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Special Report: Enactment of SB 657 (Maddy)

The Omnibus Property Tax Reform Act of 1995

Overview

SB 657 by Senator Ken Maddy was signed into law on October 2, 1995. Sponsored by Cal-Tax, the bill takes effect on January 1, 1996, although most of its provisions clarify existing statutory and case law. SB 657 addresses problems which have developed over the years in the administration of the property tax which have had a detrimental effect on the state's economy and local budgets.

Resolution of the problem areas addressed by SB 657 should help to improve the predictability and stability of the property tax for taxpayers and counties by clarifying and restating existing laws which have been repeatedly misinterpreted and misapplied. This has resulted in boom-and-bust cycles for local jurisdictions as inappropriately collected property taxes are later ordered refunded by appeals boards and courts. As a result, taxpayers and counties have engaged in unnecessary and expensive litigation.

This special report, by Carol Ross Evans, Cal-Tax vice president and legislative director, describes the bill in detail.

Property Tax Administration Areas Addressed in SB 657

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I. Intangibles

(Amends Revenue and Taxation Code Secs. 110 and 212)

Background

Generally, the California Constitution prohibits the taxation of intangibles under the property tax. Intangibles in this context include licenses, customer lists, in-place work force, going concern value, goodwill, etc.

Problem

Repeated efforts of some county assessors (for locally assessed taxpayers) and the State Board of Equalization (for state assessed taxpayers) to subject intangible business assets to property tax in violation of the constitutional prohibition has spawned substantial litigation. Recent court decisions have consistently ruled that intangible values relating to the business are not part of the value of the property on which business is conducted. What is subject to tax is the value of the property, not the value of the business. Only the values inherent in the property itself are properly subject to tax.

Solution

SB 657 provides a fair and rational approach to clarify the proper treatment of intangibles under the property tax, consistent with five recent court decisions which will guide assessors and taxpayers, and should reduce costly lawsuits. SB 657 specifically provides that:

- Intangible assets and rights are not subject to property tax.
- Intangible assets and rights relating to a business cannot be reflected in the value of its taxable property.
- Intangible assets and rights shall be removed from a unit value when property and business are assessed together as a unit.
- The exclusive nature of a concession or franchise is not to be reflected in the value of taxable property.
- Taxable property may be assessed and valued by assuming the presence of intangible assets or rights necessary to put the taxable property to beneficial or productive use.
- Intangible attributes that enhance the value of property, such as zoning and location, shall be reflected in the value of taxable property.

II. Special Franchises

(Amends Revenue and Taxation Code Sec. 23154)

Background

Revenue and Taxation Code Section 23154, enacted in 1935, requires the State Board of Equalization to assess "special franchises." This section was enacted in the aftermath of a change in California's tax structure which subjected public utilities to the property tax. Utilities had been taxed on gross receipts in lieu of property taxes.

Section 19 of Article XIII of the State Constitution prohibits taxation of "franchises" owned or used by utilities. This language is broad and covers any type of franchise, be it special or general. Section 19 also requires utility property to be "subject to taxation to the same extent and in the same manner as other property."

The only way to harmonize Section 23154 of the Revenue and Taxation Code with Section 19 of the Constitution is to conclude that the term "special franchises" refers to the right to use publicly owned real property, and thus be assessed on the "possessory interest," just as locally assessed taxpayers are assessed.

This view was held by an appellate court in *Cox Cable*, in which the court specifically said Section 23154 permits the BOE to assess "possessory interests" of utilities in real property, just as county assessors do for local assessees. This view has been virtually universal for the last 60 years.

Problem

There is still some confusion about what "special franchises" means in Section 23154, and some BOE staff have argued that it extends to a Federal Communications Commission-granted license.

Solution

SB 657 amends Section 23154 to clarify that special franchises are interests in real property and also restates that the value of an intangible asset or right shall not be reflected in the value of the real property interest. This conforms to Section 19 of the Constitution, the holding in *Cox Cable*, and to the general understanding of the last 60 years.

III. Possessory Interests

(Amends Revenue and Taxation Code Sec. 107, adds Sec. 480.6)

Background

A taxable possessory interest is a private interest in public property such as a cabin on leased national forest land. State Board of Equalization Property Tax Rule 21 requires that there must be an exclusive use for a possessory interest to exist, but allows certain concurrent uses to constitute exclusive use. There is no statutory law defining such possessory interests and their common law requirements of durability, exclusivity and independence.

Problem

1. County assessors have triggered a great deal of litigation by alleging the presence of a possessory interest in ever expanding circumstances. Recent examples include the county assessor finding that a van shuttle service has a possessory interest in the street around Los Angeles International Airport, thus owing property tax for using the street; exhibitors at city convention centers owing property tax on their booth space during a convention; and advertising companies owing property tax for placing advertising in public transit stations.
2. Current law requires taxpayers holding a possessory interest, for example renting office space in a building owned by the state, to file a preliminary change of ownership with the assessor upon each lease renewal. Most taxpayers are not aware of this requirement, nor is it logical that the tenant should be required to file a preliminary change of ownership when simply renewing a lease.

Solution

1. SB 657 establishes statutory parameters for possessory interests to guide assessors and judicial authorities and to discourage further unsupported expansion of possessory interests by defining durability, exclusivity and independence for possessory interest purposes as follows:

- "Independent means the ability to exercise authority and exert control over the management or operation of the property or improvements, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the property or improvements. A possession or use is independent if the possessor or operation of the property is sufficiently autonomous to constitute more than a mere agency."
- "Durable means for a determinable period with a reasonable certainty that the use, possession, or claim with respect to the property or improvements will continue for that period."
- "Exclusive means the enjoyment of a beneficial use of land or improvements, together with the ability to exclude from occupancy by means of legal process others who may interfere with that enjoyment. For purposes of this paragraph, exclusive use includes the following types of use in property:

(A) Sole occupancy or use of property or improvements.

(B) Use as a cotenant.

(C) Concurrent use by a person who has a primary or prevailing right to use property or improvements at any time.

(D) Concurrent uses by persons making qualitatively different uses of property or improvements.

(E) Concurrent use by persons engaged in similar uses that diminish the quantity or quality of the property or improvements.

(F) Concurrent use that does not diminish the quantity or quality of the property or improvements, if the number of those concurrent use grants is restricted.

A use of property or improvements that does not contain one of the elements in subparagraphs (A) to (F), inclusive, shall be rebuttably presumed to be a nonexclusive use."

SB 657 does not prevent an assessor, assessment appeals board or court from finding that exclusivity exists, rather where an alleged possessory interest does not fall under SB 657's definition of exclusive, which is the definition currently recognized by the courts, the burden would simply shift to the assessor to show that exclusivity exists.

2. SB 657 requires the public agency holding the fee interest in a property to file a preliminary change of ownership upon a lease renewal, rather than the holder of the possessory interest. It also prohibits any interest or penalties assessed against the holder of the possessory interest if the state or local governmental entity fails to comply with the filing requirement.

IV. Interest Rate on Property Tax Refunds

(Amends Revenue and Taxation Code Sec. 5151)

Background

In 1992, the Legislature substituted the "county pooled apportioned rate" for the statutory 9 percent rate of interest paid on property tax refunds. No minimum rate was established. Payment of interest on refunds was conditional.

Problem

1. Legislative acts are generally required to be applied prospectively. Several counties, however, have retroactively applied this lower county pooled apportioned rate for interest on property tax refunds to all pre-1993 periods that are still open. As a result, taxpayers are compelled to file lawsuits to recover the difference between the statutory 9 percent rate and the lower county pooled apportioned rate for pre-1993 property tax refunds.

2. Unanticipated in 1992, when the county pooled apportioned rate was substituted in Section 5151, was a situation such as the Orange County bankruptcy. The Orange County pooled

apportioned rate is currently negative. Taxpayers should not be penalized and receive no or below-market interest on their property tax refunds due to a county's poor investment decisions.

3. Section 5151 conditions the payment of interest on property tax refunds on "assessor's error, or as the result of an incorrect assessment not occasioned by an act or omission of the assessee." Unfortunately, some assessors try to avoid paying interest on refunds, or force a settlement at a lower amount, by threatening to withhold the payment of interest on a taxpayer's refund by alleging taxpayer misconduct where none exists.

Interest is charged on both deficiencies and refunds for the "use of money" and should be neutral in that regard. If a taxpayer engages in misconduct, there are negligence and fraud penalties that can be assessed. Interest is an improper battleground upon which such battles should be waged.

Solution

1. SB 657 makes it clear that the county pooled apportioned rate of interest applies on a prospective (post January 1, 1993) basis only by adding subdivision (b) to Sec. 5151 as follows:

5151 (b). Subdivision (a) [county pooled apportioned rate] does not apply to interest on refunds of those amounts of tax that became due and payable before March 1, 1993. Interest on refunds of those amounts of tax that become due and payable before March 1, 1993, and have not been refunded as of April 6, 1995 [the date this subdivision was amended into SB 657], shall be paid at that rate provided for by this section as it read prior to January 1, 1993. This subdivision shall not be construed to affect the interest paid on refunds of those amounts of tax that became due and payable before March 1, 1993, and have been refunded as of April 6, 1995.

This clarification has already been sustained in Los Angeles County Superior Court earlier this year. SB 657 also includes intent language that the addition of subdivision (b) to Section 5151 does not constitute a change in, but is declaratory of, existing law.

2. SB 657 inserts a minimum rate of 3 percent interest to be paid on refunds in case the county-apportioned rate is negative.

3. SB 657 deletes the conditions for payment of interest on refunds.

V. Assessment Appeals Boards

(Amends Revenue and Taxation Code Sec. 1621)

Background

1. Under Article XIII, Section 1 and Article XIII A (Proposition 13) of the California Constitution, if a property declines in value below its Proposition 13 acquisition value, assessors shall assess the property at its lower full market value. (This was added by Proposition 8 in

November 1978.) If the assessor does not lower the value, taxpayers may petition for reassessment which is heard by an assessment appeals board. An appeals board hearing must be held within two years of the date a petition is filed, or the taxpayer's opinion of value is accepted until a hearing is held.

By statute, counties are limited to five assessment appeals boards. Assessment appeals board members are appointed by the county board of supervisors and must have five years of experience as a certified public accountant, licensed real estate broker, attorney, nationally accredited property appraiser, or be determined to have competent knowledge of property appraisal and taxation.

Problem

When California property values declined sharply in the early 1990s, many assessors failed to properly decrease property tax values, preferring instead to wait for taxpayers to petition for reassessment. Consequently, some counties which did not act to lower assessments as property values declined were deluged with appeals and found it difficult to process these appeals within the two-year period required by law.

Solution

SB 657 raises the limitation on the number of assessment appeals boards a county may have to 10 from five, allowing the county flexibility to expand or contract the number of boards to deal with fluctuations in the number of appeals filed.

VI. Assessment Appeals Notice

(Amends Revenue and Taxation Code Secs. 75.31, 75.51 and 2611.6)

Background

Under current law, taxpayers may appeal their property tax assessments. The deadline for filing is September 15. Urgency legislation approved in 1995, AB 1620 (McDonald), authorizes assessors to correct an error or omission within one year due to an incorrect assessment involving a decline in value without requiring taxpayers to go through a formal appeals process.

Problem

In most counties, only taxpayers with a value increase receive an assessment notice prior to September 15. Most taxpayers don't receive their tax bill until well after September 15, beyond the deadline to file a property tax assessment appeal. Moreover, while taxpayers do receive a notice if values have increased, in most counties no notice is received when the value is unchanged even though the property may have declined in value.

Solution

SB 657 requires new information with every annual property tax bill and supplemental assessment notice that explains rights of informal assessment review if the taxpayer disagrees with the assessed value shown on the tax bill. If unable to agree on a proper assessed value through an informal review, the taxpayer has the right to file an application for assessment reduction for the following year during the period from July 2 to September 15. SB 657 also requires information on how forms for an application for reduction may be obtained.

VII. Consolidation of Assessment Appeals

(Amends Revenue and Taxation Code Sec. 1604)

Background

Current law requires county assessment appeals boards to hold a hearing on petitions for reassessment within two years of the date they are filed, or the taxpayer's opinion of value is accepted until a hearing is held.

Problem

There is a loophole in current law which allows counties to avoid the two-year limit if the appeal is "consolidated" with an appeal in a subsequent year. In a recent case, a taxpayer found that the county insisted it had "consolidated" the taxpayer's appeal into a future year without the taxpayer's written consent and after the two-year limitation had expired.

Solution

SB 657 requires that any consolidation of a taxpayer's appeal with a subsequent year must occur prior to the expiration of the original two-year limit, and with the written consent of the taxpayer.

VIII. Escape Assessments

(Amends Revenue and Taxation Code Secs. 167 and 4837.5)

Background

Under current law, assessors are authorized to make escape assessments of property not on the assessment roll (i.e. property that for some reason has escaped being assessed). The assessments generally may be made up to four years after the events that gave rise to the escape assessment.

Problem

1. Under current practice, taxpayers are often at a substantial disadvantage in challenging escape assessments because of the passage of time between the tax year at issue and the actual issuance and appeal of the escape assessments. The taxpayer may not have the slightest idea why an escape assessment has been imposed. Under current practice, taxpayers are, in effect, considered guilty until they prove themselves innocent.

2. Current law allows taxpayers to pay escape assessments over a four-year period, if the escape assessment was due to an assessor error or not due to taxpayer error. For a taxpayer required to pay the assessment in a lump sum, this can cause a significant hardship.

Solution

1. SB 657 shifts the burden of proof to the assessor in any case in which the appealed assessment is an escape assessment, unless the taxpayer failed to file a change of ownership statement, business property statement or permit for new construction. This change promotes fairness and enhances the efficiency of the equalization process.

Since the assessor has audited the taxpayer and presumably has sufficient reason to issue an escape assessment based on the audit findings, the assessor should fairly be required to present such supporting evidence in the appeal proceedings prior to the taxpayer being required to prove that the escape assessment is erroneous.

2. SB 657 allows for payment of escape assessments in four yearly installments, regardless of the reason for the escape.

IX. Disclosure of Assessor and Taxpayer Information

(Amends Revenue and Taxation Code Secs. 408, 441 and 469)

Background

Under current law, taxpayers have the right to request and inspect records held by the county assessor.

Problem

There are no teeth to enforce this provision and some taxpayers are finding it difficult to gain timely access to assessor records.

Solution

SB 657 requires an automatic continuance of an assessment appeals hearing if the assessor or taxpayer presents information at the hearing which was previously requested but not received. SB 657 requires an assessor to give taxpayers written audit information with respect to any data

which would alter a previously enrolled assessment, and requires the assessor to respond to a written request from a taxpayer for information supporting an enrolled assessment.

X. Attorney Fees

(Amends Revenue and Taxation Code Sec. 1611.6)

Background

Under current law a taxpayer may request written findings with respect to a hearing on an application for reduction in assessment. If the county fails to issue written findings, or the written findings are found deficient by a court and remanded, current law declares this to be an arbitrary and capricious action which allows an award of attorney fees against the county for the legal services necessary for the taxpayer to obtain proper findings.

Problem

Current law limits attorney fees at \$100 per hour, not to exceed \$7,500. When the county refuses to issue findings or issues deficient findings, it is not unusual in a complex property tax appeal for a taxpayer's attorney fees to exceed the limit. Taxpayers should not be on the hook for the county's deficient or failed actions.

Solution

SB 657 removes the limit on attorney fees for producing written findings from hearings for reductions in property tax assessments when the county fails to produce sufficient findings.

XI. Administrative Funding Formula

(Amends Revenue and Taxation Code Sec. 75.60)

Background

Under Article XIII, Section 1 and Article XIII A (Proposition 13) of the California Constitution, if a property declines in value below its Proposition 13 acquisition value, assessors shall assess the property at its lower full market value. (This was added by Proposition 8 in November 1978.)

Problem

Some assessors currently are not lowering property values pursuant to law on all property that has declined in value below its Proposition 13 acquisition value. Rather, some may be doing it selectively or waiting for taxpayers to file appeals.

Curiously, state law gives assessors an incentive not to reappraise such property. In computing whether assessors qualify for a share of supplemental assessment revenue to use for property tax administration, a State Board of Equalization formula to determine distribution of these funds favors counties that have not reduced values under Proposition 8. Counties must be at 95 percent of market value on their overall assessment level to qualify for property tax administration funding. This creates an incentive to ignore over-assessed properties because they offset any under-assessed property, thus making it easier to meet the 95 percent threshold.

Failure of assessors to initiate Proposition 8 reductions has significantly contributed to the logjam of appeals that counties have experienced in the past few years.

Solution

SB 657 changes the certification requirements for supplemental roll administrative funding by adding a new requirement that the absolute value of the over-assessments and under-assessments cannot exceed 7.5 percent of the total required assessed value of that county.

This removes the incentive to ignore over-assessed properties because the formula does not allow any off-setting against under-assessed properties. Under the old formula, if under-assessments equaled over-assessments, a county would be deemed to have achieved 100 percent of the correct assessment level. Under the new SB 657 formula, if the value of over-assessments equaled 5 percent of the total roll and the value of under-assessments equaled 5 percent of the total roll, the absolute value of incorrect assessments would total 10 percent and disqualify a county.