "'one sale doesn't make a market.' . . . [A] single sale may be some indication of market value, but it is suspect."); State ex rel. Geipel v. City of Milwaukee, 68 Wis. 2d 726, 229 N.W.2d 585, 591 (1975) (grant of option; holding that "because a 'sale' of the property had occurred, the assessor erred in relying on 'comparable sales' to establish the market price of the property in question and the assessment must be set aside").
146. 1 J. BONBRIGHT, supra note 6, at 42.
147. Id. at 82.
sale price and value to the owner must be faced in insurance cases,\textsuperscript{148} contract actions,\textsuperscript{149} income tax determinations,\textsuperscript{150} and numerous other areas.\textsuperscript{151} In each instance, the proper measure depends upon the purposes of the valuation process.\textsuperscript{152} The absence of any consensus as to that purpose in the property tax context underlies the difficulties encountered by the specialty cases.

B. Measuring Value to the Owner

Depreciated reproduction cost is generally the measure of the value of specialty property to its owner when the property would be rebuilt if lost, no substitute being available for purchase.\textsuperscript{153} It does not measure value to the owner, however, if the owner would not replace the property. “If the governmental authorities discontinue the use of a lighthouse...”154 Accordingly, buildings converted to a new use rarely qualify

\textsuperscript{148} See, e.g., Kingsley v. Spofford, 298 Mass. 469, 11 N.E.2d 487, 491 (1937), where the court stated that the principle of indemnity prevents interpretation of the term “actual value” in insurance statutes and policies as limited to market value of insured property in all instances:

The words “actual value” in the policies and in the statute are to be interpreted in the light of the nature of the insurance contract as a contract of indemnity... “[T]he words “actual value” do not import that recovery is limited to market value... [M]arket value does not in all cases afford a correct measure of indemnity... In some cases there is no market value properly speaking; and in others, if there is, it plainly would not of itself afford full indemnity.

\textsuperscript{149} E.g., Charles St. Garage Co. v. Kaplan, 312 Mass. 624, 45 N.E.2d 928, 929 (1942) (Uniform Sales Act measure of damages for breach of contract to purchase goods; in action by dealer, difference between contract price and market price held to mean difference between contract price and retail market price).

\textsuperscript{150} In Turner v. Commissioner, 13 T.C.M. (CCH) 462 (1954), the Tax Court was called upon to interpret regulations requiring prizes and awards to be included in the recipient’s income at “fair market value,” Treas. Reg. § 1.74-1(a)(2) (1955). The Internal Revenue Service argued that a set of cruise tickets won by the taxpayer should be valued at their retail price, the taxpayer’s replacement cost. The Tax Court found value to the owner a better measure of taxable income: “The winning... did not provide... something which they needed in the ordinary course of their lives... Their value to the petitioners was not equal to their retail cost. They were not transferable and not salable and there were other restrictions on their use.” 13 T.C.M. (CCH) at 463.

\textsuperscript{151} See 2 J. Bonbright, supra note 6, at 694 (death duties), 837 (mortgage loans).

\textsuperscript{152} Id. at 509–10;

If the general property tax is interpreted as an “ability” or “faculty” tax, value to the owner is a better standard of assessment than market value where there is a wide and measurable discrepancy between the two values. ... On the other hand, if this tax is designed fairly to allocate to property owners the costs of government made necessary by the construction and operation of their properties, undepreciated replacement cost has a shade the better of the argument as a proper tax base.

\textsuperscript{153} Id. at 91–92.

\textsuperscript{154} In re Lincoln Square Slum Clearance Project, 15 A.D.2d 153, 222 N.Y.S.2d 786, 803
as specialties; their loss would not occasion rebuilding to their present specifications.155

The owner of a converted structure could, of course, place a higher value upon it than the nominal figure assigned by the market without valuing it so highly as to reproduce it in the event of loss. Such a situation may in fact be common, but development of specialty valuation has taken no account of it. Rather than attempting a subjective inquiry into actual value to the owner in all cases, the majority of such decisions have simply approximated this by depreciated reproduction cost. This narrows the choice of methods, heightens the difference between specialty and non-specialty assessments, and increases the advantage to owners of unusual property of avoiding the specialty designation for their buildings, for depreciated reproduction cost will almost always exceed the sale price of a unique or specialized structure.

Yet the majority approach has by no means eliminated all subjectivity from the classification. Either the existence of a "market" or the unwillingness of the owner to rebuild in case of loss can rebut the specialty status, but these criteria are so ill defined as to be almost unverifiable. For example, the 1977 A & P156 valuation of one of the world's largest food processing plants found warehouses as distant as 1000 miles from this property "comparable." A & P thus avoided specialty classification, a cost-based assessment, and $2,800,000 in valuation for property tax purposes, for a potential sale as a warehouse would yield a figure well below depreciated cost. Two years later, however, Xerox Corporation was unable to convince the New York Appellate Division that those same properties were "comparable" to its complex of office, warehouse, and manufacturing buildings,157 and thus failed in its effort to reduce their valuation by $80,000,000. In that same year, the Chrysler Corporation, with $10,000,000 in assessed value at stake, won reversal of classification of an assembly plant as a specialty, the Illinois Appeals Court finding "support" for the existence of comparable sales in the A & P decision.158 Nowhere in these cases were the elements of a "comparable" sale detailed, nor was it explained why such a sale indicated a market for the


A & P and Chrysler plants but not for the Xerox complex. Yet such issues affect millions of dollars in property valuation when they produce a shift from the normal interpretation of "market value" as realizable sale price to interpretation as depreciated cost.

The willingness of an owner to rebuild in case of loss is even less amenable to factual investigation than is the existence of a market. It is not difficult for owners of unusual property to disclaim satisfaction with their investments: "Just because you spent the money . . . doesn't always mean it is worth it." Courts, on the other hand, generally assume that the construction or purchase price of recently acquired property is a fair measure of its value—a reasonable approach, if the owner has the opportunity to rebut it. It is not available, however, when these events took place a number of years in the past.

C. Depression Cases: What Is A "Market"?

The 1927 New York Stock Exchange decision was echoed in cases dealing with the enormous decline in market values during the subsequent decade. Statutes requiring payment of "fair" value in foreclosure sales of mortgaged property lent authority to the "economic heresy" of an

160. E.g., Calder Race Course v. Overstreet, 363 So. 2d 631, 634 (Fla. Dist. Ct. App. 1978) ("Indeed, the assessment may even be a little on the low side as Calder's owners would be taking a significant investment loss were they to sell the property at the assessed valuation."); New Orleans Cotton Exch. v. Board of Assessors, 39 La. Ann. 95, 1 So. 272, 272 (1887) ("there were no proofs that the cost . . . was particularly extravagant, none that the property had deteriorated in value, or that the owner would sell it for an amount less than its cost"). In Joseph E. Seagram & Sons v. Tax Comm'n, 18 A.D.2d 109, 238 N.Y.S.2d 228, 231-32 (1963), aff'd, 14 N.Y.2d 314, 251 N.Y.S.2d 460, 200 N.E.2d 447 (1964), the court stated:

Nowhere in the record is it explained how just two years before the period under review an experienced owner employing a reliable contractor and having the services of outstanding architects put $36,000,000 into a structure that was only worth $17,800,000. Such a startling result requires more than speculation before it can be accepted as fact. The Seagram case is discussed infra at text accompanying notes 198-219.
161. E.g., Medical Bldg. Land Co. v. Department of Revenue, 283 Or. 69, 582 P.2d 416, 420 (1978) (court accepted taxpayer's assertion that construction cost was unnecessarily high due to negotiated contract and work stoppages); Smith v. City of Covington, 205 Va. 104, 135 S.E.2d 220, 221 (1964) (taxpayer retained no general contractor and consequently paid more for construction than necessary).
162. Conversion of a structure to a new use also provides evidence that if lost it would not be reproduced in its existing form. See supra text accompanying notes 153-55.
164. These statutes employed a number of approaches, including refusal to confirm foreclosure sales not meeting a minimum or "upset" price, a moratorium on foreclosures, and deduction of the "fair value" of the mortgaged premises from a deficiency award. See generally Note, Mortgage
"undefined, mythical concept of 'real' or 'actual' value." Such measures, Bonbright pointed out, were more radical than a mere substitution of value to the owner for market value:

'The fact that properties can be replaced by equally serviceable properties at a mere fraction of their pre-depression costs has actually made these properties less valuable to their owners. . . . Clearly, then, a much more fundamental departure from the market-price concept than that suggested by 'value to the owner' must be in the minds of the adherents to the theory of relatively stable 'real values.' . . . The very trouble with our economic life today is that it has shattered real values . . . ."

The New York legislature responded to the "shattered real values" and subsequent wave of foreclosures and deficiency actions by requiring that the "fair and reasonable market value" of the mortgaged property, not necessarily the sale price, be deducted from the outstanding debt for purposes of determining the amount of any deficiency remaining after foreclosure of the premises by the mortgagee. If, however, the court were to find that the property had no market value as of the date of the

Relief During the Depression, 47 Harv. L. Rev. 299, 301 (1933). Moratorium legislation was upheld against constitutional challenge under the contract clause in Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934). That case found no impairment of contract in the Minnesota Mortgage Moratorium Law, noting especially the state of economic emergency it addressed and the temporary nature of the remedial legislation.

165. 1 J. Bonbright, supra note 6, at 420.
166. 2 id. at 847.
167. Valuation cases of that time give evidence of the effect of the Depression upon mortgagors: Over a period of approximately three and one-half years before the relator purchased his property on Windemere Road, the East Side Savings Bank alone sold about 840 parcels of property which it had acquired in the City of Rochester, and the Alliance Realty Corporation from 1937 to 1941 sold on the average about 725 parcels of property a year, representing an average annual volume of over $2,000,000. In 1939 about 135 of the 225 residences in Browncroft were owned by banks and by other loaning institutions. There is evidence that it was the policy of the East Side Savings Bank to liquidate the properties which it had acquired for the amount of its investment in them and that this policy depressed still further the prices of properties in Browncroft already lowered by the economic stringency confronting many property owners. Frequently prices on these properties were reduced three, four or even five times until they were sold, and from 1931 through 1934, with the surplus supply of these properties, all prices fell abruptly.


The expert Stern in his testimony brought out the known fact that several of the Savings Banks have been "dumping" dozens of properties on the market in the Williamsburgh section in the last few years, for a nominal consideration, selling them to speculators from one to seventy parcels at a time; that this type of transaction has so affected realty values that there has been no fair market as contemplated by the so-called Deficiency Judgment Law . . . .


Property Tax

foreclosure sale, it was directed to fix that sum as of the "nearest earlier date as there shall have been any market value thereof . . . ."169

The New York Court of Appeals interpreted this section of the statute as an outright repudiation of any market value measure:

In the depressed condition of the market for real property, the old standard of market value has become utterly useless. The new and unusual conditions necessarily required a new standard for determining value . . . . [T]he court should receive evidence of all elements that can in reason affect the value of the premises . . . . [T]he court should receive evidence of the age and construction of the buildings on the premises, the rent received therefor, assessed value, location, condition of repair, the sale price of property of a similar nature in the neighborhood, conditions in the neighborhood which affect the value of property therein, accessibility, and of all other elements which may be fairly considered as affecting the market value of real property in a given neighborhood. With such evidence before it, the trial court, in the exercise of its best judgment, should determine the market value of the premises in the existing circumstances.170

Rejection of the "utterly useless" equation of market value with realizable sale price for a new standard closely allied with "real" or intrinsic value in effect negated the statute's substitution of market value as of the "nearest earlier date" when that quantity existed.171

New York courts built upon the foreclosure cases to support a similar search for "real" values in tax assessments.172 Conversely, the New York Stock Exchange173 decision was cited for consideration of reproduction cost, value in use, and value to the owner as "elements" of market value

169. Id.
171. Heiman v. Bishop was in fact reversing a lower court's attempt to apply the statute according to its terms:
The court below adopted the old standard [of "market value"]. The learned referee during the hearing and in his report repeatedly stated that there was no fair and reasonable market value of the premises on the date of sale in June, 1935, or between that date and 1930, which he fixed as the "nearest earlier date" when there existed a market value of the premises . . . .

We think that the learned official referee adopted a view too narrow and strict, and contrary to the spirit and purpose of the statute. In carrying out the directions contained in the statute, the court should receive evidence of all elements that can in reason affect the value of the premises together with the opinion of experts upon the subject.

4 N.E.2d at 945.

in foreclosure actions.\textsuperscript{174} Decisions in both areas affirmed that "fair market value" (for property tax purposes) or "fair and reasonable market value" (in the foreclosure setting) must mean something other than the amount indicated by the raw data of the marketplace, the realizable sale price.\textsuperscript{175} Yet if "fairness" comprehends more than the procedure of the sale—for example, a reasonable length of offering time and advertisement—it threatens to replace the objective judgment of the market with a grant of almost unbounded discretion to the trier of fact.\textsuperscript{176} An awareness

\textsuperscript{174} E.g., Title Guar. & Trust Co. v. Hofheimer, 170 Misc. 691, 10 N.Y.S.2d 1008 (1939), aff'd mem., 261 A.D. 946, 27 N.Y.S.2d 445 (1941).

\textsuperscript{175} Bonbright found no instances in which a statutory reference to "fair" market value determined the outcome of a valuation controversy:

\begin{quote}
It is quite true that the courts have sometimes rejected "the verdict of the market place" on the ground that the prices fixed therein do not reflect "fair market values." Rarely, however, have the judges drawn the sharp distinction between "market value" and "fair market value" that this rejection would seem to imply. Instead, they have more frequently used the two terms as exact synonyms, holding that even the unqualified phrase "market value" must be interpreted to mean "fair market value." . . . Even if the statute refers merely to "market value," they have held that the attribute of "fairness" must be imported into the term. Consequently, no reported opinion coming to our attention has stated that the "fair market value" of a given property, at a specified time, is more or less than its "actual market value." Here, as elsewhere in the law, one finds no such attempt as scientists make to distinguish between actuality and desiredness or normality.
\end{quote}

\textsuperscript{176} This problem is evident in property tax cases of this period from many states. For example, in Minnesota v. Federal Reserve Bank, 25 F. Supp. 14, 18 (D. Minn. 1938), the court stated:

\begin{quote}
The fact that there is no demand for downtown property, or that the supply far exceeds the demand, may, if a literal application of the statute is applied, justify such fluctuations in assessment figures from year to year that will precipitate the fiscal affairs of the city into utter confusion . . .
\end{quote}

\textsuperscript{175} See also Washington County Nat'l Bank v. Washington County, 176 Va. 216, 10 S.E.2d 515, 518 (1940) (probably the "best located building in the town"); valuation set $15,000 above sale price because sale price "was probably less than it was worth, for there is no general demand for bank buildings"); Central Realty Co. v. Board of Equalization & Review, 110 W. Va. 437, 158 S.E. 537, 538 (1931) ("Was it the purpose of the statute to jeopardize the machinery of state, county, district, and municipality, during a depression, or was it enacted to cover ordinary conditions over a period of years? To ask the question is to answer it."). As these cases illustrate, a pragmatic issue was posed by statutory and constitutional limitations upon local rates of property taxation: were the tax base to fall as far as had realizable sale prices, tax rates could not rise enough to preserve essential municipal revenue. See generally M. BERNARD, CONSTITUTIONS, TAXATION, AND LAND POLICY (1979); Howards, \textit{Property-Tax Rate Limits: A View of Local Government}, in \textit{PROPERTY TAXATION U.S.A.} 165 (R. Lindholm ed. 1967). Bonbright commented:

\begin{quote}
The contention of taxpayers that their property should not be assessed in excess of the low market prices prevailing during the business depression is unacceptable for practical reasons. It could be sustained, if at all, only on condition that the present statutory and constitutional limits on governmental debts and on the rates of taxation be repealed. Unless these limits are removed, assessors and courts will be forced, willy-nilly, to pretend that real estate is now worth more than it really is worth.
\end{quote}

\textsuperscript{174} J. BONBRIGHT, supra note 6, at 510 (footnotes omitted). Such arguments apply, of course, only
of this danger, in fact, may be sensed in the reluctance of New York courts to invoke the foreclosure provision\(^\text{177}\) after the crisis of the 1930’s had passed.\(^\text{178}\) Only the specialty area makes general use of nonmarket valuation today. This leaves the specialty designation an all the more dramatic exception to normal valuation methods.

\textit{D. Extension to Income-Producing Property}

Commercial property for which the sale price depends upon the success of business associated with it poses a similar valuation problem. Realizable sale price is a problematic basis of taxation, not in this case because it is unacceptably low, but because it reflects managerial skill and enterprise worth rather than real property value alone. A capitalization of earnings may "furnish a good rule of thumb upon which to base a business transaction,"\(^\text{179}\) but it would "include the use of real and personal prop-

\footnotesize{\textit{Footnotes omitted.} See also Carey, \textit{Mortgage Foreclosures in Cook County}, 19 A.B.A. J. 275, 277 (1933) (court’s decision showed “a thorough grasp of the true function of a court of equity”).


\(^{178}\) When a service station owner lost his property by foreclosure in the 1974 gasoline shortage and attempted to invoke this approach, the New York Appellate Division ruled against the owner by distinguishing that situation from the "\textit{exigent circumstances in the economy}” that produced the legislation of the 1930’s:

\[E\]ven though the value of the gas station property may have been depressed at the time of the foreclosure sale, it should not affect the mortgagee’s right to a deficiency judgment. It is only when the mortgaged premises are shown to have no fair and reasonable market value at the time of the sale, taking into consideration all elements which may fairly affect value, that resort may be had to the nearest earlier date when there was a market value . . . . Farmers Nat’l Bank v. Tulloch, 55 A.D.2d 773, 389 N.Y.S.2d 494, 495-96 (1976). This does little to clarify the tests by which existence of a fair and reasonable market value may be ascertained, and the unpredictability of this approach was only dramatized by the court’s decision that the fair and reasonable market value on the date of sale was in excess of the price obtained for it. Was "\textit{market value}” being computed or superseded? As in the specialty cases, there is a discontinuity in the parties’ positions: if a market value is accepted as fair and reasonable, it is to the debtor’s advantage that it be set as high as possible, and thus offset a corresponding portion of the debt. But an unacceptably low market value may be more advantageous, for it will then be augmented by consideration of value in use and value to the owner.

\(^{179}\) People ex rel. Hotel Astor v. Sexton, 159 Misc. 280, 287 N.Y.S. 746, 752 (1935), aff’d...}
erty and corporate franchises, and such a rule for the assessment of real estate alone is misleading and wholly unreliable."180 Such considerations led New York courts to include within the specialty designation commercial property producing nonrental income. The first such cases involved the valuation of hotels:181

Concededly, the sales prices of the hotel enterprise, as well as the hotel income, reflected not only the value of the real estate—the only proper subject of the real property tax—but the worth of such additional elements as management, good will, hotel furniture and furnishings, inventory of food and beverages and the usual hotel services. . . . In these circumstances, the valuation of a transient hotel property is in essence the valuation of a "specialty," a term including real estate, which, unlike an apartment house or office building, produces income only in combination with a business conducted upon it.182

While cost-based valuation of commercial property183 parallels specialty cases following the New York Stock Exchange decision, their combination in one category entails some confusion, for in other respects they have little in common. Commercial property, such as a hotel, cannot be said to be without a market, nor of value only to its owner. Application of the specialty designation to income-producing property reduces its assessment by deeming profits from its operation irrelevant to real estate valuation184 in contrast to the effect of such classification upon unique and unmarketable structures. It is not surprising that New York decisions have referred less and less frequently to the specialty status of income-

---

180. People ex rel. Delaware, L. & W. R.R. v. Clapp, 152 N.Y. 490, 46 N.E. 842, 843 (1897) (railroad property valuation for local tax purposes held limited to reproduction cost; court found it "impossible to apportion the rentals or earnings, and credit the just proportion to real estate, to personal property, and to franchises").


183. Income data was considered only for purposes of determining the "suitability" of the structure—i.e., whether it would be reproduced if destroyed. Id. This inquiry is common to all types of specialty valuation. See supra text accompanying notes 159–62.

producing property\textsuperscript{185} even while supporting a distinction between business income and property income\textsuperscript{186} for valuation purposes.

A market value assessment should reflect a prospective bid for property alone, exclusive of any going concern upon the site. Yet a purchaser would surely consider its profitability when making an offer. "[W]e know that in ordinary circumstances investors will pay for income-producing property a price measured in large part by the amount and certainty of the income which can be obtained from such property."\textsuperscript{187} The income to be measured is that which a purchaser could expect, not necessarily that enjoyed by the present owner.\textsuperscript{188} But this distinction does not justify a disregard of income data altogether.

Some cases suggest that only rental income may be considered in property tax valuation; that hotels and race tracks, for example, not being rented by tenants, cannot be valued by the income approach.\textsuperscript{189} Yet many commercial properties are held by landlords and rented to those who actually conduct business upon them,\textsuperscript{190} and frequently the rent is measured

\textsuperscript{185} E.g., Great Atl. & Pac. Tea Co. v. Kiernan, 42 N.Y.2d 236, 397 N.Y.S.2d 718, 366 N.E.2d 808 (1977); Semple School for Girls v. Boyland, 308 N.Y. 382, 126 N.E.2d 294 (1955); Consolidated Edison Co. v. State Bd. of Equalization, 101 Misc. 2d 910, 422 N.Y.S.2d 584 (1979). Both A & P and Semple cited the Hotel Paramount case for the older definition of specialty property as unique and unmarketable, ignoring the business income definition which Hotel Paramount itself introduced. This second definition has occasionally been employed in later cases, however, e.g., Westbury Drive-In v. Board of Assessors, 70 Misc. 2d 1077, 335 N.Y.S.2d 361, 366 (1972), aff'd mem., 45 A.D.2d 821, 356 N.Y.S.2d 1017 (1974), and has never been formally disapproved. A dissenting opinion to a 1979 appellate division decision sharply criticized its application of the "unique structure" specialty definition (which the department store in question was found not to meet), pointing out that the income-producing property branch of the specialty category had been ignored. This dissent went on to criticize the unpredictable application of this designation:

I submit that an owner-operated department store in White Plains is as much a specialty as the Macy's department store in Queens County and the A & S department store in Nassau County and that the rules of assessing these structures should not differ from county to county, nor should the principles to be applied in judicially reviewing them be as unsettled and unclear as they appear to be to me.


\textsuperscript{187} People ex rel. Parklin Operating Corp. v. Miller, 287 N.Y. 126, 38 N.E.2d 465, 467 (1941).

\textsuperscript{188} E.g., California Portland Cement Co. v. State Bd. of Equalization, 67 Cal. 2d 578, 63 Cal. Rptr. 5, 432 P.2d 700, 705 (1967).


\textsuperscript{190} Lessees responsible for property tax payments may in fact be treated as owners in legal proceedings contesting the assessment. Federated Dep't Stores v. Board of Tax Review, 162 Conn.
by receipts of the tenant-proprietor. Given this situation, it is a small step to allow an owner-proprietor to introduce evidence of profitability in a review of the tax, reasoning that this figure would be relevant to its rental value were it leased for commercial purposes. This greatly weakens the rationale for ignoring nonrental income.

Courts and assessors continue to distinguish the rent upon property, actual or imputed, from enterprise income, but a satisfactory means of separating the two remains elusive. An owner's business efforts will affect the value of his property, and the property's characteris-


Assuming that the custom throughout the nation is generally to base long term leases for national chain variety stores on annual gross sales figures, it seems reasonable to permit an owner-occupied national chain variety store to offer in evidence its annual gross sales figures and suggest a property valuation for real property tax assessment purposes by applying a capitalization percentage rate to such figures.

193. Cases holding that gross income may be used as a starting point in calculating the return upon real property generally offer no details as to how such a determination should proceed. E.g., California Portland Cement Co. v. State Bd. of Equalization, 67 Cal. 2d 578, 63 Cal. Rptr. 5, 9, 432 P.2d 700, 705 (1967); Hilton Inns v. Board of Assessors, 39 Misc. 2d 792, 242 N.Y.S.2d 433, 435 (1963). A dramatic example of the type of circular reasoning encouraged by the absence of any clear definition of business income can be found in ITT World Communications v. County of Santa Clara, 101 Cal. App. 3d 246, 257, 162 Cal. Rptr. 186, 192-93 (1980):

Appellant essentially argues that a valuation of property in excess of RCNLD [reproduction cost new less depreciation] necessarily includes income attributable to enterprise value. This position, however, is founded upon the erroneous premise that a valuation in excess of RCNLD will always exceed the value of the tangible property. If the value of tangible property may in some cases properly exceed RCNLD, then a valuation in excess of RCNLD does not necessarily include income attributable to enterprise value.

This attempts to employ factual data to solve a definitional problem. The court posits cases in which property value does not exceed RCNLD, and builds upon this assumption to find a method of determining value. This may be compared to cases holding that leases upon taxable property may be ignored for assessment purposes only when they do not reflect "true value." See supra note 18. In each case, a comparison with "value" is prescribed as a step in calculating that "value."

194. See, e.g., Schleiff v. County of Freeborn, 231 Minn. 389, 43 N.W.2d 265, 270 (1950), where the court upheld valuation of $67,200 for property purchased two years earlier for $35,000, accepting testimony that the latter figure might be the fair market value of the property in 1944, at a time when it was vacant, but that since the building had been substantially occupied after that date and was so occupied at the time of the assessment, its market value had been enhanced since its purchase by
Property Tax

tics will influence the profitability of the business carried out upon it.\textsuperscript{195} A market value standard suggests that profits should be taken into account insofar as they bear upon the return reasonably to be expected by a prospective buyer, however much this projection may fluctuate from year to year.\textsuperscript{196} While this would not eliminate difficult evidentiary problems when structures have not recently been sold,\textsuperscript{197} it disposes of the need for special exceptions to general valuation principles in the case of income-producing property. In the absence of compelling justification, the dangers of arbitrary treatment and distorted valuations are reason enough to avoid creation of new classifications.

E. Extension to “Prestige” Structures

The boundaries of specialty classification were extended again, although in an ambiguous fashion, by the New York Appellate Division’s 1963 decision concerning the Seagram Building.\textsuperscript{198} At issue was the proper assessment of “one of New York’s, and the country’s, great works of modern architecture, the Seagram Building, 375 Park Avenue, at 53rd Street by Mies van der Rohe and Philip Johnson, as handsomely proportioned and serene a tower as the 20th century has conceived.”\textsuperscript{199}

\textsuperscript{195} E.g., People ex rel. Hotel St. George v. Lilly, 45 N.Y.S.2d 599, 603–04 (1943), rev’d mem., 268 A.D. 830, 49 N.Y.S.2d 374 (1944), aff’d, 293 N.Y. 898, 60 N.E.2d 30 (1944) (per curiam) (location near subway entrance increased gross sales and therefore rental value of stores).

\textsuperscript{196} A recent decision by the Washington State Board of Tax Appeals illustrates the general reluctance of valuation tribunals to recognize transitory fluctuations in “real value.” The board rejected evidence of value based upon a recent sale of the property because a “buyers’ market” then prevailed. As a dissenting member pointed out, “[t]he fact that a ‘buyers market’ existed at the time of the sale is a reflection of the true market and does not change the willing buyer-willing seller or arm’s-length nature of the transaction.” Rainier Brewing Co. v. Hoppe, Nos. 78-62 to 78-70 (Wash. B.T.A. Jan. 25, 1980) (Brand, vice chairman, dissenting).

\textsuperscript{197} Use of reproduction cost as a stable measure of “value” when income and market data reflect turbulent economic circumstances raises a question as to the effect of the economy upon building prices. In In re Real Property for Mun. Purposes, 192 Misc. 280, 80 N.Y.S.2d 340 (1948), the city objected to the use of inflated post-war construction costs in an eminent domain proceeding valuing a settlement house agreed to be a specialty. The city argued that its expert used 1941 prices because labor and material prices had greatly increased since then, and that values should be determined as of a time when conditions were normal. The court rejected this argument, not on the grounds that abnormal values could be real ones, but because no “abnormal condition” had been shown to exist. 80 N.Y.S.2d at 342.

\textsuperscript{198} A major danger is assignment to the hypothetical party of all the characteristics of the present owner, “resorting to a tour de force by which to bridge the gap between the realization value of a property and its value to the owner.” 1 J. BONBRIG, supra note 6, at 60.

\textsuperscript{199} J. BONBRIG, supra note 6, at 60.


\textsuperscript{201} Goldberger, Three Ways to Get a Sense of Extraordinary New York, N.Y. Times, Aug. 8, 1980, at C9, col. 6.
The building, completed shortly before the assessment at a cost of $36,000,000, was valued by the city at $21,000,000. However, the owners contended that a capitalization of rental income would yield a value of less than $18,000,000.

The appellate division relied upon the presumed validity of assessments in rejecting this "startling result":

It would seem to follow beyond the hope of successful contradiction that the traditional method of ascertaining value by capitalization is not applicable in this situation. Nowhere in the record is it explained how just two years before the period under review an experienced owner employing a reliable contractor and having the services of outstanding architects put $36,000,000 into a structure that was only worth $17,800,000.

The court went further, however, and suggested two possible approaches to such "prestige" structures: use of depreciated reproduction cost, by analogy to buildings of unique design, and capitalization of income, with that figure adjusted to include the value of public association of the owner's name with an architecturally outstanding structure. A concurring opinion elaborated upon this latter suggestion:

201. Id. at 231-32.
202. The court made clear that such suggestions were only dicta:
The conclusion, therefore, is that petitioner proceeded upon an untenable theory and failed to show error in the assessments which calls for affirmance of the confirmation by the referee. It would, however, be unfair to leave the impression that a building of this sort presents an insoluble problem . . . [I]t will not be idle to indicate the lines along which presentation might be made.
Id. at 232.

Earlier in its opinion the court listed the "distinctive features" characterizing buildings of this type: they are generally known by the owner's name, rather than by street address; they are constructed of unusual materials; their architecture is "noteworthy"; and they are set back from the street:

[The space involved] is employed in distinctly decorative effects. The net effect is that this building, and the limited number that resemble it, gives up a substantial fraction of the land that might be built upon, with a consequent diminution of the rentable space, and its construction involves a cost materially in excess of utilitarian standards.
Id. at 230.

203. While denying that this building constituted a "specialty," the opinion nonetheless found a parallel justifying use of the cost approach: "While here the special features do not restrict the use, they do affect the value and the absence of proof of that effect could well lead to a valuation on replacement value as a last resort." Id. at 232.
204. The court stated:
The public does not know or care about the actual ownership of the fee. The same effect could be produced if the building were identified in the public mind by the name of a tenant. In calculating the income of the building the additional increment that a tenant who could afford and would be willing to pay for such a privilege should be included.
Id. at 233.
Given a new building, prudently constructed for commercial purposes, the answer must be that the rental value assigned to the owner-tenant is too low, and, perhaps too, that the building as a whole bearing the name of its owner includes a real property value not reflected in commercial rental income.205

Four justices of the New York Court of Appeals voted to affirm the judgment of the Appellate Division, denying without explanation the taxpayer’s contention that this would tax prestige and advertising value, rather than real property alone.206 Three justices dissented. Their opinion criticized the result as a tax upon value to the owner in violation of market value assessment: “The good will follows Seagram and cannot be regarded as real property value inherent in the building itself.”207

No well-defined rules for assessment of “prestige” structures have developed; perhaps in reaction to criticism of the Seagram case, courts have been reluctant to invoke it,208 and the “limited specialty” category has remained nebulous.209 Yet the problem posed by Seagram—a divergence

205. Id. at 235 (Breitel, J.P., concurring).
207. Id. at 321, 251 N.Y.S.2d at 465, 200 N.E.2d at 450 (Burke, J., dissenting).
208. See, for example, G.R.F., Inc. v. Board of Assessors, 41 N.Y.2d 512, 393 N.Y.S.2d 965, 362 N.E.2d 597 (1977), where the court adopted elements of the Seagram approach but denied it was equating the two cases. Id. at 513–14, 393 N.Y.S.2d at 967, 362 N.E.2d at 598–99. For critical reaction to the Seagram decision, see, e.g., Murphy & Rook, State and Local Taxation, 15 SYRACUSE L. REV. 223, 225 (1964); Note, Taxation-Assessment-Valuation of Prestige Office Building Based Partially on Cost of Construction Upheld, 33 FORDHAM L. REV. 121 (1964); A Blow for Architecture, N.Y. Times, June 13, 1964, at 22, col. 2:

When it serves society badly, there is something wrong with the law. A clear illustration is in the New York State Court of Appeals decision upholding a lower court judgment that Joseph E. Seagram & Sons is to be penalized in the form of higher taxes for building an extravagantly handsome structure that has become one of the city’s chief ornaments. For New York this decision is a catastrophe.

209. Even before the New York Court of Appeals reached a decision in Seagram, the appellate division faced a similar situation in a valuation dispute over the Pepsi-Cola headquarters on Park Avenue. The appellate division simply stated:

[T]his building is not . . . in the same category as the Seagram Building, that is, a newly erected structure built especially for prestige and advertising value as well as for the headquarters use of its owner . . .

. . . The building being neither a “specialty” nor a “prestige type structure,” the cost of construction thereof is accepted only as a maximum value.

Pepsi-Cola Co. v. Tax Comm’n, 19 A.D.2d 56, 240 N.Y.S.2d 770, 774–75 (1963). The lack of any more objective and detailed explanation of the distinction between the two buildings was criticized by the dissenting opinion to the court of appeals decision in Seagram:

The narrow and highly technical character of the rule applied by the Appellate Division may be highlighted by comparison with [Pepsi-Cola Co.] . . . Since both [buildings] are new, held for business rental, and used as headquarters for the owner, the only difference is the presumed benefit accruing to the Seagram Company from having its name associated with an architecturally superior and well-known building.

14 N.Y.2d at 320, 251 N.Y.S.2d at 464, 200 N.E.2d at 449 (Burke, J., dissenting). Commentators have agreed with the dissent on this point: “It would seem, then, if there is any distinction between
between cost and income data not explicable as the result of mistaken planning—remains unsolved, and mirrors the specialty dilemma.

The strongest argument favoring the Seagram result was articulated by the appellate division: "The public does not know or care about the actual ownership of the fee. The same effect could be produced if the building were identified in the public mind by the name of a tenant."\(^{210}\) "Prestige" buildings have proven their profitability upon these terms;\(^{211}\) a prime tenant may pay sufficient rent to justify the cost of construction. Any distinction between such a building and an owner-occupied but otherwise similar structure would undermine horizontal equity between buildings of equivalent market value.

Yet, as the dissent in the court of appeals pointed out, "‘[v]alue’ under section 306 of the Real Property Tax Law . . . is market value given willing sellers and buyers . . . . In our view, this approach to value necessarily excludes any element that is unique to the present owner of a building."\(^{212}\) Would not the identification of Seagram’s corporate activities with a building of outstanding architectural quality, so important to Seagram itself, be of little or even negative value to a potential purchaser?\(^{213}\) This argument was used by the Equitable Life Insurance Company in a 1979 Iowa case: "Equitable argues that no other insurance company

---


\(^{211}\) Real estate developer Gerald Hines, for example, has retained architects Philip Johnson (who worked with Mies van der Rohe on the Seagram building) and John Burgee on numerous projects, including Houston’s Pennzoil Place. FORTUNE magazine credited him with introducing investment builders to the "use of high-quality design," and went on to add:

A Seagrams could afford to put up a costly Mies van der Rohe design in New York City. An investment builder could not, or thought he couldn’t.

Hines has altered that perception . . . . He did so because he thought well-designed buildings would make more money for him and his partners. They have.

Stuart, Texan Gerald Hines is Tall in the Skyline, FORTUNE, Jan. 28, 1980, at 101, 103.

\(^{212}\) 14 N.Y.2d 314, 251 N.Y.S.2d 460, 463, 200 N.E.2d 447, 450 (1964) (Burke, J., dissenting); cf. First Fed. Sav. & Loan Ass'n v. City of Flint, 415 Mich. 702, 329 N.W.2d 755, 757 (1983) ("[W]e reject the notion that it is proper to include, in determining value, expenditures made, as the Tax Tribunal found, to enhance plaintiff's image and business without regard to whether they add to the selling price of the building.").

\(^{213}\) Note that the value attached to the reputation and beauty of the structure itself is presumably reflected in the rent paid by ordinary tenants whose names are not associated with the building. A value of name association, over and above the value of an address in such a building, must be sought when a bonus rent is imputed to the owner-occupant. It is this value which raises the question of transferability.
would want to occupy a building so closely identified with Equitable and therefore the . . . [valuation] experts actually considered the special value or use value of the property to Equitable . . . ."\(^{214}\) Seagram does not address this problem.

A second and more serious problem in Seagram concerns potential inclusion of nonproperty values in the tax base. If association of its name with an acclaimed landmark increased Seagram’s sales but could not be expected to do the same for a prospective purchaser, should this effect enhance value for property tax purposes? A concurring opinion in the appellate division acknowledged this concern in a footnote: ""[W]ether the increased value attaches to the real estate or to business good will may well, in some cases, present problems difficult of solution."\(^{215}\) But the court of appeals dismissed such concerns: ""This does not mean that advertising or prestige or publicity value is erroneously taxed as realty value."\(^{216}\) Yet rejection of a strict market value standard may permit value to the owner to subsume all such categories. A 1928 valuation case concerning a magnificent but unprofitable hotel illustrated these difficulties. The presiding justice first proposed that whatever the property ""adds to the comfort or well-being of its owner or possessor, that fact should, as far as the limitation of human understanding will permit, be assigned its true proportion of value,""\(^{217}\) but then reduced the assessment on the grounds that the owners ""should not be penalized for their public spirit by having to pay taxes on the full structural value of a money losing hotel.""\(^{218}\) In other words, the judge’s sense of fairness, and little else, determined the amount of the tax. A similar lack of objective criteria for ""value"" in Seagram led the ensuing debate to focus upon instrumental goals, such as encouragement of architectural excellence,\(^{219}\) as if the tax base were so ill defined as to permit unlegislated incentives reflecting judicial attitudes towards design. The most unsettling aspect of Seagram is its suggestion that this may be accurate.

---


\(^{216}\) Id.


\(^{218}\) Id.

F. The Question of Highest and Best Use

Ambiguities surrounding the criterion of "highest and best use" have complicated valuation of specialty property. Under normal circumstances a valuation at highest and best use permits an assessment to encompass value for all potential uses rather than current use alone. Property valuation at highest and best use requires appraisal of each parcel "as though it were being put to its most profitable use, given probable legal, physical and financial constraints."220 It simply implements a market value standard, identifying highest and best use by reference to prices bid for the property in light of all its possible legal uses.

In the case of specialty property, however, highest and best use has been occasionally employed as a bridge between use value and market value—a means of taxing value to the owner without confronting the implications of this step.221 This may be in part a reaction to taxpayer manipulation of "functional obsolescence."222 A claim of obsolescence provides an owner with a ready argument for reducing the assessment of almost any structure below its reproduction cost less physical deprecia-


221. See, for example, McCannel v. County of Hennepin, 301 N.W.2d 910 (Minn. 1980), where the court held that airport facilities owned by Northwest Airlines were to be valued on a cost basis as specialty property, with no consideration taken of the expense to a potential buyer of converting the property to a different use:

Northwest argues that the trial court's method of valuing its property as unique property violates the general rule that property should be valued at its market value rather than its intrinsic value. Although the concepts of intrinsic value and unique property are closely parallel in cases such as this, the trial court did value the property by determining its reproduction cost, an accepted method of estimating market value. To state it differently, the trial court determined the value of the property according to its highest and best use as an airport facility without regard to who might own it. The fact that its intrinsic value to Northwest Airlines might be equal to its value to a hypothetical buyer as an airport facility does not render the trial court's method of valuation invalid.

222. This term is defined by the INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, supra note 220, at 424, as "loss in value of a property resulting from such factors as overcapacity, inadequacy, poor layout in the face of changes in style or in the art . . . ."

223. E.g., Onondaga County Water Dist. v. Board of Assessors, 39 N.Y.2d 601, 604, 385 N.Y.S.2d 13, 15, 350 N.E.2d 390, 391 (1976) (rejecting taxpayer's attempt to deduct 50% of construction cost of new pipeline as functional obsolescence: "Where . . . as in this case, the excess capacity for production was planned and constructed in reasonable anticipation of future needs, that is, with deferred utility, there is no functional depreciation."); B.F. Keith Columbus Co. v. Board of Revision, 148 Ohio St. 253, 74 N.E.2d 359, 361 (1947) (allowance for functional depreciation held proper for vaudeville theatre converted to motion picture use: "Functional depreciation occurs where property, although still in good physical condition, has become obsolete or useless due to changing business conditions and thus to all intents and purposes valueless to the owner.").
tion. The difficulty of testing this reduction against market data may have encouraged courts to rely upon the current and intended use as the standard for valuation.

The same skepticism greets claims that a unique building would enter a prospective purchaser’s calculation of value as a negative sum, the cost of demolition and removal—the “tear-down proposition” suggested and rejected in the New York Stock Exchange case. Where the building in question is sound and of use to its owner, the idea of a negative assessment appears an affront to common sense, yet it is not inconsistent with a market value standard.

A particularly interesting example of this problem arose in a 1978 New Jersey decision, Hackensack Water Co. v. Borough of Old Tappan. The water company had bought 940 acres of “natural basin property” twenty years earlier, excavated it and constructed a dam and reservoir. The division of tax appeals, accepting a stipulation that the highest and best use of the underwater property was residential, reduced its assessment by four-fifths. The borough appealed. The court detailed the steps required to turn the reservoir into a subdivision: dismantling the dam, draining the reservoir (without flooding the neighboring land), transporting millions of cubic yards of landfill, and rechanneling the dammed river. The cost of these preparations was estimated to exceed the market price of the land as residential property.

The court rejected the notion of a highest and best use yielding a lower

224. See, e.g., Stephen & Stephen Properties v. State Tax Comm’n, 499 S.W.2d 798, 800 (Mo. 1973) (argument that two-year-old tennis club, although successful, should be valued at 50% of cost to reflect functional obsolescence; testimony that this depreciation “was there the day they laid the last brick, it was there while this was in the planning stage”). The Stephen & Stephen court considered whether a prospective purchaser could expect to obtain a special use permit to operate a tennis club, such as the present owners enjoyed. The court held that, despite testimony to the contrary, “the permit limits the field of possible buyers because there is no guarantee the special use permit would pass to subsequent buyers.” Id. at 803. An interesting contrast is found in Pocono Downs, Inc. v. Board for Assessment & Revision of Taxes, 11 Pa. Commw. 81, 312 A.2d 452 (1973). That decision rejected the taxpayer’s argument that a higher capitalization rate should be applied to its income because it required a racing license which could be revoked by the state racing commission. “The court below properly observed that there was little prospect of the Commonwealth’s reversing its allowance of horse racing and that the license in fact afforded security against competition.” 312 A.2d at 454. On the difficulty of verifying claims of functional obsolescence without reference to income data, see infra note 246.


228. 390 A.2d at 125.
value than current use: "Underlying the settled rule that remote uses are irrelevant . . . is the more basic principle that property valuation should have some relationship to reality, and the reality of the matter is that the land is useful as a reservoir."

It then valued the land, as specialty property, at the original cost to the water company.

This outcome, while an understandable expression of impatience with an almost absurd extension of highest and best use analysis, did not attempt to define the limits of that approach. An unstated operational rule may be drawn from the court's reaction: highest and best use of land will not justify a lower total assessment of land and improvements than alternate uses would yield. This corollary, necessary only when the cost of returning land to its undeveloped state cancels any improvement in its ultimate value, accords with the inherent meaning of "highest and best use." But the court in Hackensack Water Co. did not elaborate upon this implication. It justified current-use valuation on the grounds that "property should be valued in the actual condition in which the owner holds it," a maxim which cannot support appraisals lower than market value.

229. Id.

230. "We do not intend here to disturb the principle that valuation of land for economically feasible uses other than its actual use is appropriate." Id. at 126 n.3. In the case of unmarketable property, does this suggest that value to the owner must replace the nominal market price of a teardown proposition, the latter proving less economically feasible than actual use? Without a separate justification for deviation from a market standard, the "economically feasible" criterion simply indicates that the higher of value to the owner and value to the market will prevail. This is clearly not appropriate in the case of marketable property of great value to the owner and modest value to the market—as becomes plain when such property is offered for sale. See, e.g., Skyline Swannanoa, Inc. v. Nelson County, 186 Va. 878, 44 S.E.2d 437, 440 (1947) (Mansion of imported marble, constructed in 1922 at cost in excess of $1 million, sold in 1944 for $60,000: "The main dwelling was designed for use as a private residence. There seems to be no market for the property for such use. Attempts have been made to convert the building to commercial use, but its architectural design has proved too much of a barrier . . . .") Nichols recounts a similar example from an unreported Massachusetts case:

The principal officer and owner of a "chain" of restaurants maintained a dairy farm from which the milk sold in the restaurants was derived, and as incident thereto built a cow-barn finished in mahogany, with marble slabs separating the stalls. Music was played while the cows were being milked, and the slogan "milk from contented cattle" had great advertising value. Later the owner met financial reverses from outside investments, and the property came into the hands of a "dirt farmer" operating an ordinary commercial milk route. A court decision was required to convince the assessors that the cow barn was worth little more than one built of ordinary materials.

Nichols, Two Problems in Tax Valuation, 24 B.U.L. REV. 1, 9–10 (1944). One would expect that the possibility of selling the marble and mahogany fixtures was raised by the assessor, if they would command a price in excess of the depreciated cost of an ordinary barn.

231. Hackensack Water Co., 390 A.2d at 125. This maxim has been cited by a number of courts rejecting allowances for functional obsolescence. E.g., Delaware Racing Ass'n v. McMahon, 320 A.2d 748, 761–62 (Del. Super. Ct. 1974), rev'd on other grounds, 340 A.2d 837 (Del. 1975) ("A property owner is and should be assessed on the basis of what improvements have been erected, not on what could have been erected, despite the fact that the latter might be more economical or finan-
values for alternate uses. It made no mention of the problem of unmarketable property, and failed even to suggest an alternate basis of assessment, such as value to the owner. The historical cost of the reservoir land almost certainly represented neither its present value to the water company, its value to a hypothetical purchaser seeking another use, nor its value to another public utility standing in the place of the present owner. Reliance upon cost-based assessment in such a situation simply demonstrates the need for general reconsideration of specialty valuation if it is to be more than a last resort for intractable disputes.

G. Summary: The Cost Approach and Its Alternatives

1. Horizontal Equity

The widespread use of cost-based assessments in specialty valuation is problematic because it sanctions radically different assessment procedures for property within and without that class. Use of reproduction cost rather than realizable sale price can result in an enormous increase in taxes upon a specialty, yet reproduction cost would not be used as the sole guide to valuation of nonspecialty buildings. Nonspecialty properties are not typically rewarded.); Pepsi-Cola Co. v. Tax Comm'n, 19 A.D.2d 56, 240 N.Y.S.2d 770, 774 (1963) ("The owner is to be assessed on the basis of the building that he erected, and as it existed on the taxable status date, and not on what he could have erected."). Clearly a property owner cannot be assessed upon the value of an imaginary structure. Yet it is equally clear that alternate uses which affect market value, either in a positive or negative fashion, should affect assessments as well. How little assistance this maxim offers may be seen by comparing it to the statement, found with equal frequency, that an assessment will not be limited by the use to which the taxpayer puts the property. E.g., Federated Dep't Stores, Inc. v. Board of Tax Review, 162 Conn. 77, 291 A.2d 714, 720 (1971) ("A taxpayer who chooses to use his land in a manner which is not consistent with its highest and best use should not be rewarded with a lower assessment, the effect of which is to increase the tax burden on others.").

232. Perhaps because the parties agreed that the highest and best use of the property was for residential development, 390 A.2d at 125, the opinion did not deal with the question of marketability in fact. It noted that the water company could not sell its property without permission of the New Jersey Board of Public Utility Commissioners, id. at 124, but did not indicate whether such approval was likely or whether such sales had taken place in the past.

233. "I would not, to the obvious detriment of the remaining taxpayers of the Borough of Old Tappan, ascribe as the true value of the reservoir land its remote original cost which has no relevance whatsoever to current market value." Id. at 127 (Handler, J., dissenting).

234. See supra text accompanying notes 156–58.

235. E.g., People ex rel. Manhattan Square Beresford, Inc. v. Sexton, 284 N.Y. 145, 29 N.E.2d 654, 654 (1940) ("In assessing an improvement upon real estate for tax purposes the maximum value which ordinarily may be placed upon it is reconstruction cost less depreciation."). Contra, Bornstein v. State Tax Comm'n, 227 Md. 331, 176 A.2d 859, 862 (1962) ("We think the contention that reproduction cost is an overall ceiling cannot be supported. . . . We find no merit in the contention that use of a capitalization factor converts an ad valorem property tax into one upon income."). See generally Gifford, Should Replacement Cost Impose a Ceiling on Real Property Tax Assessments?, 26 J. Tax'n 314 (1967). Pennsylvania does not allow use of reproduction cost in determinations of
Property may provide its owner with benefits not reflected in sale prices, yet these benefits do not affect its property taxes. Substitution of value to the owner for sale price risks taxation of prestige, sentiment, or business values rather than real estate values alone.\textsuperscript{236}

These problems are greatly exacerbated by the absence of any clear definition of a "specialty." The impossibility of replacement in the market is sometimes accepted as a criterion,\textsuperscript{237} and sometimes rejected.\textsuperscript{238} A link between income and business enterprise has sometimes been employed as a test,\textsuperscript{239} and more often ignored.\textsuperscript{240} The absence of purchasers contemplating use for its intended purpose is the best known requirement,\textsuperscript{241} yet how far the search for potential buyers may extend is not clear.\textsuperscript{242} The resulting uncertainty makes the powerful effect upon tax liability all the more offensive to horizontal equity.\textsuperscript{243}


\textsuperscript{236} See supra text accompanying notes 215–19.


It must be beyond dispute that in a town or city that has only one theater, if the theater is condemned the only recourse open to the owner, if he desires to operate a theater, is to build another one. . . . So, to compensate such an owner the cost of building another theater, less depreciation, is the only appropriate method.

\textsuperscript{238} See, for example, County of Suffolk v. C.J. Van Bourgondien, Inc., 47 N.Y.2d 507, 512, 419 N.Y.S.2d 52, 55, 392 N.E.2d 1236, 1238 (1979), where the court stated:

The county contends that claimants' greenhouses are not unique because they can be purchased on the open market. However the requirement of uniqueness goes to the function of the building, not to the availability of its components. Claimants' greenhouses were specially built for the growth of plants and flowers, and the evidence establishes, would have had to be removed or destroyed rather than be readily converted in place to other uses. Clearly, they are unique structures.

\textsuperscript{239} See supra text accompanying notes 179–97.

\textsuperscript{240} See supra text accompanying notes 156–58.


\textsuperscript{242} See supra note 145.


It is a matter of common knowledge that the cost of reproduction of buildings at present is so far above market value as to have little relation thereto, and if all properties having some degree of special use are to be valued at the ceiling of values resting upon the basis of the mounting reproduction costs less depreciation, thousands of such structures in this City will be taxed presently on a basis much higher than the remaining bulk of the taxable improvements.

The trial court had ruled that a 20-story clubhouse could not be valued as a specialty, citing such testimony as this examination of the taxpayer's expert: "Q. Is the New York Athletic Club building similar in any way to the Stock Exchange building? A. In no way whatsoever." \textit{People ex rel. N.Y.}
2. **Imperfect Markets**

The valuation of property may proceed upon an examination of actual sale prices of comparable parcels, a calculation of depreciated reproduction cost, or a capitalization of expected income. Courts reviewing property tax assessments have felt free to shift from one method of valuation to another, or to prescribe an assessment falling within the range yielded by various methods but conforming to no specific formula. This reflects a belief that, properly applied, all three methods should produce the same result, and that "real" value lies within the area they delimit, elusive only because simplifications necessary to make the calculations workable exclude the refinements that would permit them to converge. Yet in the case of specialty property these assumptions collapse. In the specialty context, the choice of a method of valuation often becomes the choice of a tax base.

Whenever the market is so limited as to produce substantial variations in the realizable sale prices of identical parcels, "market value" is a questionable measure for the tax. Should the use to which a building is put change its assessment? If, for example, a town with two theatres is able to support only one, should the operating theatre be assessed as a specialty, at its depreciated reproduction cost, while the second is assessed upon its realizable sale price? This would produce radically dif-

---

244. E.g., Medical Bldg. Land Co. v. Department of Revenue, 283 Or. 69, 582 P.2d 416 (1978): "Now we embark on the somewhat mystical process appraisers refer to as 'correlation.' From the three [cost, market, and income approaches, yielding results which differed by $1.5 million] estimates above we must come up with a single figure for the true cash value of the subject property." 582 P.2d at 420 (footnote omitted). The court then chose to rely on income data alone, despite the fact that the office building in question was newly constructed and only partially occupied, its "earnings history" consisting of rent accrued after the assessment date.

245. E.g., Chrysler Corp. v. Illinois Property Tax Appeal Bd., 69 Ill. App. 3d 207, 387 N.E.2d 351, 355 (1979) (in valuing automobile assembly plant, "[i]n theory, use of either of the two relevant approaches [i.e., income and cost] should lead to the same total value"); Gifford, supra note 235, at 314 ("Errors of one sort or another in the valuation processes undoubtedly account for most differences between capitalized-income value and [cost] value.").

246. E.g., B.F. Keith Columbus Co. v. Board of Revision, 148 Ohio St. 253, 74 N.E.2d 359 (1947) (unreasonable to allow no deduction for functional depreciation when theatre intended for live performances but used only for motion pictures contained unnecessary storage space, dressing rooms, and stage area). One commentator expressed concern that Keith would allow a lower assessment for such a theatre even if it were as profitable as similar buildings still used for live performances. Note, *Functional Obsolescence as a Factor in Valuation*, 17 U. Cin. L. Rev. 165, 172 (1948). This problem, however, is shared by all attempts to measure functional depreciation without reference to income data. See, e.g., Bend Millwork Co. v. Department of Revenue, 285 Or. 577, 592 P.2d 986 (1979); Publishers Paper Co. v. Department of Revenue, 270 Or. 737, 530 P.2d 88 (1974); Reynolds Metals Co. v. Department of Revenue, 258 Or. 116, 477 P.2d 888 (1970). This difficulty
ferent levies upon identical buildings. If, on the other hand, availability of the unused theatre as a substitute limits the operating theatre’s assessment to the price at which the abandoned one is offered, demolition of the abandoned building will have the surprising effect of raising the other’s valuation from a sacrifice price to depreciated reproduction cost, for it will now qualify as a specialty. Should the owner of the first theatre buy the second as a tear-down proposition but keep it in place to assure a market value assessment of the building in the future? These are all problems of imperfect markets; none of them would arise if an auction matched numerous buyers and sellers of similar property.

3. Realizable Sale Price as a Tax Base

Would a literal interpretation of ‘‘market value’’ improve specialty assessments? At one time Wisconsin adopted this approach. Considering a situation similar to the Seagram case, the Wisconsin Supreme Court wrote in 1922:

The statute does not contemplate that the owner shall be both seller and buyer. No safe test could be arrived at upon such a basis. It would only consist in the judgment of the assessor unchecked by external actual facts as to sales or market value. . . . [I]t must be borne in mind that the state asks a tax only upon the business value of the property of its citizens . . . . In this case we have a fine, substantial, artistic building gracing half a block in the can be solved by refusing a deduction for functional depreciation to taxpayers who will not supply the assessor with income data, in the absence of an active market for the particular type of building under consideration. The more intractable problem lies in the unequal assessment of identical buildings put to different uses when the market has already absorbed the number which can compete at the most profitable use.

247. An extraordinary example of this approach is found in Village of Burnsville v. Commissioner of Taxation, 295 Minn. 504, 202 N.W.2d 653 (1972). The assessor valued certain Minnesota River bottomland, previously classified as wasteland and assessed at less than $1 million, at more than $7 million after its acquisition by the Northern States Power Company. Four million dollars of this assessment represented a ‘‘use increment,’’ the value to the utility of substituting a connected lake for the cooling towers it would otherwise have had to construct. The Minnesota Supreme Court approved the tax court’s reasoning in reducing the total assessment to less than $1.5 million: ‘‘If we were to add a ‘use increment’ to the value of this property then we would have to add a similar ‘use increment’ to all property in the State of Minnesota, which could be used for cooling purposes.’’ 202 N.W.2d at 656-57 (quoting unreported Minnesota tax court decision). A witness testified ‘‘to the obvious fact that actual or potential ‘Black Dog Lakes’ [the lake used by the power company] exist in the bottomlands ‘all the way up and down the river.’ ’’ Id. at 657 n.6. On one level this result poses no difficulty for the valuation of specialty property according to its depreciated cost. The availability of substitutes will limit value to the owner to market value, preventing the market price of bottomland from rising to the cost of cooling towers. But the notion of a ‘‘use increment’’ is relevant to the more usual specialty situation, such as the one- or two-theatre town, if Burnsville suggests that as a general proposition use by the owner should not affect the valuation of property.
city of Milwaukee built to meet the peculiar needs of its owner, and not well adapted for other uses. The state says, Tax it at its sale value.248

Why is this unsatisfactory? Primarily because, in the usual case of non-specialty property, market value indicates something of the resources expended by the owner as well as those the owner would realize were the property offered for sale. For the owner of a costly structure to escape taxation because no other party shares such extravagant tastes poses a problem of horizontal equity different from, but no less troubling than, that presented by current specialty cases—and undoubtedly one less politically acceptable to most jurisdictions. “The literal adoption of a market-value rule would seem to do gross injustice by hitting only those taxpayers whose property happens to take marketable form.”249

It is difficult, however, to support elaborate exceptions to general valuation methods on grounds of political realism in the absence of legislative action. Almost no statutes address the specialty problem.250 Attempts to find an answer in existing legislation generally serve only to justify a

248. State ex rel. Northwestern Mut. Life Ins. Co. v. Weiher, 177 Wis. 445, 188 N.W. 598, 599 (1922). Like Seagram, this case involved valuation of an opulent office building constructed as headquarters for its owner. As in Seagram, the taxing jurisdiction proceeded upon the assumption that a business would not invest in property unless it were worth the cost: “an owner is not supposed to build to lose.” Id. A dissenting opinion, in turn, presaged Seagram by contending that such “monumental” structures embodied value not reflected in capitalized earnings, and that the recent construction of a number of such corporate headquarters signaled the development of a market for such buildings, and that the “conservative” directors of an insurance company could not be supposed to have squandered corporate funds upon a building worth only a fraction of its cost. Id. at 601 (Crownhart, J., dissenting). On the question of a strict market value standard, Weiher suggests that few points of substance have been added to the debate since 1922. Nor has Wisconsin maintained this unambiguous adherence to such a standard—its courts perhaps have realized, in Bonbright’s words, that “only the Wisconsin courts have had the courage to interpret market value in this literal sense, and in their case discretion would have been the better part of valor.” 1 J. BONBRIGHT, supra note 6, at 509. In subsequent years the court came to permit consideration of “all elements” affecting market value, including income data. See State ex rel. N. Shore Dev. Co. v. Axtell, 216 Wis. 153, 256 N.W. 622, 623 (1934); see also State ex rel. IBM Corp. v. Board of Review, 231 Wis. 303, 285 N.W. 784 (1939) (valuation of personal property).

249. 1 J. BONBRIGHT, supra note 6, at 458. Bonbright also recognized the pragmatic nature of many such decisions:

Why this vagueness in the concept of value? For one thing, even the most conscientious tax collector will tend to dodge debatable points, to give the taxpayer the benefit of the doubt. To hew close to the line of theory may give satisfaction to economists, but it will assuredly cause a stampede of irate citizens on grievance day. “Interesting questions” usually die stillborn. Id. at 479. Of course, the pragmatic approach to specialty valuation does not appease the owner, but rather the other taxpayers in the jurisdiction.

250. OR. REV. STAT. § 308.205 (1981) directs that the “true cash value” of property without a market value shall be set for tax purposes at “the amount of money that would justly compensate the owner for the loss of the property.” The Oregon tax court has invoked this section in approving the New York Stock Exchange approach to specialty valuation: “A specialized building with an ongoing use, which is the highest and best use, should be valued at that use.” Benevolent Protective Order of Elks v. Department of Revenue, 6 Or. T.R. 489, 492 (1976).
pragmatic result. The *New York Stock Exchange* decision found "a complete answer" in the statutory requirement that all property "be assessed at the full value thereof." 251 The Illinois court rejected specialty valuation for the Chrysler plant because the law prescribed uniformity of assessment at "fair cash value." 252 Phrases such as "fair market value" and "willing buyer-willing seller" 253 have been used to describe a hypothetical sale at a price equal to value to the owner more often than they have been taken to mean realizable sale price. 254 In such a situation, a refusal to follow any one of the mingled and confused notions of "value" to its logical conclusion may be justified as the "interpretation of language by its traditional use." 255

---


Illinois law requires that all real property "shall be valued at its fair cash value, estimated at the price it would bring at a fair, voluntary sale." . . . This is theoretically an objective standard of valuation; the value of particular property is set by the forces of the marketplace at a given place and time.

. . . [E]ven where special purpose property is involved, the use of reproduction cost is only one proper factor in the valuation process . . . .

The court also found "strong support" for its rejection of specialty valuation in the state’s constitutional requirement of uniformity, Ill. CONST. art. IX, § 4(a), although it did not agree with Chrysler’s contention that this provision prohibited cost-based valuation. 387 N.E. at 356.

253. In *Helvering v. Walbridge*, 70 F.2d 683, 684 (2d Cir. 1934), Judge Learned Hand criticized Treasury regulations providing that property lacked a fair market value only in "rare and extraordinary cases":

Perhaps there need not be a "market" to establish a "market value," but there must be some assurance that the value is what a "market" would establish; and a "market" itself presupposes enough competition between buyers and sellers to prevent the exigencies of an individual from being exploited. . . . "Willing" adds nothing, for, if the trade goes through at all, both must be willing, and the degree of their reluctance is not a serviceable measure.

Judge Hand concluded that the 1921 formulation, "readily realizable market value," which was replaced three years later by "fair market value," was a more expansive term, "for one may at times 'readily realize' on goods which have no true market, 'fair' or 'unfair.' " *Id.* Yet specialty cases from *New York Stock Exchange* on have attempted to find a statutory "market value" for property with a negligible or nonexistent realizable sale value. Stiles v. Commissioner, 69 F.2d 951, 952-53 (5th Cir. 1934), took that approach to the 1924 change in wording of the federal statute: "It is not necessary that market value be ascertained by quotations on an exchange or that the property be readily salable in open market."

254. *E.g.*, *Turnley v. City of Elizabeth*, 76 N.J.L. 42, 44 (1908):

We are not disposed, however, to give much force to the argument that because there are very few actual buyers for so costly a residence the valuation to be placed upon it under the statutory criterion [i.e., the price at a fair and bona fide sale] should be correspondingly depreciated. The criterion established by the statute is a hypothetical sale, hence the buyers therein referred to are hypothetical buyers, not actual and existing purchasers.

H. Specialty Valuation: Conclusions

Given the current structure of the real property tax, the problem of specialty valuation permits no single and general solution. The ad hoc approach found in many decisions, with ill-defined categories and contradictory assessment methods, requires improvement. Yet outright abolition of the distinction would produce unacceptably low assessments upon costly property of value to its owner. The initial steps must be incremental. Given that the specialty classification is judicially created, what can courts do to minimize its disruptive effect upon the predictability and objectivity of the tax?

As a first measure, the range of properties included in this class could be greatly narrowed. Recognizing that it represents a departure from general valuation methods, which equate "market value" with realizable sale price, courts could reserve specialty classification for cases in which normal valuation approaches fail. For example, property linked to enterprise income need not be given a specialty designation if the income reasonably anticipated by a normal buyer may be estimated. Similarly, the specialty classification need not be invoked in the valuation of "prestige" structures if the prestige inherent in association with the building name may be offered to a prime tenant for an enhanced rent. A structure which could be replaced by purchase, rather than by rebuilding, need not be considered a specialty, no matter how specialized its use; the availability of a substitute will prevent value to the owner from exceeding the sale price. As much as possible, the specialty classification should be reserved for exceptional cases in which sale price affords a plainly objectionable tax base.

The subjectivity involved in judging a measure objectionable, of course, demonstrates at once the difficulty of confining such an exception. Numerous types of property may be of greater value or of different use to their owners than to the market; this cannot in itself justify an increase in their assessments. Defining the "market" necessary to support a finding of "market value" presents a related problem. No real property enjoys a perfect market from an economist's point of view, but nonethe-
less most parcels require no deviation from realizable sale price in calculation of assessed value. An attempt to restrict the specialty designation to exceptional cases requires recognition that value to the owner is not the general measure of assessment and that an extremely low sale price may be a valid indicator of a market value. This in itself would go far toward restricting specialty treatment to unusual situations. Decisions frankly circumventing normal identification of sale price with market value would doubtless be more difficult to obtain than are those directing specialty classification at present.

This recognition that specialty valuation constitutes an exception to usual valuation methods could benefit a large number of cases not currently considered a part of the specialty category—those involving owner-imposed restrictions upon use or marketability. These and similar encumbrances have reduced assessments in a number of cases apparently guided by the mistaken belief that realizable sale price is the standard for all valuations. The narrow logic of such decisions signals the need for a new perspective upon the problem. If it is admitted that some small but irreducible number of cases require the exception to market value assessment now provided by the specialty approach, a starting point may be found for a new method of dealing with other unmarketable property, for which a nominal assessment may also be found unacceptable. If the specialty cases aid this extremely troublesome area, the subject of the next segment of this study, perhaps the price they have exacted in terms of the logic and predictability of assessments, attributable to "the absence of any valid philosophy for the general property tax,"259 will be in some part redeemed.

IV. VALUATION OF PROPERTY SUBJECT TO EASEMENTS AND SIMILAR LEGAL RESTRICTIONS

A. The Problem of Easements That Reduce Market Value

The long-term lease and specialty problems provide a useful background for consideration of the complex array of privately imposed restrictions that have been held at various times to affect the valuation of property for tax purposes. The most difficult questions in this area concern limitations accepted voluntarily by the owner, lowering the realizable sale price of the land but also conferring other benefits not subject to real property taxation. Should private, voluntary arrangements of this sort reduce the tax base of the jurisdiction in which the land is located? The long-term lease and specialty cases demonstrate that neither the effect of legal encumbrances nor realizable sale prices determine property tax val-

---

259. 1 J. BONBRIGHT, supra note 6, at 508.
uation in all instances. However, the majority of cases dealing with the valuation of property subject to legal restrictions do in fact allow these encumbrances to reduce the taxable value of the burdened property.

This pattern was first set by a number of New York easement cases decided early in this century. The logic of these cases hinged upon what might be termed the "additive" quality of appurtenant easements. Reasoning that the benefit of the restriction inured to other real property, courts concluded that recognition of the burden of the easement in assessment of the servient estate would cause no revenue loss to the taxing jurisdiction, and in fact was required if double taxation of the benefit were to be avoided. This appealing symmetry, however, relies upon a number of incorrect assumptions, primarily the conservation of total property value and the fact of assessment of the benefit to the dominant estate. Even more problematic are the broader applications of this reasoning in later cases that, omitting even the assumed equation of benefit and burden, merely equate taxable value with realizable sale price. The lease and specialty cases disprove any suggestion that "fair market value" is universally defined as the realizable sale price of the owner's interest. The remaining sections of this article will discuss the development of the majority approach, which permits legal restrictions to reduce the value of the burdened property, and will examine alternative methods of dealing with these situations.

1. Development of the Majority Position

The first influential case dealing with the effect of an easement upon

260. An easement is a property right; its holder may limit the uses to which the owner of property may put land or buildings. 2 AMERICAN LAW OF PROPERTY § 8.5 (A. Casner ed. 1952). An affirmative easement affords its holder a privilege of positive action, such as use of a private road, upon the burdened property. A negative easement, by contrast, limits the property's uses without conveying a right of entry to the holder of the easement. A common example of a negative easement is a limit upon the height of a building, imposed to protect a neighboring structure's view and access to sunlight.

An easement in gross benefits its holder personally, running to him as an individual rather than as the owner of a particular estate. An easement appurtenant accompanies the possession of the benefited, or dominant, estate, enhancing in some way the physical use or enjoyment of it. It passes with possession of the dominant estate. Id. at §§ 8.71, 8.75. Thus, what is termed here the "additive" concept of appurtenant easements posits that a benefit and corresponding increase in value to some dominant estate accompanies every decrease in value suffered by a burdened, or servient, estate.


261. See, e.g., infra text accompanying note 269.
valuation for tax purposes, *People ex rel. Poor v. O'Donnel*, stemmed from disputed assessments upon Gramercy Park in New York City from 1903 to 1905. Gramercy Park is a private park held in trust for the benefit of residents of the surrounding lots and maintained by their private assessments:

It is more like a London square than a New York park, and it was laid out at the foot of Lexington Avenue between 20th and 21st Streets in 1831 by Samuel Ruggles, a developer, who sold off 66 building lots around the park. The park remains in private hands, and owners of the surrounding properties are the only possessors of the keys to its iron gates . . .

However, today the keys are no longer made of gold, as they were in the past.

Protesting the park's valuation (at $500,000 for 1903 and 1904, and $750,000 for 1905), the trustees claimed in *Poor* that easements restricting its use, found in the deeds to the adjoining lots and to the park itself, deprived it of all market value: "These easements are such that the land cannot be used for any other purposes than those mentioned in the deeds, and their existence makes it necessary to devote the land exclusively to park purposes . . ." The New York Appellate Division agreed and held the assessments erroneous, finding that in its encumbered state the park could find no buyer "for any price whatever." Crucial to its reasoning, however, was its conviction that a contrary result would produce double taxation:

Since the park was established, it has been the practice of the tax commissioners to include in their assessment of the dominant tenements the full value of the park privileges or easements. The result is that the assessed value of the lots surrounding the park, exclusive of their improvements, is several hundred dollars per foot, in excess of the assessed value of lots of the same size and character in the same section of the city; this excess representing the value of the park rights, privileges, and easements appurtenant to the lots surrounding the property of the relators. This excess amounts to more than what would be the full value of the land embraced within the limits of the park if the same could be sold free and unencumbered.

---

266. 124 N.Y.S. at 38.
267. *Id.*
Property Tax

The court then described an easement’s effect upon property values in language adopted by later cases as a general principle, which might be termed an “additive” theory of value:

[W]hen an easement is carved out of one property for the benefit of another, the market value of the servient estate is thereby lessened, and that of the dominant increased practically by just the value of the easement. The respective tenements should thereafter be assessed accordingly, the determinate question of the assessable value of each of the properties affected being its market value, or the amount for which it would sell under ordinary circumstances. . . . The city has, therefore, taken unto itself the advantage of the second of the propositions heretofore laid down, namely, that the dominant estate should be increased by the value of the easement. It cannot, in fairness and justice, do this, and, at the same time, refuse to accede to the justice of the first of the propositions, namely, that the market value of the servient estate is lessened by the value of the amount of the easement.

A number of these propositions have become central to the assessment of servient estates at their realizable sale prices, rather than at unencumbered market value. Chief among these is the notion that “carving” an easement from the servient estate diminishes its value “practically by just” the increase in value to the dominant estate. Yet the generalization is erroneous. No such uniform relationship in fact exists, as may be demonstrated by any number of counterexamples. Bonbright required only one sentence:

An easement of passage over A’s forest land to the road may greatly enhance the value of B’s hotel property without correspondingly depreciating A’s land; while on the other hand an easement of light over C’s lot may merely make D’s backyard slightly pleasanter while preventing C from building an apartment house.

Such considerations, however, have not prevented the majority of courts, following Poor, from concluding without evidence that any increase in the value of the dominant estate must be accompanied by a corresponding decrease in the assessment of the servient estate.

Poor has also influenced later cases by its evident, although not explicit, definition of the property tax base, equating it with the realizable sale price of the owner’s interest. The New York court thus adopted without explanation or discussion one answer to a question which the lease and specialty cases show to be highly problematic. The lease cases dem-

268. See infra text accompanying note 294.
269. 124 N.Y.S. at 38–39.
270. 1 J. BONBRIGHT, supra note 6, at 497.
271. See infra note 329.
onstrate that rights the owner has relinquished will in some situations be figured as part of the "property" subject to tax, and the specialty cases make clear that realizable sale price is not in every instance equivalent to "market value."

The most influential contribution of Poor to the development of the additive approach, however, lay in the court's accusation that the city was inconsistent in valuing the park at a substantial sum while simultaneously assessing the neighboring lots upon a value enhanced by their park privileges. This too assumes a number of questionable points. If all property were assessed without regard to encumbrances or divided legal interests, there would be no need to consider the transfer of value from one lot to another by reason of such arrangements. Yet even under this approach an enhanced value to lots surrounding Gramercy Park could enter their assessment, due not to their owners' exclusive rights to the park, but simply to the amenity of nearby open space in the middle of a city. Surely such an assessment would not constitute double taxation, even if the aggregate of such additions exceeded the value of the park itself.272 The charge of double taxation reflects a confusion between legal interests in land and the effect a given use has upon neighboring properties' values. The additive approach, which posits a conservation of market values after imposition of an easement, equates property rights, which may be divided and conserved in mathematically precise ways, with property values, which conform to no such patterns. A conveyance of rights in the servient estate may or may not affect its market value for purposes of taxation, depending upon the definition of property employed as the basis for the tax, but the problem cannot be avoided by equating the conveyance of rights with a transfer of taxable values.

Within two years, four additional cases strengthened and extended the reasoning in Poor. A 1911 case273 held that a statute conferring upon the purchaser at a tax sale "absolute title free from all incumbrances" had no effect upon an easement granted before assessment of the unpaid tax against the servient estate.274 Instead, the court determined, the statute

272. The court in Poor found this comparison particularly persuasive: The city, in other words, having added to the market value of the surrounding lots a sum as the estimated value of the easements in the park, which exceeds or equals the value of the park itself, it cannot assess over again against either the trustees who hold the fee, nor by necessary consequence against the owners of the land benefited by the easement, the value of the park property itself which it has, in effect, already assessed and collected. 139 A.D. 83, 124 N.Y.S. 36, 39, aff'd mem. sub nom. People ex rel. Poor v. Wells, 200 N.Y. 519, 93 N.E. 1129 (1910).


274. This decision dealt only with the statute governing tax sales in Oneida County. 130 N.Y.S. at 747. Its resolution, however, was adopted by the legislature for all county tax sales in N.Y. Tax
Property Tax

merely cleared the title of liens placed upon it.275 This narrowing of the property rights conveyed at a tax sale had an immediate impact upon valuation controversies in assessment appeals, for almost all courts have assumed that identical "property" must be at issue in the two instances.276

A second 1911 case returned to the assessment question.277 The taxpayer owned land burdened, through a subdivision map filed with the county register by the grantor, by easements of access appurtenant to two neighboring lots. The owner alleged that the remaining "naked fee . . . is for all practical purposes valueless, inasmuch as the owner of said premises can do nothing with the same and it has to be kept open for the benefit of the said abutting owners."278 After the map was filed, New York City annexed this section of Westchester County and changed its system of roads. As a result, the street contemplated by the grantor was never constructed, and there was no evidence that the dominant estates had increased in value as a result of this "dormant" easement. Thus, if the taxpayer's allegations were accepted,279 the rationale for the additive approach to easements would be contradicted, for the dominant estates enjoyed no enhanced value corresponding to the servient property's loss of marketability. Yet the court chose to follow *Poor* and its rationale:

> The element of double taxation does not appear in the matter at bar . . . . But the fact is that a piece of real estate which had been deprived of all its valuable attributes, so far as the owner was concerned, was treated by the tax commissioners as if still possessing them . . . .

If, then, the parcel of real estate has no real value for which compensation

---

275. 73 Misc. 61, 130 N.Y.S. 740, 747 (1911), aff'd mem., 149 A.D. 936, 134 N.Y.S. 1126 (1912), aff'd mem., 210 N.Y. 561, 104 N.E. 1127 (1914).
278. 128 N.Y.S. at 571.
279. The court did not deal in its opinion with the possibility that the change in circumstances following annexation would affect the enforceability of the easement and so raise the value of the servient estate. See generally Annot., 25 A.L.R.2d 1265 (1952); Annot., 4 A.L.R.2d 1111 (1949).
must be paid, if taken in condemnation proceedings, how can it have a value for purposes of taxation? Its valuable qualities have been attached to the adjoining properties which, by the acquisition of easements appurtenant thereto, have been increased in value and should be assessed accordingly.

It follows, therefore, that, although the question of double taxation is not here involved, this case comes directly within the reasoning of People ex rel. Poor v. Wells.280

This resolution raises as many questions as it answers. The property may have been of no value "so far as the owner was concerned," but the long-term lease cases demonstrate that value to the owner does not always determine the property tax assessment—nor does compensation due the owner in eminent domain proceedings. Just as the lessee enjoying below-market rent holds a compensable property right for eminent domain purposes,281 so too the owner of the dominant estate may have a claim to compensation in the event condemnation destroys the easement.282 And if that easement is of no market value, as seems likely in this case, in what sense may it be said that the "valuable qualities" of the servient estate have "been attached to the adjoining properties"? If, on the other hand, the easement is of value and its loss would require compensation to the owner, why should not that award be added to the sum which would be due the owner of the servient estate to reach the total value subject to tax?

Yet another important New York Appellate Division opinion on this topic followed one year later. Owners of a dominant estate holding easements of air, light, and access over an adjoining lot objected to foreclosure of tax liens upon the servient property insofar as the process threatened to extinguish their easements.283 Following the earlier cases, the court assumed that the value of the easement had been included in the assessment of the dominant estate, and subtracted from the assessment of

281. See supra text accompanying notes 74-89.
282. E.g., United States v. Certain Land in Augusta, Maine, 220 F. Supp. 696, 700 (D. Me. 1963), where the court stated:
The authorities are divided on the question of whether the extinguishment of an equitable servitude is a taking of private property for which federal and state constitutional provisions require that compensation be paid when the land to which it is attached is taken for public use.
The state decisions are in hopeless and irreconcilable conflict, although the majority view favors compensation. The federal rule has not yet been authoritatively settled.
(Citations omitted.) See, e.g., In re Parkway in Nassau County, 256 A.D. 1094, 11 N.Y.S.2d 581 (1939); Flynn v. New York, W. & B. Ry., 218 N.Y. 140, 112 N.E. 913, 914 (1916) ("These restrictive covenants create a property right and make direct and compensational the damages which otherwise would be consequential and noncompensational."); see generally Annot., 22 A.L.R.3d 961 (1968); Annot., 4 A.L.R.3d 1137 (1965).
the servient estate. The court had no difficulty judging the easement to survive the tax sale, stating that "the lien is upon the property assessed and no more... The property assessed and the property conveyed upon the tax sale must be the same."

While this consolidated rather than extended the logic of the earlier cases, its description of the additive concept of easements proved particularly influential:

An easement is a servitude upon, and differs from an interest in, or lien upon, the land. It is not a part of, but is so much carved out of the estate in, the land, and is as much a thing apart from that estate as a parcel of the land itself conveyed from it.

The definitions of "lien" and "interest" were critical here, for the statute governing tax sales directed that title pass free of "all liens upon, claims against, interest in or right or title" to the subject property.

Many courts have followed these cases by denying the applicability of similar statutes to easements, yet this result is open to question. An easement, like a lien or a mortgage, is a legal interest in the subject property, one whose variety of forms cautions against generalizations as to its nature. Is a mortgage or a lease less an element "carved out" of the property, less "a thing apart from that estate," than an easement? If

284. 138 N.Y.S. at 656. ("The appellants in this case paid the taxes assessed upon their property, and presumptively the value of the easements was included in that assessment.").

285. Id. This differed slightly from the position of the court in Blenis, discussed supra at text accompanying notes 273–76. While Blenis would limit the title purchased at a tax sale to "the title that the owner of the property had free from liens by the way of incumbrances placed thereon," 130 N.Y.S. at 747, Jackson recognized that the tax title constituted a "new and independent grant," 138 N.Y.S. at 656, but limited it to the property assessed. Id. The controversy in Blenis took place almost 20 years after the sale for taxes, in the form of an action for abatement of a nuisance (i.e., a building blocking access to the servient estate). Because Jackson presented an objection to foreclosure proceedings themselves, the court was given an opportunity to consider in detail the status of the easement, rather than simply deferring to the precedent of Blenis.

286. 138 N.Y.S. at 656.


288. E.g., Ross v. Franko, 139 Ohio St. 395, 40 N.E.2d 664 (1942).

289. "An easement is an interest in land in the possession of another..." RESTATEMENT OF PROPERTY § 450 (1944).

290. Easements may take a number of forms, including leases, contracts, restrictive covenants, and rights of way. "When a conveyance creates the right to use certain land but the conveyance is not sufficiently precise to create a possessory interest, the interest created, if one is created, is necessarily an easement." 2 AMERICAN LAW OF PROPERTY § 8.21 (A. Casner ed. 1952).

291. Jackson distinguished an easement from "an interest in, or lien upon, the land." 138 N.Y.S. at 656, quoted supra at text accompanying note 286. Yet an easement is "an interest in land in the possession of another," RESTATEMENT OF PROPERTY § 450 (1944), and even the New York Court of Appeals, relying upon Jackson, held that the purchaser at a tax sale need not accept property burdened by easements when "said liens were in no way referred to by the terms of sale." Tax Lien Co. v. Schultze, 213 N.Y. 9, 106 N.E. 751, 752 (1914).
these interests are to be distinguished, it must be because an appurtenant easement attaches to another parcel of property, unlike a mortgage or lease. Yet the significance of this distinction received little attention at the time these cases set the pattern for the assessment of encumbered property. "Why the easement should have received exceptional treatment we are unable to say," wrote Bonbright. Nor have courts following the New York approach supplied the rationale he found lacking.

These four cases, taken together, provide an internally consistent set of rules for assessments and tax sales of property encumbered by appurtenant easements. Their influence was such that by 1914 the New York Court of Appeals could begin an opinion on the foreclosure question by simply quoting Poor to the effect that an easement "carved out" of one property lessened its market value, and increased that of the dominant estate, "practically by just the value of the easement." Numerous later disputes were resolved by reference to this pattern, without re-examination of its premises or reasoning.

2. Application to Restrictive Covenants

Other jurisdictions have relied upon the New York cases both in similar settings, such as the sale for taxes of property burdened with an easement of access, and in cases involving other forms of restrictive covenants. Although restrictive covenants may be termed easements, they often depart from the pattern supporting the New York scheme. A restriction upon new construction, for example, may raise the market price of

292. J. Bonbright, supra note 6, at 497.
295. E.g., District of Columbia v. Capital Mortgage & Title Co., 84 F.Supp. 788, 790 (D.D.C. 1949) ("The District of Columbia loses by way of taxes on the servient tenement, should have been fully recouped by taxes on the dominant estate. ... The District of Columbia, therefore, loses nothing."). The court stated in Ehren Realty Co. v. Magna Charta Bldg. & Loan Ass' n, 120 N.J. Eq. 136, 184 A. 203, 203-04 (1936):
   The parcel ... situate in the middle of the block is without any substantial value unless included with it is the right of way. ... It cannot have been the intention of the legislature that the assessor should fix the value of such lands independent of the means of reaching them, for the assessed value would be trifling, and much income thereby lost to the taxing district ... The tax sale is based on the assessment. Nothing passes thereby except what has been assessed.
296. See generally Nichols, Real Property Taxation of Divided Interests in Land, 11 Kan. L. Rev 309, 320 n.94 (1963) ("Restrictive covenants are treated analogously to easements.").
Property Tax

all lots in a residential subdivision—such an effect in all probability being the purpose of its imposition—without diminishing the value of any one "servient" estate. And certainly if the effect of the restriction is to diminish sale prices, the logic of assuming value to be "carved out" of one lot and added to another disappears altogether. Yet most such cases have assumed that a transfer of value takes place, basing their reasoning on the New York example.

A 1929 Oregon case, Crawford v. Senosky,298 affirmed the grant of an injunction against construction of a gas station in an area restricted by deed from commercial activity until 1932—a measure "necessary to the successful development of this addition into a high-class residential district."299 The defendant, however, had purchased the property at a tax sale, and the court noted that Oregon law provided title thus obtained "shall be superior to any lien, claim or charge whatever against such lands, except the lien of tax certificate . . . and the taxes for the current year."300 Yet the court felt that affirmance of the injunction required only a citation to the early New York cases:301 "But the foreclosure of a tax lien does not cut off easements that have been carved out of one property for the benefit of another."302 The attraction of the additive approach was such that the court employed it in a different context from that in which it developed, with no discussion of these differences, and in opposition to the literal terms of the statute dealing with tax titles.303

The New Mexico Supreme Court took a similar approach to a restriction upon the sale of alcohol. In Alamogordo Improvement Co. v. Pendergast,304 the defendant had purchased land sold for unpaid taxes. A prior deed prohibited the sale of alcohol upon the lot. This restriction had been placed upon all lots in the area by the company originally owning all land in the town. Again, the court found this an exception to the general grant of new and paramount title at tax sales, citing the New York precedent:

It may be said that generally, all easements or rights which are subject to separate valuation for assessment purposes, and which have been carved out of the servient estate, since they are, theoretically at least, taxed as a part of the dominant estate, remain inviolate upon sale of the servient estate. This

298. 128 Or. 229, 274 P. 306 (1929).
299. 274 P. at 306.
300. Id. at 307 (citing Or. Laws § 4371).
302. 274 P. at 307.
303. The New York cases were similarly in opposition to a literal reading of statutory language dealing with tax titles. See supra text accompanying notes 273–75.
304. 43 N.M. 245, 91 P.2d 428 (1939).
we hold, is the majority rule even though the state, as purchaser under tax
sale, and thereafter vendor to individuals, does in fact, give by its deed a
‘new and paramount’ title.\textsuperscript{305}

The court’s assumption that the benefit of the easement was taxed to the
dominant estate made it clear that no separate valuation of the easement
alone had taken place. To assume ‘‘theoretically at least’’ that such an
assessment had taken place seems highly unrealistic, as no statute or prior
decision required it, and accounting for all legal encumbrances would be
a difficult task for an assessor. In answer to these objections, the court
reverted to language reminiscent of the New York Stock Exchange\textsuperscript{306}
opinion:

Counsel for appellee urges consideration of the fact that our statute, un-
like that of some states, makes no provision for the assessment of such, or
other, easements. It is answer enough to that contention to point to the re-
quirement that all (emphasis ours) property shall be assessed according to
the value thereof. . . . Theoretically, it is a simple thing to do.\textsuperscript{307}

The question of tax sales has interesting implications for the valuation
process. Can valuation of a benefited parcel at an enhanced figure reflect-
ing that benefit be justified if a tax sale of the burdened parcel would
extinguish the easement or servitude? Many courts have assumed that the
grant of a truly ‘‘new and paramount’’ title at a tax sale would produce
double taxation,\textsuperscript{308} and destroy property rights upon which taxes had been
paid.\textsuperscript{309} Yet by the New York hypothesis, the benefit assumed to be taxed
to each estate in its dominant capacity should be equivalent to the burden
suffered by each estate in its servient role. If this is so, extinguishing both
the benefit and the burden should destroy no value, and disregard of the
encumbrance in assessment should not produce double taxation. The
court did not accept these consequences of the New York approach,\textsuperscript{310}
but neither did it re-examine the initial assumptions. If each home but one

\textsuperscript{305} 91 P.2d at 430.

\textsuperscript{306} ‘‘A complete answer to this contention, however, is that section 6 of the Tax Law . . .
provides: ‘‘All real and personal property subject to taxation shall be assessed at the full value thereof
. . . .’’’ People ex rel. N.Y. Stock Exch. Bldg. Co. v. Cantor, 221 A.D. 193, 223 N.Y.S. 64, 68
(1927), aff’d mem., 248 N.Y. 533, 162 N.E. 514 (1928), discussed supra at text accompanying notes
139–46.

\textsuperscript{307} Alamagordo Improvement Co. v. Prendergast, 43 N.M. 245, 91 P.2d 428, 434 (1939).

\textsuperscript{308} 91 P.2d at 431.

\textsuperscript{309} Id.

\textsuperscript{310} ‘‘There is the further allegation that such scheme and plan was intended to and did in fact,
enhance the value of the lots so sold . . . .’’ Id. at 429. The court accepted this allegation, id. at 432,
in overruling a dismissal of the development company’s complaint, and thus laid the ground for a
final argument against disregard of the restriction for assessment purposes: such a course would
‘‘foolishly reduce’’ tax collections. Id.
in the subdivision paid taxes upon a value reflecting the proscription upon liquor sales, and the restriction remained in effect until foreclosure of the tax lien upon the delinquent owner's lot, each assessment was based upon a correct valuation as of the assessment date.

In part, these cases reflect a confusion between property rights and property values. Payment of taxes upon a value reflecting a particular condition establishes no right to enforce or maintain it. A home located next to a private park or a well-maintained structure may command a premium price for that reason, but payment of taxes reflecting that value confers no right to block construction in the park or enforce stringent maintenance standards for the neighboring building. The fact that a benefited parcel has been assessed at a higher level because of the restriction does not automatically confer upon its owner a right to preserve that restriction after a tax sale of the servient estate. Nor would the possibility of such extinguishment necessarily impose an unreasonable burden upon parties affected by the restrictions. Like mortgagees, these subdivision owners may take private steps to ensure continuation of their agreements. Taxes upon the property, for example, might be paid by a homeowners' association, financed by fees from its members.

The court's approach in Alamogordo requires an initial presumption, never stated explicitly, that the value of the subdivision lots reflected more than the neighborhood's condition on the assessment date. The court must have viewed the sale prices as a reflection of the potential buyers' belief that the restriction upon sales of alcohol would remain enforceable in the future. In this case, the court's fear of double taxation, although still not conclusive, would be strengthened. Taxpayers might have relied upon future application of the New York rule, which would safeguard the restriction even in the event some homeowners were delinquent in their property tax payments. But this hypothetical justification requires some indication that the New York rule would be applied in New Mexico. How could homeowner reliance upon that approach be justified when a future decision of the state's supreme court was required to adopt it? Surely the purchaser at the tax sale had some justification as well for relying upon the statutory language promising a "new and paramount" title.

Consideration of the purchaser's position raises yet another distinction between the Gramercy Park situation and a case such as this involving mutual restrictive covenants. The former case provided taxpayers with an argument for consistency in assessments: the enhanced valuation of land carrying rights to the park was said to require a diminished assessment of the park itself,311 each parcel commanding one price in light of the ease-

311. See supra text accompanying notes 267–69.
ment and another in its absence. But the Alamogordo opinion assumed that the restriction raised the value of all lots subject to it,312 while the purchaser at the tax sale demonstrated a belief that the most profitable use of the lot contravened the restriction—probably, although not necessarily, because other parcels continued to be bound. Only on the purchaser’s land could alcohol be sold. Together, these assumptions depict three levels of value: one for each parcel if none are encumbered, a second and higher level if all are encumbered, and a third and still higher level for one parcel if it alone is not encumbered. What does this scheme imply for the New York rule?

Assessment of all parcels at the second level is not necessarily inconsistent with the position that any parcels sold for unpaid taxes will be free of the restriction. Perhaps the announcement of such a policy would reduce or eliminate the difference between the first and second levels. To assess all parcels at the second level once such a tax sale has taken place would be incorrect: the then-current sale price, whether at the first level or somewhat above that, if the effect of one unencumbered parcel is not the same as the effect of no encumbrances at all, must govern. But consistent assessment of all parcels at a sale price reflecting the benefit of the encumbrance is justifiable even if a tax sale conveys new title free of the restriction.

This array of market values makes it clear that the Alamogordo approach basically addresses a private need for concerted action. Any given homeowner may be better off ignoring the restriction. Uniform enforcement may raise all values in the aggregate, and principles of property law may permit such restrictions to run with the land, binding all in the chain of title from the original grantor.313 But what has this to do with tax assessment or tax titles? A private scheme for raising property values may make use of existing legal mechanisms, but this does not resolve a case questioning their existence, such as Alamogordo. Not every land use restriction raising real estate values is either available314 or acceptable315 to

312. See supra note 310.
313. See generally RESTATEMENT OF PROPERTY §§ 487(e), 530 (1944).
314. E.g., Southern Burlington County NAACP v. Township of Mt. Laurel, 67 N.J. 151, 336 A.2d 713 (1975) (invalidating zoning restrictions the effect of which was to prohibit construction of low-income housing by, e.g., permitting only single-family detached residences and setting minimum lot area at 20,000 square feet), cert. denied and appeal dismissed, 423 U.S. 808 (1975).
315. This is demonstrated not only by the absence of such restrictions in many communities, but by the enactment of measures such as rent control and limitations upon condominium conversion which reduce market values of rental housing units below their unregulated levels. See J. Heilbrun, Summary of the Proceedings, Conference on Rent Control: Its Effect on Housing Availability and Assessed Values 10 (Oct. 25–26, 1977) (copy on file with the Washington Law Review).
any given jurisdiction—even if it would increase property tax revenues.\textsuperscript{316}

An opposite result in \textit{Alamogordo}, in fact, could actually have improved the municipality’s financial position, given public awareness of the state of the law. A homeowners’ association with mandatory fees, such as that maintaining Gramercy Park, could guarantee payment of taxes upon the property of its members. The effect of such an arrangement upon market values might well reflect as much confidence in the future of the restrictions as would be promoted by \textit{Alamogordo}. In that case, assessments properly based on sale prices should reach the second level, that which obtains when all parcels are encumbered. Thus tax revenues should be as high as they would be under \textit{Alamogordo}. The municipality should in fact gain by the amount of taxes due upon delinquent property of the type which led to that decision in the first place.

A later case in agreement with \textit{Alamogordo},\textsuperscript{317} which considered subdivision deeds prohibiting commercial structures and homes costing less than $2500,\textsuperscript{318} ridiculed the notion that a tax sale should confer a truly “new and paramount” title:

To follow such a theory would create a great insecurity of titles by placing unreasonable burdens upon landowners by putting them in the precarious position of seeing that every one of their 1,058 neighbors are properly assessed and their taxes paid, in order to protect their property from the loss of the restrictive covenant.\textsuperscript{319}

Yet homeowners’ associations with membership rights appurtenant to subdivision lots may cover thousands of units, managing park land, marinas, golf courses, and roads, and assessing members for dues to cover these expenses.\textsuperscript{320} Surely such an organization could ascertain that no member’s property is delinquent in tax payments. This possibility is in any event no more fanciful than the assumption, accepted in these cases,\textsuperscript{321} that assessment of all property affected by easements had taken

\begin{footnotes}
\item[316] See \textit{cf. supra} note 310.
\item[318] 169 P.2d at 782. The covenants also prohibited homes located less than 20 feet from the lot boundary. Plaintiffs asserted that these restrictions were “necessary to the successful development of this subdivision into a high-class residential district.” \textit{Id.}; \textit{cf. supra} text accompanying note 299.
\item[319] \textit{Id.} at 788.
\item[320] \textit{See}, e.g., Sudden Valley Community Ass’n v. Turner, Nos. 78-18 to 78-37 (Wash. B.T.A. Feb. 8, 1980) (association for owners of 4500 subdivision lots; membership appurtenant to land; 20 property tax appeals relating to association property, including golf courses, a country club, administration buildings, picnic areas, marinas, beaches, parks, private roads, and nature trails).
\item[321] Alamogordo Improvement Co. v. Prendergast, 43 N.M. 245, 91 P.2d 428, 430 (1939) (“It may be said that generally, all easements or rights which are subject to separate valuation for assessment purposes, and which have been carved out of the servient estate, since they are, theoretically at least, taxed as a part of the dominant estate, remain inviolate upon sale of the servient estate.”);
\end{footnotes}
those restrictions into account. In effect, these cases reject the imposition of administrative burdens upon homeowners seeking to maximize their property values but exhibit no similar hesitation toward administrative burdens upon the tax officials charged with assessing that property. Even more troubling is the unwillingness of these cases to re-examine the assumptions behind the early New York easement decisions—assumptions open to some question even within the context that gave rise to them initially, and far more problematic when applied to other settings.

3. Mills, Golf Courses, and Low-Income Housing

The belief that easements produce a transfer and conservation of value has influenced decisions in a variety of factual situations. An intriguing set of opinions early in this century dealt with taxation of mill rights and flowage easements, the right of mill owners to flood adjoining lands when damming a stream to produce a steady fall of water. Although a few early mill cases were cited in the first New York easement decisions, 

Crawford v. Senosky, 128 Or. 229, 274 P. 306, 308 (1929); Hayes v. Gibbs, 110 Utah 54, 169 P.2d 781, 786 (1946) (“In determining this value ['full cash value' for assessment purposes] no deduction is made for mortgages, liens, rights of dower, and similar interests. But an easement is not a lien, it is rather a servitude imposed upon the land sometimes said to be ‘carved out' of the servient estate.”)

Note that Hayes here assumes the validity of Jackson’s distinction between a mortgage and a lien. See supra text accompanying notes 286–92.

322. A concurring justice in Hayes had perhaps a more realistic view: “It is practically impossible for a county assessor to know of all easements, building restrictions and the like which exist in his county. Indeed in this very case the assessor testified that he acted in ignorance of the building restrictions here involved.” 169 P.2d at 789 (Wolfe, J., concurring).

323. This situation gave rise to a number of different property tax questions: the effect of a sale of “flowage rights” from the owner of the flooded land to the owner of a dam or mill, e.g., In re Petition of Auditor General, 260 Mich. 578, 245 N.W. 522 (1932); or of the conveyance to the owner of a mill or plant of the right to utilize power generated at a separate dam, e.g., Crocker-McElwain Co. v. Assessors of Holyoke, 296 Mass. 338, 5 N.E.2d 558 (1936); Essex Co. v. City of Lawrence, 214 Mass. 79, 100 N.E. 1016 (1913); or of conveyance of the right to draw water from a pond or lake to power a mill by its fall, e.g., Quinebaug Reservoir Co. v. Town of Union, 73 Conn. 294, 47 A. 328 (1900). Other variations arose when municipal boundaries divided the dam and the mill, e.g., City of Bangor v. City of Brewer, 142 Me. 6, 45 A.2d 434 (1946); Union Water-Power Co. v. City of Auburn, 90 Me. 60, 37 A. 331 (1897); Blackstone Mfg. Co. v. Inhabitants of Blackstone, 200 Mass. 82, 85 N.E. 880 (1908); Winnipiseegee Lake Cotton & Woolen Mfg Co. v. Town of Gilford, 64 N.H. 337, 10 A. 849 (1887); or the pond and the dam or mill, e.g., Beaverton Township v. Lord, 235 Mich. 261, 209 N.W. 122 (1926); Amoskeag Mfg. Co. v. Concord, 66 N.H. 562, 34 A. 241 (1891); People ex rel. Adirondack Power & Light Corp. v. Durey, 126 Misc. 188, 213 N.Y.S. 623 (1925), rev'd, 221 A.D. 294, 223 N.Y.S. 215 (1927); In Re Hall, 116 A.D. 729, 102 N.Y.S. 5, aff'd mem., 189 N.Y. 552, 82 N.E. 1127 (1907), between different taxing jurisdictions. Each of these cases dealt with the "value" of taxable property when the owner no longer held the legal right to utilize land in certain ways—a question linking the mill and easement cases.

324. E.g., Blackstone Mfg. Co. v. Inhabitants of Blackstone, 200 Mass. 82, 85 N.E. 880
and later mill decisions took account of the developing easement law, for the most part their specialized factual setting inhibited any larger influence upon valuation cases in other contexts. Interestingly, New Hampshire courts were able to analyze the problem correctly as one of aggregating all interests in the assessed land, while New York decisions exhibited some confusion in this area—an exact reversal of their positions with regard to the long-term lease.

Beyond these little-noticed cases, however, the additive approach of the New York courts toward assessment of servient property gained widespread acceptance. Its subsequent employment in a wide array of situations


326. E.g., Amoskeag Mfg. Co. v. Concord, 66 N.H. 562, 34 A. 241, 242 (1891): If A., owning a farm in Bow and an adjoining farm in Dunbarton, sells to B. the Dunbarton farm, and a perpetual right to carry to it ... water flowing from a spring on the Bow farm, the easement thus created in Bow land, and ... annexed to Dunbarton land, is in Bow, and is taxable in Bow to its owner. ... After the conveyance of the interest in the Bow farm from A. to B., giving B. a right to carry the water to the Dunbarton farm, and after he exercises that right, there is as much water-producing real estate in Bow as there was before. See also Winnipesaukee Lake Cotton & Woolen Mfg. Co. v. Town of Gilford, 64 N.H. 327, 10 A. 849, 850-51 (1887), quoted infra at text accompanying note 383.


329. Courts accepting what is here termed the "additive" approach—the New York assumption that the value of the encumbrance is transferred from the servient estate to the dominant, which reduces in practice to assessment at realizable sale price—generally have done so in the context of a tax sale, holding easements to survive foreclosure of a tax lien upon the assumption that their value was previously assessed to the dominant estate. E.g., District of Columbia v. Capital Mortgage & Title Co., 84 F. Supp. 788, 790 (D.D.C. 1949); Alvin v. Johnson, 241 Minn. 257, 63 N.W.2d 22, 24 (1954) ("weight of authority" behind New York rule); Alamogordo Improvement Co. v. Prendergast, 43 N.M. 245, 91 P.2d 428, 430 (1939) ("It may be said that generally, all easements or rights which ... are, theoretically at least, taxed as part of the dominant estate, remain inviolate upon sale of the servient estate. This, we hold, is the majority rule. ..."'); Ross v. Franko, 139 Ohio St. 395, 40 N.E.2d 664, 665 (1942) ("[g]reat weight of authority" behind New York rule); Crawford v.
tions illustrated certain implications not considered by the early cases. It was applied to mineral interests,330 covenants not to compete,331 rights in air space,332 driveways,333 public parks,334 irrigation ditches,335 and oil pipelines336—to say nothing of the rights of way337 and restrictive coven-

Senosky, 128 Or. 229, 274 P. 306, 307 (1929); Hayes v. Gibbs, 110 Utah 54, 169 P.2d 781, 786 (1946) ("better considered cases" support New York rule); cf. Arizona R.C.I.A. Lands, Inc. v. Ainsworth, 21 Ariz. App. 38, 515 P.2d 335, 337 (1973) (by enacting statute preserving easements after tax sale, "the Arizona legislature has simply aligned this jurisdiction with the prevailing view on the matter"); Nichols, supra note 296, at 320 (taxation of easements "normally becomes an issue only when the question is raised of survival after a tax foreclosure sale"). In a few states, however, the New York approach has been adopted in the assessment context itself. E.g., Tualatin Dev. Co. v. Department of Revenue, 256 Or. 323, 473 P.2d 660, 663 (1970) ("The courts of other states have been confronted with similar situations and have held that when the use of land is so restricted that its ownership is of no benefit or value, the assessment for tax purposes should be nothing or merely nominal.") The RESTATEMENT OF PROPERTY in 1944 articulated the rationale for the additive approach:

In the case of . . . an [appurtenant] easement the dominant tenement has its value for sale purposes increased by the existence of the easement. Upon a sale of the land constituting this tenement, whether the sale is for tax purposes or not, the purchaser gets the benefit of the easement. Accordingly the value of the land for sale purposes and hence for tax purposes is increased because of the existence of the easement. RESTATEMENT OF PROPERTY § 509(2) comment d (1944). Note the emphasis upon realizable sale price ("value for sale purposes") and upon an assumed survival of the easement after tax sale. The RESTATEMENT pointed out that, subject to constitutional restrictions, "the legislature is at liberty to determine the effect of a tax sale." Id. at § 509 comment b. The position of the RESTATEMENT added to the influence of the majority view. E.g., Alvin v. Johnson, 241 Minn. 257, 63 N.W.2d 22, 24 (1954).

330. E.g., State ex rel. Svoboda v. Weiler, 205 Neb. 799, 290 N.W.2d 456, 458 (1980) (mineral interests subject to separate assessment survive tax sale); cf. Hunt v. Boston, 183 Mass. 303, 67 N.E. 244, 246 (1903) (excavation rights extinguished by sale for taxes, upon assumption that they were included in assessment of the fee).

331. E.g., Messett v. Cowell, 194 Wash. 646, 79 P.2d 337, 342 (1938) (tax sale extinguished covenant not to extract lime upon property).


333. Ross v. Franko, 139 Ohio St. 395, 40 N.E.2d 664, 665 (1942) (easement to use driveway survives tax sale, upon assumption that it was taken into account in assessment); cf. Rice v. Reich, 51 Wis. 2d 205, 186 N.W.2d 269, 271–72 (1971) (lease of driveway created easement).


335. Upper Harmony Ditch Co. v. Carwin, 189 Colo. 190, 539 P.2d 1282, 1285 (1975) (easement for ditch across land not affected by sale of land for unpaid taxes, upon assumption that the easement was not included in assessment of the property in default). Contra Harmon v. Gould, 1 Wn. 2d 1, 94 P.2d 749, 754 (1940) (easement for ditch across land extinguished by its sale for taxes, the tax lien being superior to all other interests).


that first gave rise to this approach. Two of the most provocative settings have only recently begun to attract attention: the assessment of common areas in residential developments, and the assessment of federally subsidized housing subject to rent limitations.

New York courts did not hesitate to extend the additive approach to open areas within housing developments, holding that the homeowners' rights had destroyed the taxable value of common parkland, "or, it may be, stating it better, it has shifted the taxable value from the park lands to the other lands in the development...." In 1970 the Oregon Supreme Court adopted a similar position when it assigned a zero tax value to a nine-hole golf course which county assessors had appraised at more than $160,000. The course was included in a "planned adult residential community" to meet the county planning commission's open space requirements, but it had not shown a profit in three years of operation. The court felt the New York cases provided the best solution, stating that "when the use of land is so restricted that its ownership is of no benefit or value, the assessment for tax purposes should be nothing or merely nominal."

This result risks inconsistency with the long-term lease cases. Should the realizable sale price of encumbered property set its taxable value? A 1973 Maryland case dealing with beachfront property quoted testimony by a developer concerning deed restrictions prohibiting construction:

It is not the beach itself that has value, it is the lots that lie behind the beach that have the value... But the beach itself has no fair market value. I can tell you from my own experience in developing waterfront property that the happiest day of your life is—for the developer—is the day that he can give that to the community.

---


341. 473 P.2d at 661. The earnings history of the golf course was quite short, it having opened in 1966 and the tax years in controversy being 1967 and 1968. Id. at 660-61. The Oregon court permitted an even shorter earnings history to influence an assessment in Medical Bldg. Land Co. v. Department of Revenue, 283 Or. 69, 582 P.2d 416 (1978), where the building in question had been open less than one year at the time of assessment.


343. Supervisor of Assessments v. Bay Ridge Properties, Inc., 270 Md. 216, 310 A.2d 773, 777 (1973). There the assessors sought to diminish rather than deny the additive effect of the easement, arguing that, as 380 of the 1110 subdivision lots had not yet been sold, 380/1110 of the original value must remain in the beach itself. The court rejected this notion that easements appurtenant to the unsold lots "remained in a state of suspended animation":
By this reasoning, any property which has become a net burden to its owner should receive a zero value assessment. Yet an owner losing money because of an unfavorable lease or mortgage is not entitled to a zero valuation of his property on that account.

The most dramatic case in this series was a 1976 decision by the Washington Supreme Court, *Twin Lakes Golf and Country Club v. King County*, which reduced the assessed value of an eighteen-hole golf course from $660,000 to zero. The golf course was designed to meet the county’s “common open space” requirement for planned unit developments. The zoning agreement, recorded plat maps, and deed covenants to lot purchasers restricted it to use as a golf course. The golf course had lost money in each of its six years of operation. In the briefest of all these decisions, the Washington court referred to the New York, Oregon, and Maryland cases discussed above, to the statutory directive that property be assessed at its “true and fair value in money,” and to the willing buyer-willing seller standard. It then concluded that “when the use of land is so restricted that its ownership is of no benefit or value, the assessment for tax purposes should be nothing.”

---

References:

344. *Tualatin*, the court found support for a zero value assessment in the city’s refusal to accept the golf course as a donation from the developer. 473 P.2d at 664. Yet why should the city undertake to maintain a private development’s golf course? Many parcels of real estate, restricted or not, may have market value without being suitable for municipal ownership. Such a situation arose when the Beverly Hills home of Mary Pickford and Douglas Fairbanks, Sr., was sold for over five million dollars. The city, local universities, and charitable organizations all declined the home as a gift prior to its sale because its operating costs were estimated at $300,000 to $400,000 annually. Lindsey, *For Sale: Home w/View of Movies’ Golden Years*, N.Y. Times, Mar. 19, 1980, at A16, col. 5 (“It couldn’t be given away, so the legendary home of Mary Pickford and Douglas Fairbanks Sr. was put on the market today for $10 million.”); *Pickfair Sold to Jerry Buss*, N.Y. Times, Sept. 20, 1980, at 24, col. 4.


346. 87 Wn. 2d 1, 548 P.2d 538 (1976).

347. *Id.* at 3, 548 P.2d at 539.

348. *Id.* at 4, 548 P.2d at 540.


351. *Twin Lakes*, 87 Wn. 2d at 4, 548 P.2d at 540. Like *Twin Lakes*, cases adopting this approach have generally not considered the effect of provisions allowing members of the titleholding association to revoke restrictions upon use of the common areas in the future. E.g., *Waterville...*
The startling conclusion that an eighteen-hole golf course has no value for tax purposes makes *Twin Lakes* somewhat more dramatic than most easement decisions, but the distinction is qualitative only. It merely extends the method of reasoning found in those cases.  

The assessment of government subsidized rental housing affords another setting for the valuation of restricted property. Restrictions upon the rents charged for these units may be viewed in a number of ways: as the equivalent of an unfavorable long-term lease, as the quid pro quo for the subsidies and income tax advantages enjoyed by the owners, or as an encumbrance restricting the use and benefit of the property as effectively as easements and covenants.

One of the first cases in the area was *Knickerbocker Village*, the 1962 New York Appellate Division decision discussed above with regard to the long-term lease. The court there rejected the taxpayer's contention that statutory restrictions upon the income and future sale of the project brought it within the precedent of the easement cases. Instead, it found these restrictions "personal to the owner," comparable to mortgage indebtedness. The court observed that the "restrictions upon its sale of real property result solely from petitioner's ownership. The restrictions were

---

Estates Ass'n v. Town of Campton, 122 N.H. 506, 446 A.2d 1167 (1982) (homeowners' rights in common property, although revocable by two-thirds vote of members, held to deprive it of all but nominal taxable value).

352. *Tualatin*, for example, the court cited with approval the reasoning of Borough of Englewood Cliffs v. Estate of Allison, 69 N.J. Super. 514, 174 A.2d 631 (1961), which required that deed restrictions limiting property to use as a public park affect its assessment. The *Tualatin* court criticized the result in that case, however, which assessed the property upon 10% of its unencumbered value: "Assigning a money value to such a speculative possibility [i.e., a sale of 'bare legal title' in its encumbered state] seems to us unnecessary; the figure could only be arrived at arbitrarily." 473 P.2d at 664. Thus the zero value result represented not a divergence from the reasoning of earlier cases but merely a less compromising application of their logic. A witness in a New Jersey case following *Allison*, dealing with valuation of a subdivision's common beach area, illustrated the logical inconsistencies inherent in any such attempted compromise. He testified that under a willing buyer-willing seller standard the beach "has no value":

But I must say that it does, it has to have some value . . . . I don't think it could be sold. Well, it probably could be sold in the market, but it certainly couldn't be sold for very much money, because there are too many strings attached to the property . . . .

. . . .

. . . It can't be used for much other than it is being used now; and on that basis, I would say it has zero value. But I am trying to be practical about this thing. It must have some value for taxation purposes.


voluntarily assumed and to a large extent induced by the advantage of a 20-year exemption in respect of the improvement."354 Yet the possibility of lifting those restrictions was certainly as remote as that of freeing any servient estate from an easement. As a dissenting opinion pointed out, "[t]hese are restrictions on the property and not on the owner—and the restrictions 'run' with the land if that be the test."355

The voluntary, tax-motivated imposition of restrictions was crucial to the Michigan Tax Tribunal's refusal to value low-income housing financed by the National Housing Act356 by a capitalization of actual rents received:

[W]e are mindful that in many so-called 'tax sheltered' real estate ventures the entrepreneurs enter into them with the full expectation that there will be little or no cash income for many years.

... [A]re such properties not to bear their fair share of the property tax burden because their cash income flow is tailored to suit the income tax convenience of the owner? A dollar saved on income tax liability is just as bankable as one shown on the bottom line of a profit and loss statement.357

The tax tribunal did not press the analogy to the long-term lease, a restraint understandable in view of the position of the Michigan Supreme Court on that issue.358 That parallel seemed dispositive, however, to the dissenting justices in a New Hampshire case considering assessment of subsidized housing:

Public utilities are subject to regulation as monopolistic enterprises . . . . On the other hand, the rental of privately owned housing stands upon a different footing. The plaintiff's project is subject to regulation because the plaintiff agreed that it should be . . . in order to finance its project upon favorable terms and to obtain other economic advantages.359

354. 226 N.Y.S.2d at 987.
355. Id. at 990 (Breitel, J., dissenting).
359. Royal Gardens Co. v. City of Concord, 114 N.H. 668, 328 A.2d 123, 125 (1974) (Duncan, J., and Kenison, C.J., dissenting). The majority had held that it could not "distinguish for valuation purposes a state and federally regulated utility from a federally regulated housing project which limits the income to be received by the owner." Id.
This view did not sway the majority, whose equation of public housing with public utilities dictated that regulated return affect valuation in each case.

The Supreme Judicial Court of Massachusetts took a similar view in 1979, holding that regulated income, not fair market rents, must be used in capitalizing the income of a subsidized housing project. Together, the Massachusetts and New Hampshire opinions persuaded the Rhode Island Supreme Court to disavow its earlier suggestion that the example of the long-term lease cases should produce a valuation of limited-income housing based upon full market rent: "We have reexamined our position in light of two decisions since . . . . We now adopt a stance that rejects that implication." Beyond an exhaustive description of those cases, however, the court gave no rationale for its change of heart.

These cases bear witness to the strong judicial inclination to base assessments upon the realizable sale price of an owner's interest, even without the support of theories positing transfer of value or conservation of the municipal tax base. They offer a test of other arguments favoring this measure with regard to encumbered property generally. To what extent should nonrent return, even in the form of income tax deductions, be considered income from taxable property? Should governmental approval or enforcement of restrictions upon property affect their influence upon assessments? What relevance has the concept of highest and best use in the valuation of encumbered property?

B. Implications for a Definition of Taxable "Property"

1. "Fair Market Value"; "Willing Buyer-Willing Seller"—of What?

The encumbered property and long-term lease cases share a definitional problem: what "property" is being taxed? But while the lease decisions

---

361. In Kargman v. Jacobs, 113 R.I. 696, 325 A.2d 543 (1974), the court had criticized use of regulated income as a measure of property value:
The investors are restricted to a maximum 6% return. However . . . investors in such developments can obtain a federally guaranteed mortgage at a rate of 3% . . . . There is no personal liability on the investor's part in event of a foreclosure by the Federal Government . . . . The depreciation benefits were described as "excellent" and the 6% return as the frosting on the cake.

. . . . In seeking to establish fair market value, one looks for the fair rental value rather than the actual income received. In using the income approach, the significant element to be established is the realty's capacity for earning income rather than income actually derived from its operation. At this point there is no credible evidence that [the taxpayer's] rental was fair rental income.

325 A.2d at 546, 548 (citation omitted).
offer a fairly narrow set of alternatives, the easement cases provide numerous variations. Is an encumbered golf course to be viewed as a physically separate entity for sale to a willing buyer, if one could be found, or as a part of the residential development?363 Should the plaza fronting an office building share its assessment?364 Are the dams and canals a part of the mill,365 the "flagship" store a part of the shopping center,366 the walkway a part of the hospital complex?367 Any structure, however valuable, could be viewed as a collection of separate components, each individually of little worth to the market.

Would not even these components, however, command a market price if the purchaser could in turn demand payment for their use by the owner of the larger structure? If the walkway, plaza, dam, or "flagship" store serves a useful function for the related, admittedly valuable entity, a separate assessment should be accompanied by presumption of an arm's-length relationship between the owners. An encumbrance upon one parcel implies a bargained-for compensation, not necessarily a loss in value to its owner—notor a later purchaser succeeding to the right to collect it.

These considerations run counter to the additive approach. They suggest that, far from transferring an invariant monetary value from the servient to the dominant estate, an encumbrance may enhance the total value of the two parcels, with fair compensation imputed to the servient land. The owner of the encumbered parcel, or an earlier owner in the chain of title, consented to the restriction, and it is not to be assumed that this was done gratuitously. The present owner may not share in this benefit, and may have purchased the encumbered lot at a lower price as a result. However, realizable sale price cannot be assumed to be a proper limit upon taxable value here any more than in the long-term lease situation. The problem requires a multifaceted definition of "property": a determination of its physical extent, potential uses, and the rights accompanying ownership.

The Oregon tax court recently demonstrated that even precedent employing the additive approach368 need not guide a tribunal recognizing the parallel between the easement and lease. It denied an unprofitable golf course in a planned unit development a zero value for tax purposes, and

363. See supra text accompanying notes 346–52.
distinguished an Oregon Supreme Court decision granting zero taxable value to another golf course\textsuperscript{369} on the grounds that the subdivision in question was still under construction. However, the tax court then went further, attacking the logic of the majority approach altogether:

The intent or objective of the developers in these [golf course] cases is that by voluntarily accepting governmental and contractual restrictions upon a portion of the planned unit development, the owners of the surrounding homesites are assured that attractive open space will always be there. This has the effect of making the surrounding homesites more valuable in the marketplace. The developers, as taxpayers, also contend, however, that this renders the restricted property valueless in the marketplace. The theory is that it transfers the value that previously existed in the dedicated open space to the surrounding properties which are assessed and taxed at an "increased value."

The fallacy of this theory is the assumption that there is only so much value to be allocated among the parcels. Market value may increase in one area without detracting or taking away from another . . . .

Although the property may be additionally restricted in its use by virtue of contractual arrangements, obligations or representations to the unit owners in the development, such restrictions are not considered for purposes of determining the property's assessed value. Since the benefit of the restrictions reside in individuals rather than the public, the benefit of the restrictions as well as the "remaining" uses are totaled for purposes of determining the property's assessed value. [Citing a decision of the Oregon Supreme Court adopting the majority view of the long-term lease question.\textsuperscript{370}]

The Illinois appellate court similarly rejected the additive approach in a 1980 appeal from a zero value assessment of a lake held by a homeowners' association under a restricted use deed.\textsuperscript{371} The property tax appeal board had taken the familiar position that "the value of the amenities associated with the lake were reflected in the assessments of the adjoining residential lots . . . . [T]he lake property had no value independent of the lots and properties which contained the restrictive covenants and . . . it therefore had no assessable value."\textsuperscript{372} The appellate court had little difficulty demonstrating the error of this reasoning:

In determining what is the fair cash value of real property for tax purposes

\textsuperscript{369} Id.


\textsuperscript{372} 414 N.E.2d at 175.
the guiding standard is directed towards determining that price at which ready, willing and able sellers and buyers would agree. This standard presupposes that the property is available for sale on the market and that there are buyers interested in purchasing it; it does not, however, permit an assessing body to give consideration to legal restrictions on the use of the property or infirmities in the title of the taxpayer.

It is apparent that property adjoining or in close proximity to a body of water, a park, golf course or other scenic view may well have an increased value because of its location. However, there is no assessment principle in Illinois which provides that the assessed value of the scenic property may itself be correspondingly reduced because of its effect on surrounding property.

We conclude that insofar as the valuation of the Association's lake property was based upon the amenity theory of assessment, whereby its value was transferred to the adjoining properties, it was erroneous.\textsuperscript{373}

Clearly, rejection of the theory that an encumbrance enhances the value of the benefited parcel and diminishes the value of the burdened parcel equally deprives the additive approach of its primary support and requires a new analysis of the easement question. It is possible to identify a number of aspects of this task common to the long-term lease and specialty problems already discussed.

2. \textit{Imputation of Payment}

A refusal to assume that an encumbrance reduces the value of the servient estate, that its imposition carries no corresponding benefit, may be justified by both the capitalization of market rent in the long-term lease cases and the equation of highest and best use with value to the owner in the specialty cases. Both demonstrate that realizable sale price does not always govern property tax assessments. Would not a highest and best use of the servient estate require fair market rental for the rights transferred to the dominant estate? The mill cases early in this century proved the feasibility of this method,\textsuperscript{374} ruling that the "value of land by reason

\textsuperscript{373} \textit{Id.} at 176 (citations and footnotes omitted).

\textsuperscript{374} For example, in Central Maine Power Co. v. Inhabitants of Turner, 128 Me. 486, 148 A. 799, 801 (1930), the court held that the land's potential for water power development increased its assessment even when it was flooded by its owner. The court stated:

[L]and upon which a mill privilege exists is taxable at its worth as land enhanced by the value of its capacity for water power development . . . . If the privilege is undeveloped or, developed, is not utilized, the capacity of the land for power development . . . . is nevertheless an element of value to be considered in its tax valuation.

\textit{See also} Penobscot Chemical Fibre Co. v. Inhabitants of Bradley, 99 Me. 263, 59 A. 83, 87 (1904) ("It is not, where is the water power created by the appellant's dam used? but, how much is its
of its adaptability to a certain purpose is not lost when actually devoted to the purpose for which it is adaptable.\textsuperscript{375}

If the "property" subject to tax is equated with the "property" the taxpayer may offer for sale, any owner may obtain a zero value assessment. He need only enter long-term contracts burdening the land, benefiting himself personally by a lump sum payment, and affording no advantage to a prospective purchaser. Some of these elements were presented to the Oregon tax court when a developer sought a zero value assessment for a subdivision's water systems, on the strength of the golf course cases, arguing that "it would willingly give them away if assured its contractual responsibilities would be properly carried out."\textsuperscript{376} Is this qualitatively different from a zero value assessment for the encumbered golf course that could not be given away,\textsuperscript{377} or the encumbered beach that was granted a zero value assessment after testimony that "the happiest

\textsuperscript{375} In Union Water-Power Co. v. City of Auburn, 90 Me. 60, 37 A. 331, 334–35 (1887), Judge Emery stated in dissent:

\textit{I do not see the necessity, and I doubt the expediency, of undertaking to determine whether what is called "the water power" is wholly appurtenant to the dam, or wholly appurtenant to the mill, or partly appurtenant to each...} 

\textit{It is simply a parcel of land over which a stream of water flows and falls, and is to be taxed in the town in which it is situated. So far as the land is more valuable by reason of the stream and fall upon it, so far are these to be considered in the valuation of the land, and no further. This consequent increase in value is a question in commercial economics, and requires for its determination the consideration of possible revenues to be drawn from the land, and the possible price to be obtained for it.}

\textit{This monopoly, this revenue or chance of revenue from it, should be included in an estimate of the value of the land.}

This dissenting opinion in \textit{Union Water-Power} came to command more respect than the majority's view, e.g., Slatersville Finishing Co. v. Greene, 40 R.I. 410, 101 A. 226, 230 (1917) (holding that land flooded by its owner was nonetheless to be valued in light of its potential for producing power; "The principles thus enunciated [in the dissent to \textit{Union Water-Power}] have been followed in the later Maine cases."); Whiting-Plover Paper Co. v. Town of Linwood, 198 Wis. 590, 225 N.W. 177, 179 (1929) (more recent cases "pay no great tribute to the soundness of the doctrine" of the majority opinion in \textit{Union Water-Power}); Annot., 108 A.L.R. 829 (1937); Annot., 64 A.L.R. 143 (1930). Massachusetts courts, by contrast, utilized the additive approach in such situations. E.g., Essex Co. v. City of Lawrence, 214 Mass. 79, 100 N.E. 1016 (1913) (dam from which water power was conveyed to plants and mills in the vicinity held to have thus lost taxable value—although owners of the dam received 260 ounces of silver annually for each mill power conveyed).

\textsuperscript{376} Whiting-Plover Paper Co. v. Town of Linwood, 198 Wis. 590, 225 N.W. 177, 178 (1929).

\textsuperscript{377} Brooks Resources Corp. v. Department of Revenue, 6 Or. T.R. 217, 224 (1975) (subdivision water systems possess independent value, but that value must be assessed for tax purposes as part of the residential lots), rev'd, 276 Or. 1177, 558 P.2d 312 (1976) (separate assessment of water systems proper where subdivision not organized under Oregon unit ownership law).

\textsuperscript{378} Tualatin Dev. Co. v. Department of Revenue, 256 Or. 323, 473 P.2d 660 (1970), discussed \textit{supra} at text accompanying note 340.
day of your life is—for the developer—is the day that he can give that to the community"?378

Once the additive approach is rejected, is a distinction between an appurtenant easement (e.g., the encumbrance upon a golf course or beach benefiting residential property) and an easement in gross (e.g., a timber lease,379 hunting license,380 or rental arrangement381 benefiting its holder personally) valid? Should not both enhance the value of the servient estate? Surely the capacity of the servient land to benefit either persons or property contributes to the commercial value of its component legal interests—a value that is not diminished by conveyance of those rights. “It would be anomalous to hold that a possessory interest has no value merely because the [purchaser] has agreed to pay what it is worth.”382

Or, as the New Hampshire Supreme Court held in an 1887 mill case:

The entire value of a parcel of land may consist in its capacity to render other lands valuable; as if in a desert a single acre were found whereon artesian wells could be sunk, producing sufficient water to irrigate and make fertile the whole desert. The acre would be of great value, because by means of it lands otherwise worthless could be made valuable. It could not be justly appraised without considering its effect upon them. But the increased value of the irrigated lands would not be the measure, or form any part, of its value.383

A summation-of-interests approach to valuation of encumbered property draws considerable support from decisions holding that the value of

---


380. Woodburn v. Skagit County, 120 Wash. 58, 206 P. 834 (1922).

381. Macht v. Department of Assessments, 266 Md. 602, 296 A.2d 162 (1972), provides a good example of the difficulties encountered when the majority approach is applied to a situation in which the owner of the servient estate (burdened here with a negative easement ensuring a neighboring office building’s light and view) receives continuing payments from the owner of the benefited property. Should the easement reduce the value of the servient estate? To the contrary, the Maryland court held that an increase in its assessment was warranted by the lease of air space, and consequent income to the owner. However, the court was unable to reconcile this result with its support for the New York easement cases, merely suggesting that “[u]nder certain facts, the value of the servient estate may not be diminished at all, and may even be increased.” 296 A.2d at 169. It cited for this proposition Slatersville Finishing Co. v. Greene, 40 R.I. 410, 101 A. 226 (1917), a mill case which may be read as contradicting the logic of the New York easement cases. See supra note 374.

382. Texas Co. v. County of Los Angeles, 52 Cal. 2d 55, 338 P.2d 440, 444 (1959) (refusing to deduct present value of rental payments in calculating lessee’s interest in exempt property for tax purposes), discussed supra at note 78.

Property Tax

clear title, not the deficient or unmarketable title that the current owner
may hold, is the basis of the tax.\textsuperscript{384}

The law requires an assessment of the value, not of the purported owner’s
title, but of the land; the assessed value of the land represents the value of all
interests. . . . [T]he fact that the title of the alleged owner is dubious is not a
proper basis for reducing the land’s value for tax purposes.\textsuperscript{385}

The difference between realizable sale price of the owner’s interest and
the assessed value of the property in such a case is measured by the cost
of obtaining clear title.\textsuperscript{386} Parallel reasoning in the easement cases would
value all interests in the property for tax purposes, assuming them available to yield fair return at current market levels for a prospective pur-
chaser.

3. Property Rights and Market Values

The golf course cases provide a clear illustration of the confusion be-
tween property rights and property value that pervades the consideration
of encumbrances in property tax decisions. Does a conveyance of rights
in the common areas to owners of subdivision lots signify a shifting of
value? This was the view of the taxpayers who prevailed in Twin
Lakes:\textsuperscript{387} “The economic phenomenon that has occurred here is that of a
dominant estate absorbing the value of the servient estate. . . . It should
surely shock the conscience if the servient estate were again to be taxed . . . .”\textsuperscript{388} Yet the effect of the golf course upon the value of the lots is not
determined by ownership rights alone. Lots bordering the course will
command a higher price than similar but more distant parcels enjoying
equivalent rights.\textsuperscript{389} Land next to a private park will enjoy a higher mar-

\textsuperscript{384} E.g., Town of Secaucus v. Damsil, Inc., 120 N.J. Super. 470, 295 A.2d 8 (1972); Stack v.
City of Hoboken, 45 N.J. Super. 294, 132 A.2d 314 (1957); Hoover v. State Bd. of Equalization,

\textsuperscript{385} Stack v. City of Hoboken, 45 N.J. Super 294, 132 A.2d 314, 318 (1957). See supra text
accompanying notes 105–10.

\textsuperscript{386} One court has stated:
The difference between $90,000, the conceded value if there were not a cloud on title, and the
sales price of $35,500 undoubtedly represents the buyer’s estimate of the cost to it of eliminat-
ing, either through purchase or litigation, the outstanding adverse claim to title. . . . [This fact]
affords no justification for applying a discount in a tax valuation case.

Town of Secaucus v. Damsil, Inc., 120 N.J. Super. 470, 295 A.2d 8, 10 (1972), discussed supra at
text accompanying note 108.

\textsuperscript{387} Twin Lakes Golf & Country Club v. King County, 87 Wn. 2d 1, 548 P.2d 538 (1976),
discussed supra at text accompanying notes 346–52.

\textsuperscript{388} Brief for Respondent at 22–23, Twin Lakes.

\textsuperscript{389} Tualatin Dev. Co. v. Department of Revenue, 256 Or. 323, 473 P.2d 660, 661 (1970),
discussed supra at text accompanying note 340 (lots bordering public golf course sold for $2500 to
$4000 more than others in the development, although all had equal rights to use the golf course).
ket value than land less favorably situated, even if this additional value is accompanied by no grant of rights in the park land at all.

Conversely, a grant of property rights may produce no increase in the market value of the dominant estate.\textsuperscript{390} In the best possible case, such a grant might raise the value of each parcel—the dominant enjoying, for example, certain access to air and light, the servient receiving an assured income in exchange.

The transfer of property rights at issue in these cases is no more an impediment to valuation of all interests in the land than is execution of a long-term lease. The titleholding association and lot owners might be considered collectively as owners of the full fee,\textsuperscript{391} the willing sellers in a hypothetical exchange. Less hypothetically, the specialty cases might support assessment at the value of this possibly unmarketable property to its owners, surely a significant sum.\textsuperscript{392}

A demonstration of these logical flaws does not, however, address the fears of double taxation that have influenced many courts. Assessment of the servient estate at its unencumbered value would be inconsistent with an assessment of the dominant estate at a realizable sale price reflecting its easement rights.\textsuperscript{393} But consistency may be achieved directly, without hypothesizing a transfer of value. If imputation of payment from the

\textsuperscript{390} See supra text accompanying note 270.

\textsuperscript{391} This was the approach taken in a 1935 eminent domain case, \textit{In re Public Beach}, 269 N.Y. 64, 199 N.E. 5 (1935), which dealt with beach property that, before being taken by the city as a park, had been held by the Neponsit Property Owners' Association. Because the association had only legal title subject to easement rights in all homeowner-members, the New York Appellate Division had limited its award to the truly nominal sum of six cents. The New York Court of Appeals took a different view, requiring that the value of the members' rights be included in the award to the association:

\begin{quote}
Since all owners of dominant tenements enjoyed, irrevocably, membership rights, accorded by the appellant, coextensive with their easements upon the land taken, the easements, for practical purposes, had become merged in the membership rights. . . . When such an organization was formed, the property owners were expected to, and have looked to that organization as the medium through which enjoyment of their common right might be preserved equally for all. In such circumstances, the ownership of the fee and the right of beneficial ownership are not completely severed. For all practical purposes, both have become vested in the membership corporation . . .
\end{quote}

\textsuperscript{392} See infra text accompanying notes 399–401.

\textsuperscript{393} The value of common areas to the homeowners and titleholder was illustrated dramatically in \textit{Sudden Valley Community Ass'n v. Turner}, Nos. 78-18 through 78-37 (Wash. B.T.A. Feb. 8, 1980), discussed supra at note 320. The association sought a zero value assessment for its golf course and marina "in accordance with the \textit{Twin Lakes} doctrine." \textit{Sudden Valley}, slip op. at 2. The board denied this request, in part because the association had purchased the property in question from the developer, in settlement of litigation, for $1.8 million one year before the disputed assessment. \textit{See id.} at 9.

\textsuperscript{394} See supra text accompanying note 270.

\textsuperscript{395} This was the approach taken in a 1935 eminent domain case, \textit{In re Public Beach}, 269 N.Y. 64, 199 N.E. 5 (1935), which dealt with beach property that, before being taken by the city as a park, had been held by the Neponsit Property Owners' Association. Because the association had only legal title subject to easement rights in all homeowner-members, the New York Appellate Division had limited its award to the truly nominal sum of six cents. The New York Court of Appeals took a different view, requiring that the value of the members' rights be included in the award to the association:

\begin{quote}
Since all owners of dominant tenements enjoyed, irrevocably, membership rights, accorded by the appellant, coextensive with their easements upon the land taken, the easements, for practical purposes, had become merged in the membership rights. . . . When such an organization was formed, the property owners were expected to, and have looked to that organization as the medium through which enjoyment of their common right might be preserved equally for all. In such circumstances, the ownership of the fee and the right of beneficial ownership are not completely severed. For all practical purposes, both have become vested in the membership corporation . . .
\end{quote}

\textsuperscript{396} The value of common areas to the homeowners and titleholder was illustrated dramatically in \textit{Sudden Valley Community Ass'n v. Turner}, Nos. 78-18 through 78-37 (Wash. B.T.A. Feb. 8, 1980), discussed supra at note 320. The association sought a zero value assessment for its golf course and marina "in accordance with the \textit{Twin Lakes} doctrine." \textit{Sudden Valley}, slip op. at 2. The board denied this request, in part because the association had purchased the property in question from the developer, in settlement of litigation, for $1.8 million one year before the disputed assessment. \textit{See id.} at 9.

\textsuperscript{397} See infra text accompanying notes 399–401.
owner of the dominant estate were feasible, a precise reduction in assessment could be made. At the other extreme, assessment of each estate without regard to the easement would provide a workable approximation of the unencumbered (and unbeneﬁted) value in many cases, far less precise but well within the enormous range of error that is the norm in all real property assessment. A third alternative, where practical, would be valuation of the dominant and servient estates as one unit—a solution illustrating again the need for a deﬁnition of the “property” to be taxed before the location of “value” is ascertained.

4. Defining the Physical Unit

The most intractable difﬁculties in valuation of encumbered property arise from the need to assign independent values to integral components of a larger unit. Were the dominant and servient estates under single ownership, they could be valued as one, and the presence of an easement would not disturb the equivalence of unencumbered value, value at highest and best use, and realizable sale price. If instead the units must be valued as if they were self-contained, that symmetry is lost. Calculating the value of a servient estate according to its highest and best use requires that the value of the encumbrance be calculated as if the owner of the dominant estate had made payment for the beneﬁt received. Whether this is done by ignoring the encumbrance or by imputing payment, the resulting value of the servient estate will differ from its realizable sale price.

A few cases have attempted instead to divide the total highest and best use value of the entire unit among its component parcels. In Homer v. Dadeland Shopping Center, the Florida Supreme Court valued parking

394. While this article deals primarily with assessment difﬁculties rooted in the absence of a clearly deﬁned tax base, numerous quantitative studies have demonstrated the problems of assigning accurate valuations even when that base is equated with realizable sale price. Most such studies compare assessed values with sale prices of parcels that have been sold over a given period. If all assessments were made at a uniform percentage of market value, homeowners would pay a rate of tax different from the nominal ﬁgure, but the rate would be the same for each. Therefore inequities among taxpayers are measured by the “coefficient of dispersion”—the deviation of individual assessment/sale ratios from the central or average ratio, variously deﬁned, for a particular group. See generally INTERNATIONAL ASS’N OF ASSESSING OFFICERS, supra note 220, § 1.2. Census ﬁgures indicated that such composite coefﬁcients of dispersion in 1976 ranged from 13.8% in Connecticut to 41.1% in Pennsylvania and Montana. ACIR, supra note 1, at 141. A recent study of real property assessments in New York City found coefﬁcients of dispersion below 20% for only three of 37 types of housing properties. N.Y.U. Grad. School of Public Admin., Real Property Tax Policy for New York City I-16 (1980). Assessment/sale ratios for housing were found to vary from 22.3% for single-family units to 68.3% for newer elevator buildings. Id. at I-14.

395. Cf. 2 J. BONBRIGHT, supra note 6, chs. 19, 20 (use of “unit rule” in allocating value of corporate enterprise among taxing jurisdictions).

396. 229 So. 2d 834 (Fla. 1970).
areas restricted to that use by easement at the same number of dollars per square foot as the land upon which stores were located:

The shopping center was designed and operated as an economic whole . . . .

. . . [T]he land used for the parking area is an integral part of the shopping center and just as important to its development as the land upon which the buildings are erected. The tax assessor was justified in placing the same value on the land used for the parking area as the land upon which the improvements were erected.

The Connecticut Supreme Court reached an opposite conclusion in valuing similar lots:

The three parcels of land are zoned for commercial-general business and are in the principal commercial area of Stamford. The highest and best use of these three parcels of land would be for commercial buildings. Their actual use is for parking lots restricted to customers of the department store. . . . [T]he finding by the referee that the highest and best use for each of the parking lots would be for commercial buildings has not been attacked by the plaintiff. A taxpayer who chooses to use his land in a manner which is not consistent with its highest and best use should not be rewarded with a lower assessment, the effect of which is to increase the tax burden on others.

Yet the Connecticut court ruled that the adjacent department store was to be valued by a capitalization of fair market rent, a figure reflecting the availability of free parking in the immediate area. This produces inconsistent assessments, similar to those resulting from assuming conflicting uses for land and for improvements upon it.

---

397. Id. at 836 ("Although the provision in a lease granting the tenant exclusive rights to conduct a particular type of business may be considered a restrictive covenant, the requirement of a 'parking area' in other instruments relating to the shopping center created an easement.").

398. Id. at 836-37.


400. The taxpayer had in this case relied not upon the easement cases but upon a claim of "functional depreciation" caused by the servitudes. "No case, however, has been cited by the plaintiff wherein the functional depreciation factor has been applied in a factual situation similar to that of the present case." 291 A.2d at 720. Since both the parking areas and the department store were subject to a sale-leaseback from the taxpayer to the General Electric Pension Trust, an accurate measure of the rental value of the entire set of parcels could serve to calculate its market value as an integrated parcel. Use of the lease value for the store and the unencumbered commercial value for the parking areas, however, would almost certainly overstate the total assessment.

401. E.g., Sabin v. Department of Revenue, 270 Or. 422, 528 P.2d 69, 72-73 (1974) (existing improvements inconsistent with the use of the land contemplated in its tax valuation could increase its assessment only if a prospective purchaser would value them for, e.g., the cash flow they offered before the land was converted to the higher use); Portland Golf Club v. State Tax Comm'n, 255 Or. 284, 465 P.2d 883 (1970) (rejecting attempt to value golf course land at its use for residential purposes while valuing improvements as part of a golf course).
Could the *Homer* approach be applied to subdivision common areas? A 1976 Florida decision[^402] suggested that possibility, directing separate assessment of tennis courts, swimming pool, sidewalks, parking lots, and the playground of a residential development, "with an adjustment being made in the value of each residential unit. This leaves to the [titleholding corporation] the responsibility of collecting the taxes through the assessment authority of its declaration. . . . [T]he total valuation of the entire project must be just valuation . . . ."[^403] It is not clear what precise steps the court contemplated that the assessor take to "adjust" the valuation of the residential lots.[^404] Despite this ambiguity, the decision makes an important contribution by recognizing the need to consider together servient and dominant estates, the homeowners and the titleholding corporation, in assessment.

How should the total value of such a unit be apportioned among these parts? The artificiality of this division ensures that any method chosen will itself be to some extent arbitrary. "One of the most important but most frequently disregarded truths about value," Bonbright wrote, "is that only by a somewhat rare coincidence does the sum of the values of the different parts of an organic whole equal the value of the whole."[^405]

If the parts are valued as *separated* from the whole, the sum of their values is likely to be far less than the value of the whole. On the other hand, if the parts are valued as *parts* of the whole, their sum total of values may greatly exceed the value of the whole.

. . . . . . .

The same situation applies, to a greater or less degree, with different types of property. What is the value of the left-hand member of a pair of $4 gloves? Practically nothing if the part is valued separately from the whole; approximately $4 if the part is valued as a part of the larger whole. Obviously, neither of these figures—zero or $4 per glove—can be multiplied by two as an expression of the value of a pair of gloves. On the other hand, if we start with the $4 value of the entire pair and prorate that figure between the two gloves by dividing by two, we get a value per glove that is utterly meaningless.[^406]

[^402]: Department of Revenue v. Morganwoods Greentree, Inc., 341 So. 2d 756 (Fla. 1976).
[^403]: Id. at 759.
[^404]: It is unclear, for example, how the court reconciled its view that the assessor should follow the example of Homer v. Dadeland Shopping Center, 229 So. 2d 834 (Fla. 1970), which "while noting that the lot was impressed with restrictive covenants, upheld their disregard," 341 So. 2d at 759, with its directive that the assessor "consider the effect of the easements" in valuing the common areas. Id. One explanation might be that the court wished a uniform land value to be assigned to the residential lots and common areas, following Homer, and recognized that the resulting value for the common areas would differ from their assessment as independent, unencumbered parcels. However, the opinion contains insufficient discussion to confirm this interpretation.
[^405]: 1 J. BONBRIGHT, supra note 6, at 76.
[^406]: Id.
While any allocation may be subject to dispute, a unified assessment at least provides a nonarbitrary figure to be allocated—no small benefit from the point of view of the taxing jurisdiction. Whether this method or another is applied in individual instances is less important than recognition that any such effort must first determine the composition of the "property" to be assessed.

C. A Summation-of-Interests Approach to the Easement Cases: Conclusions

Three major advantages have encouraged the widespread adoption of the additive approach to valuation of encumbered property. It recognizes that the distinctive feature of an appurtenant easement—the transfer of benefit to other real property—permits its effects, unlike those of a mortgage, lease, or easement in gross, to be contained within the property tax system. It sanctions assessment at realizable sale price, avoiding the hypothetical or contrary-to-fact assumptions unpopular with courts and taxpayers alike. Finally, it has the appeal of a scientific conservation law, promising to uphold tax revenue by preserving "value" in measure, if not in its original location.

The advantages of the additive approach, however, are offset by serious drawbacks, the most troubling being its departure from the definition of "property" as the sum of all legal interests in a given parcel, a definition the advantages of which were demonstrated in the lease cases. The emphasis of the additive approach upon the quality of the owner's title runs counter to the concept of property utilized in mortgage, lease, and title cases. It is a small step from this to assessment at realizable sale price even absent a transfer of value justification—a transition evident in the subsidized housing cases.

Given its status as a departure from general assessment principles, the additive approach can ill afford to rest upon assumptions as unrealistic as the transfer of value and the conservation of the tax base. The diminution in value of the servient property by reason of the easement bears no necessary relation to the enhancement in value of the dominant estate. Nor is it necessarily realistic to assume, as have many tax sale cases, that assessment of the dominant estate took into account whatever advantage it did enjoy because of the encumbrance.

407. This step may be compared with eminent domain proceedings in which the calculation of the value of the undivided fee precedes a determination as to allocation of that sum among parties with an interest in it. See supra text accompanying notes 81–89.

408. See supra text accompanying notes 321–22.
A summation-of-interests approach may be constructed for the valuation of property subject to easements as well. The mill cases support such an attempt by demonstrating that the "property" to be taxed need not be the property as encumbered, just as it is not the property as leased; the productive capacity of the land, even if bound by the owner to the use of another, can affect its assessment. Similarly, highest and best use need not comprehend a gratuitous transfer of this capacity. "It should not be assumed that taxing . . . the right of the mill to have water power from the dam . . . should reduce the tax . . . upon the corresponding right of the dam to receive compensation therefor." The enhancement of property value, "a question in commercial economics," should not be confused with a transfer of property rights; the former may properly affect the assessment of a number of parcels without threatening double taxation.

These considerations lead, not necessarily to a single method of assessing all encumbered parcels, but to a number of compatible approaches. The encumbrance may be considered equivalent to a lease under the majority approach to the long-term lease question—not "disregarded" in assessment, but treated as one piece of evidence as to the potentially profitable uses of the land. As with leased property, the value should reflect the price commanded from a purchaser contemplating receipt of full current market value for rights granted to the dominant estate. The dominant estate would then be assessed upon the price a willing buyer would offer in light of the need to pay full market value for the easement.

This imposes a considerable burden upon the assessor, requiring a determination of the "market value" of a rarely traded and possibly unique commodity. Where, as in the mill cases, the actual consideration for such a conveyance can be ascertained, the problem is minimal. At the other end of the spectrum, where no comparable transactions afford any evidence of market value, the encumbrance might be ignored in the assessment of both the estates, upon the assumption that the imputed payment could be no less than the burden to the servient estate and no greater than the benefit to the dominant. This assumption should generally produce...
error favorable to the taxpayers, ignoring as it does any net benefit they enjoy from the arrangement. Realistically, perhaps the best that can be said for it is that it will often produce enough distortion to provoke a determined search by some party, assessor or taxpayer, for more direct evidence of value. In many cases, sales of one or both estates after imposition of the encumbrance may provide a first step in that direction. The point is not that such computations are feasible in all events, but rather that where they are they provide a superior alternative to the additive approach.

Assessment of the dominant and servient estates as a single unit offers a less complicated alternative where an arbitrary division of total value between the two parcels is acceptable. A separate assessment of subdivision common areas may treat the homeowners’ association or corporation holding title to the space as a representative of its members, permitting a summation of legal and beneficial interests in the property. This would require a corresponding adjustment to assessments of the residential lots, because use of their realizable sale price as the tax base would produce a double assessment of the beneficial interest in the common areas. Where an entire development is encumbered by a plan of mutual restrictive covenants, use of realizable sale price in assessment requires no conservation of value theory and implies no necessary consequences as to the quality of title afforded by a tax sale.\textsuperscript{413} The restriction may be likened to the benefits of a neighborhood association, or other amenity provided by joint action, raising the sale price of all affected residential property. If at a future time it is discontinued, or ceases to enhance the market value of the property, later assessments should reflect that change.

The summation-of-interests approach to assessment does carry certain implications as to the effects of a tax sale. By defining the property subject to tax as the aggregate of all legal interests in a given parcel, it suggests, absent statutory directives to the contrary, that the property subject to a lien for unpaid taxes encompasses the same interests, including easements appurtenant to other land. The equation is not a necessary one, however. The fact that the legislature has conferred preferential status upon certain interests, such as easements, preserving their effect after a tax sale, does not in itself bar a highest and best use assessment of the type suggested above. Conversely, assessment reflecting the effect of an easement, as an aspect of the productive capacity or desirability of the

\footnotesize{in value by the lease of the air rights should be roughly equivalent to the value of the rent reserved in the lease. At least, the Machts should have the opportunity to establish the factor of such diminution in value. It is clear, however, that they have had no such opportunity and the assessors, in fact, gave no consideration to such a factor.\textsuperscript{413} See supra text accompanying notes 304–22.}
land, carries no commitment to preservation of this arrangement upon foreclosure of a tax lien. The contrary assertion in many cases adopting the majority view\textsuperscript{414} echoes their emphasis upon ascertaining the geographic location of the easement, viewing it as a unit of value to be attached to one estate or the other. If, instead, its effect upon both is viewed as a "question of commercial economics,"\textsuperscript{415} the requirement of consistency leads only to an assessment based upon the situation at the time of valuation.

Some of these points may aid valuation of federally subsidized housing subject to rent restrictions. Such a limitation, voluntarily assumed, running with the land in fact if not in theory, and enforced by government agencies although not initiated by them, poses the same question as does a conventional easement: is the "property" to be taxed the property as encumbered? It also illustrates the link between the easement and long-term lease questions, for it lends itself almost equally well to interpretation under either rubric. This suggests that a summation-of-interests approach would base assessment upon fair market rent rather than contract rent. This is, if anything, less difficult than the standard lease problem, for the owner is no victim of changing economic circumstances, and has received numerous income tax benefits to offset the rent limitations.

Would such assessments result in decreased maintenance of housing projects, or, as the Massachusetts court seemed to fear,\textsuperscript{416} force worthy developments to cease operation altogether? The straightforward answer is that such predictions require more than valuation theory for support, and the policy choices implicit in them should not be made by assessors, nor by courts ostensibly passing on assessment questions. Prospectively, a clear rule governing valuation would diminish the possibility that future investors might rely upon incorrect property tax projections. As with many valuation questions, the unsettled state of the law in this area casts doubt upon the justification for past reliance upon a given method.\textsuperscript{417}

\textsuperscript{414} See id.
\textsuperscript{415} Union Water-Power Co. v. City of Auburn, 90 Me. 60, 37 A. 331, 334 (1897) (Emery, J., dissenting), discussed \textit{supra} at note 374.
\textsuperscript{416} In Community Dev. Co. v. Board of Assessors, 377 Mass. 351, 385 N.E.2d 1376, 1378 n.10 (1979), discussed \textit{supra} at text accompanying note 360, the court commented: "At the board [of assessors] hearing, there was evidence that the company would be forced to default on the mortgage for the housing project if the valuation of the project were based on 'fair market rentals.'"
\textsuperscript{417} Unfortunately, a factual investigation might well reveal that most housing projects of this type are in such poor repair as to greatly diminish the excess of market rent over actual receipts. The taxpayers in Community Dev. Co. v. Board of Assessors, 377 Mass. 351, 385 N.E.2d 1376 (1979), discussed \textit{supra} at text accompanying note 360, argued that the condition of their buildings, constructed in 1974, was "very poor, with a very advanced stage of physical deterioration," that amenities promised in their advertising brochure were never installed, and that advertised "fair market rentals" bore no relation to the fair rental value of the apartment units ("it is possible that the use of the words 'fair market rental' may have misled the [Appellate Tax] Board"). Brief for Appellant at 5.
These considerations provide no single rule for the valuation of any given parcel of encumbered property, but they suggest the type of questions with which such an inquiry must begin. Many of the cases examined here have avoided these steps. They have simultaneously exhibited an extreme respect for the fact of the encumbrance, treating it as an immutable attribute of the property like elevation or latitude, and an insufficient sensitivity to the unstated definitional issues being resolved through the valuation process.

In the end, confusion as to the nature of the tax base unites the lease, specialty, and easement cases. How, for example, should a "flagship" department store, designed in part to draw business to other tenants of a shopping center, be classified? It is in part a specialty, designed for a specific use, valuable to the owner of the entire shopping center but not commanding a market price reflecting its cost. But it exhibits as well many elements of the transfer of value theory so important to the easement cases. In such a situation, the New York Court of Appeals, which had pioneered the majority approach in both specialty and easement areas, was unable to do better than to compromise the claims of the assessor and the taxpayer, blaming the confusion on the unpredictable nature of property "value." Similarly, the Massachusetts court found that its adherence to the majority approach in the lease area and its recognition of restrictions in the easement area left it no ground for a coherent and consistent response to the subsidized housing question. The only way to

16-17, app. 42, Community Dev. Co. The appraiser hired by the taxpayers reported, "The general quality of construction is very poor, with the partitions and the floors being thinner and less substantial than that found in most apartment buildings of comparable age. . . . The appraisers have rarely, in their experience, viewed a property of this age in such an advanced state of physical deterioration." Id. app. 94–95.

418. G.R.F., Inc. v. Board of Assessors, 41 N.Y.2d 512, 393 N.Y.S.2d 965, 362 N.E.2d 597 (1977), determined that, in such a situation, the income approach understated the value of the department store and the cost approach overstated it:

Construction of the Gimbel's store would not have been justified, economically, on the basis of the expected return from the Gimbel's store alone. Instead the improvements were justified in part by Gimbel's status as a "flagship" store, drawing shoppers to the remainder of the shopping center. The developer, eager to increase the rental value of the smaller stores, subsidized the construction . . . .

Id. at 514, 393 N.Y.S.2d at 967, 362 N.E.2d at 599. The court ridiculed the notion that a compromise value could not be justified: "Logic and economic analysis suggest the incongruity of combining what are on their face incompatible theories of valuation . . . . Pragmatism, however, requires adjustment when the economic realities prevent placing the properties in neat logical valuation boxes . . . ." Id. at 515, 393 N.Y.S.2d at 968, 362 N.E.2d at 599.

419. Community Dev. Co. v. Board of Assessors, 377 Mass. 351, 385 N.E.2d 1376 (1979), discussed supra at text accompanying note 36. One year later, in Mashpee Wampanoag Indian Tribal Council, Inc. v. Assessors of Mashpee, 379 Mass. 420, 398 N.E.2d 724 (1980), the Massachusetts court faced the confluence of the specialty and easement problems. The Council members claimed that deed restrictions preventing conveyance of their property deprived it of taxable value. The court rejected that view, directing that the fair cash value of property in such circumstances be
avoid arbitrary and unpredictable results in such hybrid cases is to address the definitional questions common to the three areas. Consistent reliance upon the concept of property developed in the lease cases can be the crucial first step in that process.

V. POSTSCRIPT: A ROLE FOR LEGAL ANALYSIS IN VALUATION CONTROVERSIES

The legal aspects of valuation for property tax purposes have attracted limited attention in the decades following publication of Bonbright’s treatise—perhaps in part due to his own skepticism toward such efforts. Bonbright’s pessimism arose from his belief that progress upon methodological questions required a prior and explicit determination of the nature and purposes of the tax, a task beyond the power of appraisers and value theorists. “The trouble lies far too deep to be cured by either of these economic skin specialists. It lies in the absence of any valid philosophy for the general property tax or for the general real-estate tax.”

The issues examined here, however, reveal an important role for legal analysis. They suggest that, contrary to Bonbright’s view, valuation inquiries may proceed inductively, from the study of specific assessment disputes to general conclusions as to the tax itself. In a fairly simple setting, the lease cases offer a workable definition of the tax base as the sum of all legal interests in the assessed parcel, a value not limited by the realizable sale price of the rights retained by the owner of the fee. Although the specialty cases dispel any premature hope that all valuation questions might be this easily resolved, they do illuminate the definitional issue in a negative fashion by demonstrating conclusively that the sale value of the owner’s interest forms no universal ceiling upon assessments. Finally, the easement cases present the summation-of-interests definition with its most severe test, for seventy years of case law has taken a different approach. But the demonstrably mistaken premises guiding the first such cases, the unacceptable conclusions reached by later decisions adopting this reasoning, and the willingness of a number of later courts to re-examine and reject that precedent, all urge adoption of the summation-of-interests definition of the tax base in the easement context as well.

ascertained “from the intrinsic value of the property.” 398 N.E.2d at 726. This result is as confusing as the New York Court of Appeals decision in G.R.F., but lacks that case’s frank acknowledgment of illogic and inconsistency. The Maryland Supreme Court was similarly unable to reconcile the lease and easement aspects of a conveyance of air rights in Macht v. Department of Assessments, 266 Md. 602, 296 A.2d 162 (1972), discussed supra at note 381.

420. I J. BONBRIGHT, supra note 6, at 508.
Harmonization of assessments in these three areas, although an important goal, is secondary to a better understanding of the nature of the tax. The long-term lease and specialty cases provide such clarification, precisely the type of contribution to the "philosophy" of the tax sought by Bonbright. In this way they offer a means of resolving many of the problems first identified in his pioneering study.