



STATE & FEDERAL TAX LAW

Tim Eifler
502.560.4208

[Email Tim](#)

Erica Horn
859.231.3037

[Email Erica](#)

Maddie Schueler
859.231.3987

[Email Maddie](#)

Stephen Sherman
502.568.5405

[Email Stephen](#)

Jennifer Smart
859.231.3619

[Email Jennifer](#)

Residents of Kentucky Retirement Community Owe Property Tax on Leasehold Interest

*Erica L. Horn
Madonna E. Schueler*

The Kentucky Court of Appeals has held possession of a residential unit in a retirement community constitutes a taxable leasehold interest.¹ The units at issue are part of the “Springhill Village Retirement Community”, which is owned and operated by two purely public charities exempt from taxation under Section 170 of the Kentucky Constitution.

Recognizing the two charities are tax-exempt entities, the property valuation administrator (“PVA”) assessed the residential units *to the residents* to whom the units had been leased. The PVA assessed the residents pursuant to KRS § 132.195, which provides that when any real or personal property exempt from taxation is leased to “a natural person, association, partnership or corporation in connection with a business conducted for profit”, the leasehold is subject to state and local taxation.

The charities and individual residents of the community appealed the assessments to the Kentucky Board of Tax Appeals (the “KBTA”). The KBTA voided the assessments on the basis that the charities were tax-exempt and the property was being used for a charitable purpose. However, the Kenton Circuit Court reversed holding that by focusing on the *use* of the property, the KBTA failed to recognize “the separate interests of the residents as part of the ‘bundle of rights’ encompassed within the total legal interests in the real estate.” The charities and individual property owners appealed to the Kentucky Court of Appeals. The Court adopted the Kenton Circuit Court’s legal analysis holding the residents are responsible for property tax on the value of their “interests”, which the Court categorized as a leasehold interest.

The Court continued, however, and found the PVA’s valuation of the residents’ property erroneous, and thus the assessments were vacated. The Court instructed the PVA to follow the “well-settled” Kentucky law for determining the fair market value of a leasehold interest for tax purposes. This well-settled law states that the fair market value of a leasehold interest is the difference between the fair market value of the real property with the leasehold and the fair market value of the real property without the leasehold. While this formula for valuation sounds easy, its application may be difficult. For example, in this case, the residents were prohibited from transferring the unit or subletting the unit. Query what constitutes the fair market value of the property with the leasehold in place.

The charities and residents have until approximately March 10, 2017 to seek discretionary review from the Kentucky Supreme Court.

¹ *Grand Lodge of Kentucky, Free and Accepted Masons et al. v. City of Taylor Mill et al.*, Case No. 2015-CA-001617-MR (Feb. 10, 2017).

