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MEMORANDUM

FROM: Jim Woodward

RE: An Overview of Ad Valorem Tax Incentive Transactions in Georgia

Introduction

Like many states throughout the country, Georgia offers ad valorem property tax abatements to entice new and expanding companies to select Georgia as the target of their investment. While the objective in each instance is the temporary reduction of property tax for the investing company, each state's abatement program is somewhat unique and is designed to navigate the ever-evolving case law on the subject. Tennessee, for example, has adopted a payment-in-lieu-of-tax (PILOT) program whereby an industrial development board takes title to certain property and then leases the property to the former owner in exchange for a specified rent, or PILOT, payment. This sale-leaseback arrangement has no bond requirement and is one of the simpler approaches to ad valorem tax abatements. Conversely, Georgia, like Missouri and a handful of other states, has developed a relatively complicated sale-leaseback structure which requires the issuance and validation of industrial revenue bonds prior to an award of a property tax abatement. This memo is designed to provide a brief summary of the Georgia courts' treatment of ad valorem property tax abatements and to highlight the essential elements of the sale-leaseback model which has become the accepted vehicle for structuring ad valorem property tax abatements in Georgia.

I. Legal Analysis of Georgia Tax Abatements

a. General Requirements

Pursuant to Georgia law, all real and personal property is taxed according to its fair market value.[1] Such tax shall be uniform and shall be charged against the owner of the interest in the property.[2] Local governments may not grant property tax abatements directly to private parties, and pursuant to the Georgia Constitution, all laws exempting

[1] O.C.G.A. § 48-5-6.
[2] Ga. Const. Art. VII, Sec. II, Para. I; O.C.G.A. § 48-5-9.

property from ad valorem taxation are void.[3] Nonetheless, the Georgia Supreme Court has upheld tax abatement arrangements in certain instances.[4] In these cases, the private taxpayer may not receive the benefits of the abatement directly, and the general public must receive certain notices relative to the project. In light of these core requirements, Georgia attorneys have developed a sale-leaseback arrangement whereby the property subject to an abatement is transferred to a governmental entity (an authority), and the public, as well as the local taxing jurisdictions, receives notice of the transfer pursuant to a taxable revenue bond validation proceeding.

b. Transfer of Property

While private property must be taxed according to its full, fair market value, public property is exempt from property tax so long as it remains owned by a public entity.[5] Accordingly, by transferring privately-held property to a governmental entity, a private entity may enjoy all or some of the tax savings available to the government. The recipient of this property is typically a local development authority (e.g. a general enabling act or statutory development authority or a constitutional amendment authority) which has been created specifically to promote the expansion of industry and trade within the designated county or municipality.[6] By statute or constitutional amendment, this authority generally has the power to acquire, sell or lease property as well as the power to issue bonds.[7] The county, city or authority attorney should review the enabling statute or constitutional amendment of the transferee to ensure that the local authority has the requisite power to transfer the desired tax savings to the company. For example, in rare cases the constitutional amendment creating an authority will provide that the property of such authority will have the same immunity from taxation as the property of the county or municipality in which the authority resides.[8] In such instances, the taxpayer's property will avoid tax entirely and will receive a full ad valorem exemption on the transferred property. Conversely, other constitutional amendments state explicitly that the authority's exemption from taxation shall not extend to its tenants or lessees.[9] Most often, however, a court will conclude that, while a development authority's fee interest in the property is exempt from taxation, the private company, as the tenant of such property, must pay ad valorem tax on its leasehold interest in the property, except if the lease agreement is structured as a usufruct.[10]

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[3] Ga. Const. Art. VII, Sec. II, Para. I.
[4] Hart Cnty. Bd. of Tax Assessors v. Dunlop Tire & Rubber Corp., 314 S.E.2d 188 (Ga. 1984); Charlton Dev. Auth. v. Charlton County, 317 S.E.2d 204 (Ga. 1984).
[5] Delta Air Lines, Inc. v. Coleman, 131 S.E.2d 768, 771 (Ga. 1963).
[6] O.C.G.A. § 36-62-6.
[7] Id.
[8] See footnote 11.
[9] See Dunlop Tire & Rubber Corp., 314 S.E.2d at 190 (citing Kingsland Development Authority, Ga. L. 1962 pp. 813, 814; Americus-Sumter Payroll Development Authority, Ga. L. 1962, pp. 933, 938; LaGrange Development Authority, Ga. L. 1964, pp. 779, 780).
[10] Supra note 7.

c. Leasehold Estate or Usufruct

An interest in land will fall into one of three property classes: (i) the absolute or fee simple estate; (ii) the estate for years or leasehold estate; or (iii) the usufruct.[11] The fee simple estate is the broadest form of ownership, and the usufruct, which is essentially a mere license to use certain property, is the most limited interest in land. An intermediate estate is the leasehold estate which provides the occupant with broad possessory rights to use and develop property subject to a lease agreement with the fee owner.

A leasehold estate is a severable interest in the land and, for tax purposes, is classified as a distinct real property estate.[12] A usufruct is not a taxable interest in real property.[13]

The Supreme Court has provided that "the provisions of the lease must be scrutinized objectively to determine whether the legal effect of the agreement between the [parties] is to give the [company] a usufruct or an estate for years."[14]

The Court of Appeals has outlined the following five factors that should be considered to determine whether the parties to a lease agreement intended to create a leasehold estate or a usufruct:

1) The terms used in the instrument of conveyance to describe the grantee's rights;

2) Any provisions in the instrument addressing the parties' understanding as to liability for ad valorem taxes;

3) The grantor's retention of dominion or control over the leased property;

4) Which party has retained the duties to keep and maintain the premises and appurtenances; and

5) Whether the grantee may assign the lease or allow any part of the leased premises to be used by others without grantor's consent.[15]

d. Taxation of Leasehold Estates

Georgia law provides that each county board of tax assessors has a legal duty to "see that all taxable property within the county is assessed and returned for taxes at its

[11] W.C. Harris & Co., 282 S.E.2d 880 (Ga. 1981); Diversified Golf v. Hart Cnty Bd. of Tax Assessors, 598 S.E.2d 791 (Ga. Ct. App. 2004).
[12] See Delta Air Lines, 131 S.E.2d at 771.
[13] Chatham Cnty Bd. Of Assessors v. Jay Lalaji, Inc., Airport Hotels, 849 S.E. 2d 768 (Ga Ct. App. 2020).
[14] Allright Parking of Georgia, Inc. v. Joint City-Cnty. Bd. Of Tax Assessors, 260 S.E. 2d 315 (Ga. 1979); Macon-Bibb Cnty. Bd. Of Tax Assessors v. Atlanta Se. Airlines, Inc., 414 S.E.2d 635 (Ga. 1992).
[15] City of Coll. Park v. Paradies-Atlanta, LLC, 815 S.E.2d 246 (Ga. 2018); see also Joint Dev. Auth. of Jasper Cnty. V. McKenzie, 887 S.E.2d 372 (Ga. Ct. App. 2023), cert. denied (July 13, 2023).

fair market value."[16] Georgia law also provides that "each county board of tax assessors shall . . . exercise its powers and discharge its duties and is specifically authorized, without limitation, to use a method or methods of valuation for leases related to revenue bonds or other revenue obligations issued by a local government authority for a capital project or projects to be leased primarily to a nongovernmental user or users, based on assessments of the increasing interest of the nongovernmental user or users in the real or personal property, or both, over the term of the lease, or to use a simplified method or methods employing a specified percentage or specified percentages of such leasehold interests."[17]

The Supreme Court has provided that a board of tax assessors' methodology for determining the fair market value of the leasehold interest will not be set aside provided that the methodology is not arbitrary and unreasonable.[18]

As taxable property (except if the fee simple estate is held by certain types of constitutional amendment authorities as described below), the local board of tax assessors may levy ad valorem tax on the leasehold estate. However, because the owner of a fee simple estate is typically assessed taxes upon the full value of the property, the owner of a leasehold interest ordinarily is not required to pay ad valorem tax on its property interest.[19] Any determination otherwise would result in the imposition of a double tax on the same property. However, when a development authority or other tax-exempt entity owns a fee simple interest in the land, the board of tax assessors may levy a tax upon the leasehold estate at the time it passes to private ownership.[20] If the development authority is a constitutional amendment authority, the leasehold interest may be exempt from ad valorem taxes altogether. The Supreme Court of Georgia has ruled that if the development authority is created by local constitutional amendment, the development authority's interest in the property and the lessee's leasehold interest are exempt from ad valorem property taxes provided that the local constitutional amendment does not specifically state that the exemption shall not extend to the authority's tenants and lessees.[21]

e. Negotiating the Leasehold Value of a Leasehold Estate

Although a company's leasehold interest is subject to taxation (except if the fee simple estate is held by certain types of constitutional amendment authorities as described above), the company may negotiate with the local board of assessors to reach an agreement on the value of such leasehold interest.[22] In effect, this negotiated rate may serve as a tax abatement on the property. If approved by the board, the abatement may extend to realty, personalty or both, but it may not circumvent Georgia's

[16] O.C.G.A. §48-5-306(a).
[17] O.C.G.A. §36-80-16.1(e)
[18] See DeKalb County Bd. of Tax Assessors v. W.C. Harris & Co., 282 S.E.2d 880 (Ga. 1981); see also Coweta County Board of Tax Assessors v. EGO Products, Inc., 526 S.E.2d 133, 134 (Ga. Ct. App. 1999); and see also SJN Properties, LLC V. Fulton County Board of Tax Assessors, No. S14A1493, WL 1393398 (Ga. Mar. 27, 2015).
[19] Id. at 773.
[20] Id. at 771.
[21] See footnote 11.
[22] Coweta County Board of Tax Assessors v. EGO Products, Inc., 526 S.E.2d 133, 134 (Ga. Ct. App. 1999).

constitutional requirement of uniform taxation.[23] For instance, if a county typically limits property tax abatements to 50% of the tax otherwise due on such property, a company that negotiates an abatement on similar property (providing the same type of employment and employees) in excess of 50% may contravene Georgia's constitutional requirement of uniform taxation and risk losing the abatement entirely.[24] Likewise, if a municipality has a history of limiting ad valorem abatements to real property, an abatement that extended to personalty would violate this requirement of uniform taxation. The Georgia Constitution requires taxable property within the same class within a county must be assessed with uniformity among similarly situated taxpayers.[25] Accordingly, if a company reaches an agreement with a local board of assessors to reduce the value of such company's leasehold interest in property that has been transferred to a local development authority, a Georgia court most likely will uphold such agreement provided the negotiated value of the leasehold interest is comparable to values designated for similarly-situated taxpayers.[26]

As stated above, when a development authority is created by local constitutional amendment and the ad valorem property tax exemption is not expressly limited to the authority (the leasehold interest is also exempt), the company will probably not have to pay taxes on its leasehold estate. Notwithstanding the fact that a company may not be obligated to pay ad valorem taxes on its leasehold estate because it is exempt or because it has no value, typically, in connection with a sale-leaseback transaction, the company makes a payment in lieu of taxes which equals the negotiated amount that the company would have paid on its leasehold estate as if the exemption did not apply.

f. Taxation of Usufructs

As discussed earlier, a usufruct is not a taxable interest in real property. Similar to sale-leaseback transactions with a constitutional authority, typically, in connection with a sale-leaseback transaction with a usufruct, the company makes a negotiated payment in lieu of taxes each year during the term of the transaction.

g. Gratuities Clause

The issuance of industrial development revenue bonds enables the sale-leaseback structure to avoid violation of the Gratuities Clause of the Georgia Constitution,[27] and it provides certain legitimacy to the arrangement by subjecting the transaction to public scrutiny and a court validation. GA CONST. Art. III, Sec. VI, Para. I(a) Article 3 provides, "Except as otherwise provided in the Constitution, the General Assembly shall not have the power to grant any donation or gratuity or to forgive any debt or obligation owing to the public…."[28] This provision against the granting of gratuities by the General Assembly has been interpreted by Georgia courts to apply to cities and counties as

[23] Id. at 136.
[24] See Id.
[25] Ga. Const. Art. VII, Sec. I, Para. III.
[26] Id.
[27] Ga. Const. Art. III, Sec. VI, Para. VI.
[28] Id.

well.[29] While this prohibition does not impact a company's ability to transfer private property to a governmental entity, it may preclude a development authority from conveying such property back to the company following the expiration of the tax abatement. To avoid any risk of violating the Gratuities Clause, most Georgia attorneys advocate the issuance of bonds which, as described below, will generate a stream of rental payments from the company, as lessee. By paying rent during the term of the tax abatement, the company accumulates equity in the property and may purchase the property for a nominal fee following the expiration of the abatement, or lease, term, thereby acquiring the property for value and avoiding the Georgia Constitution's prohibition against gratuities.

h. Bond Validation

Georgia law requires revenue bonds issued by a governmental body to be validated by a superior court of the state.[30] While this process is somewhat laborious and time-consuming, one advantage of the validation is the receipt of a judicial approval or "blessing" of the transaction. The validation process also requires the development authority, as issuer of the bonds, to publish notice of the validation proceedings in a local newspaper.[31] This notice provides the general public, as well as the local taxing jurisdictions, with an opportunity to contest the bond issue and underlying transaction. In the event a party fails to contest the bonds and such bonds are validated according to Georgia law, a court is likely to deny subsequent challenges to the bonds or any matters, such as the property tax abatement, which are addressed in the validation pleadings.[32]

II. Overview of Sale-Leaseback Bond-Financing Documents

a. Inducement Resolution

Once a new or expanding company has negotiated with a county or municipality to receive an ad valorem tax abatement, the local development authority in such county or municipality will pass an inducement resolution or approve a memorandum of understanding. This inducement resolution or memorandum of understanding reflects the authority's commitment to issue bonds to finance the project for lease and exclusive use by the company.

b. Bond Resolution

Following a commitment by the development authority to issue bonds, the bond documents are drafted, negotiated and ultimately approved pursuant to a bond resolution. This resolution authorizes the chair or vice-chair of the development authority to execute the necessary documents to issue taxable revenue bonds, and the primary bond documents (the trust indenture, the lease agreement, the guaranty and the bond purchase agreement) are attached as forms approved by the authority.

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[29] City of Lithia Springs v. Turley, 526 S.E.2d 364 (Ga. Ct. App. 1999).
[30] O.C.G.A. § 36-82-73.
[31] O.C.G.A. § 36-82-22.
[32] See Charlton Dev. Auth., 317 S.E.2d at 204 (holding that a tax levy agreement which was referred to in bond validation proceedings was beyond subsequent challenge by the county).

c. Trust Indenture

Often, a corporate trustee (e.g., a bank) is selected to serve as trustee for the benefit of the bondholders. Pursuant to the trust indenture, the bank agrees to represent the interests of the bondholders, and the bank receives from the development authority, as issuer of the bonds, a security interest in the rental payments received from the lessee of the project (i.e., the taxpayer company) and in the limited warranty deed. In other words, the trust indenture is analogous to a loan agreement whereby the borrower (i.e., the development authority) agrees to make certain payments of principal and interest, as more fully set forth in the bond, to the lender (i.e., the holders of the bond). As with most loans, the lender receives certain collateral (i.e., assignment of the rent payments and a security deed) as assurance that the borrower will satisfy its debt obligations.

The indenture also outlines the process for payment of the bond proceeds to the borrower as well as the process for repayment of such funds. Essentially, the bonds are sold to the bondholders in various installments as funds are needed to finance the project. For instance, when the taxpayer company (acting as construction agent for the development authority) desires reimbursement for certain project expenses, the taxpayer company (on behalf of the development authority) will notify the trustee that it wishes to take a draw from the bonds. A bond is sold, and the bond proceeds are placed in a project fund. The taxpayer company will provide the trustee with a requisition and supporting documentation (e.g., project invoices). The trustee transfers funds from the project fund to the taxpayer company.

Note that, in a true financing, the bonds would be sold by a marketing agent to one or more parties. A bond issue whose sole purpose is to support a property tax abatement typically is sold exclusively to the beneficiary of the abatement (i.e., the taxpayer company). For this reason, such bonds are often called "phantom" bonds. In other words, the company serves both as the provider and the recipient of the bond proceeds and the transaction does not reflect a true (i.e., third-party) financing arrangement.

d. Repayment of the Bonds.

The development authority, as issuer of the bonds, is obligated to make payments of principal and interest on the bonds to the bondholders (in this case, the taxpayer company). This obligation, however, is not guaranteed by the full faith and credit for the development authority or local community. Instead, the debt service is financed from the rent payments received from the taxpayer company which leases the project for the term of the tax abatement. In other words, as landlord of the project, the development authority receives rent equal to the principal and interest owed on the bonds. These payments of principal and interest are transferred to the trustee who remits such funds to the bondholders (i.e., back to the taxpayer company). Because the company serves as tenant of the project as well as holder of the bonds, the indenture states that the company may make rental payments to itself pursuant to a Home Office

Payment Agreement, thereby permitting the company to avoid the hassle and expense of wiring funds to and from the trustee.

e. Sale and Leaseback of the Project.

As stated, a taxpayer company may not receive an ad valorem tax abatement until the abated property has been transferred to a local development authority or other governmental unit. Accordingly, at the outset of the abatement, the taxpayer company must transfer to the development authority all real property pursuant to a warranty deed and all personal property pursuant to a bill of sale. Following the initial transfer, all future real property improvements will become property of the development authority by virtue of the deed; however, subsequently-acquired personal property must be transferred to the development authority. As a result, by December 31 of each year, the taxpayer company should transfer all personal property acquired during the year to the development authority. These additional transfers will ensure that the newly-acquired personal property will be owned by the development authority as of January 1, the determination date for property tax liability.

Once the development authority has acquired title to the project pursuant to a bill of sale and warranty deed, the authority will lease the agreement to the taxpayer company pursuant to a lease agreement in exchange for rent equal to the debt service due on the taxable bond issue. The authority will lease and operate the project for the duration of the property tax abatement and will transfer the property to the company via bill of sale and/or quitclaim deed upon the expiration of the abatement (and the lease agreement). Because the lease agreement is deemed a capital lease, the company may acquire the project for a nominal fee without violating the Gratuities Clause of the Georgia Constitution. Under federal tax law, the lease is a financing lease and the company retains all tax benefits (depreciation rights, etc.).

f. Bond Purchase Agreement and Guaranty Agreement.

Pursuant to a bond purchase agreement, the company agrees to purchase all bonds issued by the development authority in connection with the project. The company, therefore, will be the sole holder of the bonds and, therefore, the sole lender of financing for the project. Because the bonds are not sold to the public, any SEC filing and disclosure requirements are avoided. As additional security for the bonds, the company, as lessee of the project, also executes a guaranty agreement whereby the company guarantees repayment of the principal of and the interest on the bonds.

g. Zero Sum Transaction.

Unless the bonds are sold to a third party (i.e., someone other than the taxpayer company), the transaction does not represent a typical financing arrangement. The development authority issues the bonds for sale to the company. While the development authority is obligated to the company (as holder of the bonds), this obligation is commensurate with the company's obligation to pay rent to the authority (as landlord of the project). Likewise, the company must transfer funds for the purchase

of the bonds, but this cash outlay is commensurate with the funds the company receives as construction agent or manager of the project. The transfers of funds are a wash and do not ultimately require any outlay of funds from the development authority or the company (other than funds the company otherwise would have spent to acquire the project).

h. Illustration.

Assume that a company desires to acquire a conveyor system for $1 million and to receive a tax abatement on such equipment. The company will purchase the conveyor system as it would irrespective of the tax abatement. The company then transfers the conveyor system to a local development authority. The authority acquires the conveyor with funds it has received from the company as purchaser of a bond issued by the authority. While the company has transferred (on paper) $1 million to the authority upon purchase of the bond, the company immediately receives a refund of such payment after showing proof that the company, as agent for the authority, spent $1 million to acquire the equipment. The authority must pay to the company the principal and interest due on the $1 million bond; however, this stream of funds is provided by the company as rent for the exclusive use of the conveyor system, which is owned by the authority.

III. Conclusion

Georgia typically classifies the interest of a private company in a sale/leaseback arrangement as a leasehold estate that is subject to taxation. Although the property is subject to tax, the company may negotiate with the local board of tax assessors to obtain an abatement of the tax. If obtained with the board's consent, the abatement may extend to real and personal property, but it may not violate Georgia's constitutional requirement of uniform taxation. Once the new or expanding company has been authorized to receive an abatement, such company is advised to adhere to the foregoing industrial development bond requirements, including the court validation and notice procedures, which have become the established method for obtaining tax abatements in Georgia.