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STATE OF MINNESOTA

IN SUPREME COURT

No. A05-0442

Kmart Corporation,

Relator,

vs.

County of Stearns,

Respondent.

AMICUS CURIAE BRIEF OF THE MINNESOTA COUNTY ATTORNEYS ASSOCIATION

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LEGAL ISSUE

Did the failure of the tax petitioner to timely provide expense figures related to real estate warrant the dismissal of the petitions pursuant to Minn. Stat. § 278.05, subd. 6 (a), (the 60 Day Rule)?

The Tax Court held: In the affirmative.

STATEMENT OF THE CASE

Relator filed property tax petitions challenging the Estimated Market Value (EMV) of the subject property for the January 2, 1999, 2000 and 2001 assessment dates for taxes payable in 2000, 2001, 2002. In December 2001, Respondent filed a motion to dismiss pursuant to Minn. Stat. § 278.05, subd. 6 (a) for the first assessment date in question. The motion was postponed and not heard until September 9, 2004. The delay was due to an agreement to wait for decisions of the Minnesota Supreme Court in cases which might assist in deciding the case and because relator filed for bankruptcy. After Relator emerged from bankruptcy, Respondent renewed the Motion adding two additional tax years.

On January 5, 2005, the Tax Court granted Respondent's motion to dismiss. On March 3, 2005, the Tax Court denied Relator's motion for Reconsideration. Relator appealed these Orders to the Minnesota Supreme Court. The Minnesota Supreme Court granted the motion of the Minnesota County Attorney's Association ("the Association") for leave to file an Amicus Brief in this case.

STATEMENT OF FACTS

The subject property is a Kmart store located in Waite Park in Stearns County, Minnesota. During the assessment dates in question, Relator was a tenant in the subject property. For purposes of this case, the Association will assume that Relator met the production requirements contained in Minn. Stat. § 278.05, subd. 6 (a) except for

"expense figures." Relator provided the Court with an affidavit which contained the following language. (Relator's Br. 6)

> Kmart prepares and maintains expenses to the operation of the business it conducts on the subject property. Kmart does not prepare or maintain any statements or records that separately identify the operating expenses for the real estate of the subject property. Real estate-related expenses relating to the ownership or operation of the real estate are not maintained by Kmart as the tenant. Therefore, the anticipated expense information was not "available" to Kmart under the 60-day rule.

The Tax Court found the following facts after reviewing the Lease Agreement dated October 19, 1992. (Relator's App. 22 (Tax Court's Jan. 4, 2005 Order at p. 3))

> The Lease Agreement commenced on October 19, 1992. Under the Lease Agreement, the rent payable from its commencement and throughout its anticipated 25-year term is $567,150 per year, with no additional percentage or overage rent required. Further, under the Lease Agreement, Petitioner is required to pay certain real estate expenses as follows: Petitioner shall pay all real estate taxes. Lease Summary at 1; Petitioner shall reimburse the landlord for insurance premiums for the common areas. Lease Summary at 5; Petitioner shall at its own expense, carry out such repairs, replacements, improvements and maintenance as it deems necessary to keep the premises in good order. Lease Summary at 9; Petitioner shall pay all charges for utility raw materials (gas, water, sewage, telephone, electricity etc.) furnished to the premises during the lease term. Lease Summary at 10.

Based upon these findings, the Tax Court found that Relator failed to provide expense figures regarding the operation of the real estate. The Tax Court also concluded that since Relator was required to pay those expenses regarding the operation of the real estate, it must have those expense figures available to it. Therefore, the Tax Court concluded that dismissal of the petitions was warranted under the provisions of Minn. Stat. § 278.05, subd. 6 (a).

STATEMENT OF INTEREST OF THE MINNESOTA COUNTY ATTORNEYS ASSOCIATION AS AMICUS CURIAE

The Association is a not-for-profit, independent, voluntary organization of County Attorneys dedicated to improving the quality of justice in the State of Minnesota. This mission is accomplished by providing: leadership on legal and public policy issues related to the duties of county attorneys; enhancing communication and cooperation between county attorneys and the judiciary, county government, the bar, and other public and private organizations; fostering professionalism and competency by providing training, education, and support to county attorneys; and enhancing mutual cooperation and support among county attorney offices.

County Attorneys have extensive and ongoing responsibilities to represent the government in property tax appeals filed pursuant to Minn. Stat. §§ 278.01 to 278.14. Absent an election in limited circumstances from a city or town, Minn. Stat. § 278.05, subd. 2 provides that the "attorney of the county in which these taxes are levied shall take charge of and prosecute the [chapter 278] proceedings ... ."

The Association[1] has a strong interest in this case because an affirmance of the decision of the Tax Court will clarify the type of expense figures related to the real estate which must be provided pursuant to Minn. Stat. § 278.05, subd. 6 (a) when the petitioner is a tenant. Such a clarification will promote consistency by tax petitioners in

[1] In addition to the undersigned, the following assisted in the preparation of this brief: Thomas G. Haluska, Assistant Anoka County Attorney; Robert T. Rudy, Assistant Hennepin County Attorney; Suzanne W. Schrader, Assistant Dakota County Attorney and M. Jean Stepan, Assistant Ramsey County Attorney.

the information they supply, by county attorneys in the decisions to make a motion to dismiss under this statute and by the Tax Court in its decisions once motions are made.

ARGUMENT

The failure of the tax petitioner to timely provide expense figures related to real estate warranted the dismissal of the petitions pursuant to Minn. Stat. § 278.05, subd. 6 (a), (sometimes referred to as The 60 Day Rule).

1. **Expense figures related to real estate paid by the tenant are crucial facts necessary for a proper analysis of income producing property.**

Relator is a tenant of the subject property. As such, it does not have the same access to income and expense figures related to the real estate as the landlord. A tenant will always have access to income figures related to the real estate. The income is the rent that is paid by the tenant to the landlord. A tenant may have varying degrees of access to expense figures related to real estate because of the structure of the lease in place.

Types of leases are defined and identified in a table in Appraisal Institute, The Appraisal of Real Estate, 477 (12th Ed. 2001). These lease types differ based upon who is responsible for the payment of certain expense categories. The authors identify five different expense categories which relate to real estate. Those categories are: utilities; property taxes; insurance; property maintenance and structural repairs. These categories of expenses are not related to the business conducted on the premises. Utilities provide basic services for the real estate such as heat, air-conditioning, water, light, and sewer. Property taxes are based on the structure not on equipment related to the business.

Insurance coverage on the structure is related to the real estate. Structural repairs are obviously related to the real estate. For a more thorough discussion of operating expenses relating to real estate see The Appraisal of Real Estate, supra, at 512-519. A gross lease is defined as a lease where the tenant pays the rent (income) and the landlord pays all the expenses. A single net lease is defined as a lease where the tenant pays the rent, utilities and property tax or insurance and the landlord pays the property maintenance, structural repairs and the property tax or insurance (whichever category the tenant does not pay). A double net lease is defined as a lease where the tenant pays the rent, utilities, property taxes and insurance and the landlord pays the property maintenance and structural repairs. A triple net lease is defined as a lease where the tenant pays the rent, utilities, property taxes, insurance and property maintenance and the landlord pays the structural repairs. Finally, an absolute net lease is defined as a lease where the tenant pays the rent, utilities, property taxes, insurance, property maintenance and structural repairs and the landlord pays none of the expenses in these categories.

The rent charged by the landlord depends greatly on who is responsible for the payment of expenses. For example, when rent is $100 per year and the tenant is responsible for the expenses of $100 per year under an absolute net lease, this is comparable to a situation where the rent is $200 per year where the landlord is responsible for the expenses under a gross lease. In order for an assessor to make sense of the income figure (rent), the assessor must know the expense figures and who

is responsible for paying the expenses. In a situation where the tenant is the tax petitioner, it is imperative for the assessor to be provided with these expense figures known by the tenant so that the assessor can be aware of who pays and the amount of these categories of expenses.

This example is an oversimplification of what actually occurs. As this Court is well aware, rent (or income) may not be a simple definite number negotiated by the parties. Rent can be subject to, among other things, an "overage rent" clause in the lease, which can adjust the rent above a base rent depending on the level of retail sales which take place on the premises. The Appraisal of Real Estate, supra, at 483, See, e.g., Kmart Corp. v. County of Becker, 639 N.W.2d 856 (Minn. 2002); Kmart Corp. v. County of Douglas, 639 N.W.2d 863 (Minn. 2002); Kmart Corp. v. County of St. Louis, 639 N.W.2d 866 (Minn. 2002). Likewise, in addition to the lease providing for certain categories of expenses to be borne by the landlord or tenant, expenses can be subject to expense caps or stops, among other things, which can modify the amount of expenses borne by each party. The Appraisal of Real Estate, supra, at 506. An expense cap allows the tenant to pay an expense up to the cap with the landlord paying the expenses above the cap. An expense stop allows the landlord to charge the tenant expenses above a certain amount. With these concepts in mind, it is clear why expense figures related to real estate paid by the tenant are crucial for an assessor to obtain to analyze the subject property and to make comparisons of the subject property to other income producing properties.

2. **Relator's claim that tenant paid expenses relate only to the business and not the real estate is not true and without merit.**

Relator claims that all tenant paid expenses relate to the business and not the real estate. In Kmart Corp. v. County of Otter Tail, File No. C9-00-551, (Minn. Tax Ct. Order dated November 16, 2000) the Tax Court agreed with this claim. In an order denying dismissal, the Tax Court essentially found that expenses paid by the tenant under the lease which included utilities, property tax, insurance and maintenance expenses were related to the business and not related to the real estate. Obviously there may have been some expenses which were related to the business, but the above listed categories of expenses relate to the real estate, not the business. This ruling is clearly erroneous. However, the reasoning behind this ruling is interesting. The reasoning was that in using the income capitalization approach, expenses are subtracted from income to arrive at what is called net operating income. To arrive at a value under this approach the net operating income is divided by a capitalization rate. The Appraisal of Real Estate, supra, at 530. The Tax Court reasoned that the rent paid by the tenant does not include the tenant paid expenses. The subtraction of those expenses, already having been made, does not have to be made to the rent to arrive at the net operating income. Consequently those tenant paid expenses did not have to be used in the income capitalization approach.

The problem with this reasoning is that it is flawed. First, it requires the Court to adopt a fiction that all tenant paid expenses are not related to real estate. That is

clearly incorrect. Second, it requires the Court to ignore the plain language of Minn. Stat. § 278.05, subd. 6 (a). That statute requires the production of expense figures, it does not use the term expense figures that could be used in an income capitalization approach. Third, it requires the Court to ignore how relevant and important the tenant paid expense figures relating to real estate are in analyzing what makes up rent of the subject property and how it compares to the make up of the rent of rental comparables (comparables used to test if the rent of the subject property is at market rent) and capitalization rate comparables (comparables used to calculate a capitalization rate). Clearly, tenant paid expenses which fall into one of the five previously identified categories relate to the real estate and must be provided under the statute.

3. **Relator's claim that tenant paid expenses relating to real estate need not be provided because they are not relevant to the income capitalization approach is incorrect and without merit.**

Under this alternative argument Relator admits that the five previously identified categories of tenant paid expenses relate to the real estate but claims that these expenses are not relevant to the income capitalization approach and therefore need not be provided under Minn. Stat. § 278.05, subd. 6 (a). In Kmart Corp. v. County of Douglas, File No. C7-00-309, (Minn. Tax Ct. Order dated January 11, 2001) the Tax Court reconsidered its previous Order granting dismissal of the petition on the basis that the expense figures provided were inadequate. The Court reaffirmed the dismissal but on grounds that the income figures provided were inadequate. The decision included dicta, which indicated that since tenant paid expense figures were not

necessary for an income capitalization approach, those figures were not relevant and did not have to be provided under the statute. This analysis was also followed in Kmart Corp. v. St. Louis County, File Nos. C1-00-600670, C3-00-60671, C8-00-600665, CX-00-600666, (Minn. Tax Ct. Order dated January 11, 2001). Under this analysis, relevancy became the yardstick for determining whether the expense figures had to be provided under the statute.

This claim and the Tax Court's decisions are incorrect and without merit. Relevancy is not the standard under Minn. Stat. § 278.05, subd. 6 (a). The statute never uses the word "relevant" in describing the income or expense figures that must be provided. The Tax Court should never have attributed that standard when the statute does not clearly provide for it. A relevancy standard at such an early stage of litigation is vague because it would be difficult to clearly determine the weight, if any, that should be given to the various approaches to value, which may ultimately be included in an appraisal report. Another question would be if a relevancy test is used, would the tax petitioner be the appropriate "gate keeper" to determine what must be provided in order to comply with the statute. It is better to have a "bright line" rule that all expense information relating to the real estate in the possession of the tax petitioner must be provided rather than a vague relevancy test.

Finally, the expense information of a tenant is relevant in these cases. While it may not be directly used in the final formula of the income capitalization approach, it is used in determining market rent of the subject property and a market capitalization rate,

which are two of the three factors in the formula. Market rent of the subject property is determined by starting with the actual rent of the subject and comparing it to actual rent of a number of rental comparables. In order to make an accurate comparison, the assessor must first know the amount of expenses and the party who paid the expenses of the subject property and the rent comparables in order to accurately make the comparison and a determination of market rent. The same holds true for making a determination of a market capitalization rate to apply to an income capitalization approach to value. Capitalization rates are calculated by dividing the net operating income by the sale price of capitalization rate comparables. The Appraisal of Real Estate, supra, at 529-530. The assessor must know the amount and the party who paid the expenses in order to accurately make the comparison of the capitalization rate comparables to each other and to the subject property. For these reasons, tax petitioners who are tenants must provide tenant paid expenses relating to real estate in order to comply with Minn. Stat. § 278.05, subd. 6 (a).

4. Relator's claim that tenant paid expenses relating to real estate need not be provided because they are not available is not true and without merit.

Under this alternative argument Relator claims it does not separately account for expenses that are related to real estate from expenses related to the business. Relator claims that it does not have to provide any expense figures related to the real estate because there is not a separate accounting for them. In Kmart Corp. (Anoka) v. County of Anoka, File Nos. CX-01-2784, C5-02-2281, C8-03-4232 (Minn. Tax Ct.

Order dated March 4, 2004; Kmart Corp. (Blaine) v. County of Anoka, File Nos. C1-00-27775, C1-01-2785, C2-02-2885, C-1-03-4234 (Minn. Tax Ct. Order dated March 4, 2004 and Kmart Corp. (Columbia Heights) v. County of Anoka, File Nos. C3-01-2786, (Minn. Tax Ct. Order dated March 4, 2004) the Tax Court agreed with this claim. However, the five expense categories for tenants that relate to the real estate have been clearly identified in the table in The Appraisal of Real Estate, supra, at 477. In order to comply with Minn. Stat. § 278.05, subd. 6 (a), Relator has the choice of providing the records which include all of the expenses or providing excerpts of those records which include the five categories of expenses previously identified. Expense figures related to real estate paid for by the tenant are available to the tenant and must be provided by one of these methods.

5. Relator's claim that tenant paid expenses relating to real estate need not be provided because of the doctrine of stare decisis and because tax petitioners have relied on Tax Court case law is incorrect and without merit.

The Minnesota Supreme Court has analyzed the doctrine of stare decisis for tax cases in Care Institute, Inc.-Maplewood v. County of Ramsey, 576 N.W.2d 734, 737 (Minn. 1998).

> ... Underlying the doctrine of *stare decisis* is the principle that, for the sake of certainty, law, once established, is applicable to subsequent cases in the same court in which the facts are substantially the same, even if the parties are not, and is binding on all other courts of equal or lower rank.

The Court later pointed out in a footnote that it was not bound by decisions of the Tax Court. Likewise in this case, the Minnesota Supreme Court is not bound to follow Tax

Court decisions under the doctrine of stare decisis because of its position as an appellate court.

In support of its position that the doctrine of stare decisis should be applied in this case, the relator contends that there is "strong reliance on the earlier, overruled interpetation" of the 60-Day Rule. (Relator's Br. 42) This position implies that vast numbers of petitioners have been taking the position that a tenant's expenses for the property need not be given to the assessor. That is simply not the case. Since the Tax Court reversed itself in the dicta with regard to expenses in Kmart Corp. v. County of Douglas, supra, the only petitioner to rely on the ruling that expenses of the property paid by a tenant are not required by the 60-Day Rule has been Kmart Corporation.

Since the Tax Court's decision in Kmart Corp. v. County of Douglas, supra, there have been twenty-one reported decisions where the Tax Court applied the 60-Day Rule in response to a motion to dismiss.[2] Eleven of those motions raised issues other

[2] Outboard Service Co. (Conrad Larson) and Darryl R. Larson v. County of Cass., File No. C6-04-486 (Minn. Tax Ct. Feb. 2, 2005); Kmart Corp. v. County of Dakota, File Nos. CX-00-7261, C1-00-7259, C4-00-7255, C7-01-7289, C6-01-7283, C1-01-7269, C6-02-7410, C8-03-7838, CX-04-6913, (Minn. Tax Ct., Jan. 27, 2005); Kmart Corp. v. County of Stearns, File Nos. CX-00-404, CX-01-1465, C2-02-1387, (Minn. Tax Ct. Jan. 04, 2005); Stillwater Village Ltd. Partnership v. County of Washington, File No. C1-04-2980, (Minn. Tax Ct. Sept. 27, 2004); Long Lake Villa, LP v. County of Washington, File No C4-04-2262, (Minn. Tax Ct. Sept. 8, 2004); Vape v. County of Hennepin, File Nos. 30550 & 30549, (Minn Tax Ct. August 9, 2004); KinderCare Learning Centers, Inc. v. County of Hennepin, File No. 30795, (Minn. Tax Ct. April 6, 2004); 1100 Nicollet Mall, L.L.P. v. County of Hennepin, File No. TC-29591, (Minn. Tax Ct. Mar. 25, 2004); Kmart Corp. v. County of Anoka (Anoka), File Nos. CX-01-2784, C5-02-2881, C8-03-4232, (Minn Tax Ct. Mar. 4, 2004); Kmart Corp. v. County of Anoka (Blaine), File Nos. C1-00-2775, C1-03-4234, C1-01-2785, C2-02-2885, (Minn. Tax Ct. Mar. 4, 2004); Kmart Corp. v. County of Anoka (Columbia Heights), File Nos C3-01-2787 (Minn. Tax Ct. Mar. 4, 2004); Gregorich v. County of Anoka, File No. C6-02-4557, (Minn. Tax Ct. Oct. 8, 2003); Gregorich v. County of Anoka, File No. C6-02-4557, (Minn. Tax Ct. Mar 10, 2003); Knutsen v. County of Hennepin, File No. 29752, (Minn. Tax Ct. Mar 6, 2003); SPX Corp. v. County of Steele, File No. CX-01-342, (Minn. Tax Ct. Dec. 26, 2002); VanOss v. County of Wright, File No. C3-02-1005, (Minn. Tax Ct. Aug 20, 2002); Goldberg v. County of Ramsey, File No C2-01-2651, (Minn. Tax Ct. Oct. 25, 2001); Arvinitis v. County of Ramsey, File No. C2-01-2679, (Minn. Tax Ct. Oct. 25, 2001); Haugo Properties v. County of Wadena, File No CX-99-644, (Minn Tax Ct. July 23, 2001); Kmart Corp. v. County

than the sufficiency of the data provided. Stillwater Village (Whether the 30-day extension in the statute at that time was applicable.); Long Lake Villa (Whether information provided prior to the 60 days complies with the 60 Day Rule.); Vape (Whether personal problems petitioner had to deal with rendered the information "unavailable" under the statute.); KinderCare (Whether the property was income-producing property.); 1100 Nicollet Mall (Whether a lease must be provided when it is characterized as a "loan repayment," whether a lease on file with a city liquor license office must be provided by a petitioner, and timeliness of the motion.); Gregorich (Two orders addressing whether the property was income-producing property.); SPX (Whether a lease to a wholly owned corporation makes it income-producing property, and whether a profit must be shown for leased property to be income-producing.);VanOss (Whether the assessor had a duty to inform petitioner about the 60-Day Rule.); Goldberg (Whether the county had a duty to inform petitioner about the 60-Day Rule.); Arvinitis (Whether the county had a duty to inform petitioner about the 60-Day Rule.). Of the remaining ten orders that addressed the sufficiency of the data, seven were Kmart cases, one was a *pro se* litigant who provided no data (Knutsen), one was dismissed because a court ordered settlement altering a lease was not provided by the petitioner (Outboard Service Co.), and the remaining one did not address expense data paid by a tenant (Haugo).

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of Itasca, File No. CX-00-692, (Minn. Tax Ct. July 11, 2001); Kmart Corp. v. County of Becker, File No C2-00-395, (Minn. Tax Ct. Mar. 16, 2001).

On the other hand, because the expense data issue was not reached by the Supreme Court in the Kmart Corp. v. County of Douglas, 639 N.W.2d 863 (Minn. 2002), many counties have consistently and steadfastly maintained that because of the *in rem* nature of these proceedings, expense data for the property includes all expenses of the property, regardless of who pays the expense item. This rule, of course, is tempered by whether or not the expense data is available to a given petitioner. Motions for dismissal where the county has maintained this position have been heard and decided as recently as March of 2004[3] and February of 2005.[4] Motions in Ramsey County maintaining that position are still pending in Tax Court. While the outcome may have been decided on other grounds (sufficiency of proof in Anoka County and timeliness of the motion in Dakota County) that does not change the fact that the counties have consistently held the position that any expense data for the property that is available to a petitioner must be given to the assessor within 60 days of filing the petition.

It is abundantly clear that the only litigant who has relied on the Tax Court's decision in Kmart Corp. v. County of Douglas, supra, is Relator. Relator has created the issue by its resolve to limit the information it shares with assessors, contrary to the spirit and intent of the statute.

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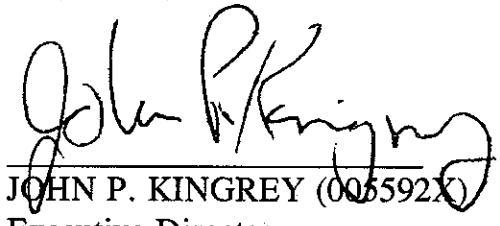
[3] Kmart Corp. v. County of Anoka (Anoka), File Nos. CX-01-2784, C5-02-2881, C8-03-4232, (Minn. Tax Ct. Mar. 4, 2004); Kmart Corp. v. County of Anoka (Blaine), File Nos. C1-00-2775, C1-01-2785, C2-02-2885, C1-03-4234, (Minn. Tax Ct. Mar. 4, 2004); Kmart Corp. v. County of Anoka (Columbia Heights, File Nos C3-01-2787 (Minn. Tax Ct. Mar. 4, 2004)

[4] Kmart Corp. v. County of Dakota, File Nos. CX-00-7261, C1-00-7259, C4-00-7255, C7-01-7289, C6-01-7283, C1-01-7269, C6-02-7410, C8-03-7838, CX-04-6913, (Minn Tax Ct. Jan. 27, 2005)

CONCLUSION

The Supreme Court should affirm the Tax Court's decision dismissing this case and clearly enunciate that tax petitioners who are tenants must provide all expense figures for utilities, property taxes, insurance, property maintenance and structural repairs which are paid for by the tenant or otherwise known by the tenant in order to comply with the production requirements of Minn. Stat. § 278.05, subd. 6 (a).

Respectfully submitted,



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