STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
.20 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 445-4982

WILLIAM M. BENNETT
First District, Kentfield

BRAD SHERMAN
Second District, Los Angeles

ERNEST J. DRONENBURG, JR.
Third District, San Diego

MATTHEW K. FONG
Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

BURTON W. OLIVER
Executive Director

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No. 92/16

TO COUNTY ASSESSORS:

REPORT: "ADMINISTRATIVE IMPLICATIONS OF INVALIDATING PROPOSITION 13"

The State Board of Equalization, at the request of Assemblyman Thomas M. Hannigan, Chairman of the Assembly Select Committee on Property Tax and Local Government Finance, completed the referenced report.

In preparation, last December we asked you to respond to a questionnaire about the potential impact of a U.S. Supreme Court decision overruling Proposition 13. The attached report, prepared by Board staff with the help of members of the California Assessors' Association, discusses many of the issues raised by your responses to the questionnaire.

Thank you for your cooperation in this effort.

Sincerely,

Verne Walton

Verne Walton, Chief
Assessment Standards Division

VW:sk
Enclosure

ADMINISTRATIVE IMPLICATIONS OF INVALIDATING PROPOSITION 13

Preparing for a Possible Overruling Decision by the
United States Supreme Court

(A report by Board of Equalization staff and the California Assessors' Association, for the Chairman of the Assembly Select Committee on Property Tax and Local Government Finance.)

FOREWORD

This report is prepared in response to a request by Assemblyman Thomas M. Hannigan, Chairman of the Assembly Select Committee on Property Tax and Local Government Finance.

Assemblyman Hannigan asked the staff of the Board of Equalization to prepare a paper outlining the administrative implications for county assessors and the Board of Equalization if the United States Supreme Court invalidates the assessment provisions of Proposition 13.

The paper is the product of a collaborative effort by Board staff and members of the California Assessors' Association.

Background

On June 6, 1978 California voters chose to change radically the existing system for taxing their real property. From a system where comparable properties had comparable tax bills, voters moved to a system where the tax on their real property is now based on the property's value at the time of acquisition. Thus, the passage of Proposition 13 retired the existing current market value system in favor of an acquisition value system.[1]

Now, legal challenges to the acquisition value system have raised the possibility that California may have to choose an alternative

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[1]Proposition 13 also mandated that all assessed values be rolled back to reflect market value as of March 1, 1975. Additionally, a maximum tax rate was established at one percent (plus specified voter-approved bonded indebtedness).

system. Specifically, the U.S. Supreme Court has agreed to hear the case of Nordlinger v. Hahn, in which the plaintiff challenges the constitutionality of the acquisition value system under Proposition 13. The suit claims that under this system similarly situated taxpayers (i.e., owners of comparable properties) are denied the guarantee of equal protection under the law.
Just as Proposition 13 presented property tax administrators with the challenge of adapting to a radically different system for assessing real property, so potentially does Nordlinger v. Hahn. County assessors, the Board of Equalization, and the Legislature all need to be prepared for the possible changes that may come to the property tax system in the event the acquisition value system is invalidated by the Supreme Court.

Objectives

In response to Assemblyman Hannigan's request, the purpose of this paper is twofold: First, we outline the administrative implications of an overruling decision for county assessors and for the Board of Equalization. Second, we make recommendations about how property taxes should be administered immediately after such a decision, to assure orderly and uniform assessment practices during an interim period while permanent implementation is being enacted.

INTRODUCTION

The Impact of Proposition 13 on Property Tax Administrators

The immediate impact of Proposition 13 on state and local property tax administrators was a massive redirection of resources. With 1978 assessments due by July 31[2], county assessors had less than eight weeks after the election to adjust assessed values to reflect the terms of the new law. For its part, the State Board of Equalization needed to provide guidance and direction to assessors in time for such guidance to be useful in completing the 1978 assessments.

Thus in the short-term, assessors abandoned a year's worth of market value appraisals by their staffs, instead focusing on the task of completing their first acquisition value assessment roll. The Board of Equalization, meanwhile, concentrated on providing timely interpretation and direction for assessors in implementing the new system.[3]

Once the 1978 assessment rolls were completed, county assessors and the Board of Equalization were confronted with the long-term problem of adapting to an acquisition value system with significantly reduced resources. Staff reductions resulted directly from an immediate, sharp decline in local property tax revenue.[4]

Given the extreme nature of the change to the property tax system, and considering the short period of time in which administrators

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[2]Although each year's assessment roll is due July 1, the Board granted a 30-day extension to all assessors on June 8, 1978. The Legislature subsequently extended the due date to August 21, 1978.

[3]One of the main accomplishments for the Board was the drafting of a series of regulations implementing Proposition 13. Property Tax Rules 460-471, adopted June 29 on an emergency basis, provided a degree of clarification on issues such as when a transaction constituted a change in ownership and what building projects qualified as new construction.

[4]Statewide per capita levies from the local property tax declined 53% from 1977 to 1978, the first year after Proposition 13 was adopted.

had to adapt, the changeover to the acquisition value system was fairly smooth. But the adaptation to the system mandated by Proposition 13 wasn't made in just the few weeks following the election. Indeed, most administrators had been preparing for the possible adoption of Proposition 13 for months prior to the election.

Preparing for a Possible Reversal of Proposition 13

It is expected that the Supreme Court will decide Nordlinger no later than July 1992. Thus it is likely that, just as in 1978, property tax administrators will be in the process of completing their annual assessments while the legality of those assessments is in doubt.

As in 1978, property tax administrators in 1992 are preparing in advance for a significant change to the property tax system. Board of Equalization staff and the California Assessors' Association have met to discuss the administrative implications of Nordlinger. Additionally, Board staff developed a questionnaire, distributed to all county assessors on December 18, 1991, designed to identify the major administrative problems anticipated by assessors and the Board in the event of an overruling decision by the Supreme Court. Much of the analysis presented in this paper derives from the results of the completed questionnaires.

Assumptions about What the Court Will and Will Not Do

There is a key difference in the approaches to preparation for the Nordlinger decision in 1992 and Proposition 13's passage in 1978. That is, in 1978 administrators knew in advance exactly the language of the constitutional amendment. Certainly there was lots of room for interpretation and clarification, but the governing language was known. Thus, not only was it known in advance that Proposition 13 meant real property would be valued based on its acquisition value, but it was also known that the measure would become effective immediately after the election.

With Nordlinger, however, there is no certainty about what the court would do or, just as important, what it would not do in the process of invalidating the acquisition value system. For example, we do not know whether the court would, in striking down Proposition 13, specify some alternative system.
Similarly, we do not know whether the court would direct that the acquisition value system be scrapped entirely, or just partly. If only partly, which parts?

Further, there is uncertainty about the time frame for converting to an alternative system. Would the court direct that all acquisition value-based assessments be declared invalid immediately? Or would this decision be left to state courts or the Legislature, leaving open the possibility for a temporary moratorium on acquisition value assessments?

Administrators cannot feasibly prepare for all possible outcomes of the Nordlinger suit. However, by making a few logical assumptions about what the court would do in an overruling decision, we can focus on a narrow range of administrative implications. These assumptions, incorporated in the aforementioned questionnaire, are as follows:

▸Invalidation of the Acquisition Value Concept

We assume that the Court will strike down the system of reappraising real property only upon change in ownership or new construction.

▸Current Market Value System

We assume that in its ruling, the Court will require that some form of current market value system be installed in order to guarantee equal protection.

▸Timing of Implementation

We assume that the Court will not provide direction as to the timing of implementing the current market value system. Practically, however, we assume for purposes of many sections of the report that either the Legislature or the state courts will require implementation immediately (i.e., for the 1992-93 assessment year).

These assumptions derive from a combination of opinions from legal experts about what the Court would likely do, and from staff's recognition that preparing for certain outcomes (e.g., an immediate conversion to market value assessments) is prudent even if their probability is uncertain.

ADMINISTRATIVE IMPLICATIONS FOR COUNTY ASSESSORS

The questionnaire distributed to county assessors in December 1991 was in part designed to extract from assessors information or their opinions about the consequences of having to convert to a current market value system immediately after an overruling decision by the court. At the same time, several other questions were aimed at the long-term administrative issues connected with conversion to a current market value system.

Several points are important to make before moving to an analysis of the assessors' responses. First, we have interpreted the responses in light of the circumstances of the development of the questionnaire. That is, in order that we could report on the results timely, we asked assessors to return the completed questionnaires in less than two weeks after they were mailed. Thus, assessors had little opportunity to weigh their responses. In many cases, assessors simply chose not to answer particular questions.

Second, several questions, particularly those asking for estimates or other unknown information, were highly subjective in nature. The responses to these questions have been taken for what they are: assessors' best attempts to provide information or make forecasts based on limited facts.

Because of the above-described limitations on the questionnaire and the assessors' responses, we will not draw a question-by-question analysis of the results. Such an approach would have the effect of attaching an unwarranted appearance of precision to the collective responses. Instead, we will use the responses as guidelines for more general discussions about administrative issues.

Staffing

Staffing issues arise in two principal areas: Adequacy of experience and training, and sufficiency of numbers.

▸Experience and Training

We asked assessors to provide the relative numbers of staff with experience in a pre-1978 assessment environment (i.e., under a current market value system) contrasted with those whose only

experience is post-1978. Collectively, the responses indicate that about a third of real property appraisers in California county assessors' offices have pre-1978 experience.

By itself, the prevalence of post-1978 appraisers might seem benign. But combined with assessors' responses about anticipated training needs, it seems clear that this lack of experience is expected to be a significant problem if a current market value system is instituted.[5]

Board staff believes that there are several reasons why an appraiser's lack of experience in a current market value system would present an administrative problem for assessors and, in turn, the Board of Equalization.

First, we know that a large percentage of the "appraisals" performed in the post-1978 era have actually consisted of confirming that a purchase price falls within a broad range of value. This results mainly from Proposition 13's requirement that real property be appraised only upon change in ownership (e.g., purchase) or new construction.

Obviously, when a property is purchased in the open market (as most are), the primary value indicator (i.e., the purchase price) is supplied to the appraiser; from there it is simply a matter of making the above-described confirmation that the price paid is consistent with recent sales of comparable properties. This is particularly true in light of the statutory rebuttable presumption that a property's purchase price establishes its assessed value in an open market transaction.

By contrast, under a current market value system appraisers typically reappraise entire neighborhoods at once. Thus, but for a few properties there is no purchase price to rely on. Instead, appraisers use the relatively few sales that <u>have</u> recently occurred, making adjustments for differences in physical characteristics, location, and other factors (known as comparability adjustments), to arrive at value indicators for the majority of properties in the neighborhood. Because the acquisition value system does not justify this type of comprehensive market analysis, many post-1978 real property appraisers probably lack adequate experience and training in

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[5]Assessors expect that post-1978 appraisers will need about twice the additional training than will be needed by pre-1978 appraisers.

neighborhood canvassing, in making comparability adjustments, and in reconciling more than one indicator of value.

Business property appraisers and clerical staff are also short in terms of pre-1978 experience. However, this should present less of a problem for assessors, since the nature of the duties performed by these positions is less affected by Proposition 13. On the positive side, the majority of administrators in county assessors' offices do have pre-1978 experience; this fact should make conversion to a current market value system much smoother than it otherwise would be. Where administrators lack this experience, conversion would be slowed while administrators learn from other sources (e.g., the Board of Equalization) about implementing a current market value system.

▸Staff Numbers

Nearly all counties responding to the questionnaire anticipate a need for more staff if a current market value system is adopted. The magnitude of this expected need varies, but 20 of the 40 assessors responding expect they will need at least 50% more real property appraisers. The need for additional staff in other areas (e.g., clerical) is generally expected to be somewhat less.

This is consistent with what we know about the differences between an acquisition value system and a current market value system; simply, the latter requires more appraisals with less information (i.e., no purchase price) about most properties being appraised.

At the same time that assessors will be needing more appraisers to complete a market value assessment roll, certain functions that are necessary under Proposition 13 will presumably be unnecessary if a current market value system is adopted. Specifically, all counties currently have some staff devoted to the task of analyzing and tracking title changes for change in ownership purposes. Also, it is likely that supplemental assessments will become moot under a current market value system.[6] In many counties, these two functions occupy a substantial portion of the assessor's clerical staff. Thus the anticipated need for increased staffing may be partially offset by a redistribution of existing resources.

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[6]The assumption here is that the Legislature would see fit to either repeal the supplemental assessment statutes or to limit their effect to new construction.

Workload

The questions about workload cover a broad range of topics, from assessment appeals to property characteristics records to availability of computer-assisted appraisal techniques.

▸Assessment Appeals

In general, county assessors expect large increases in the number of assessment appeals filed if a current market value system is adopted. On average, responses to the questionnaire indicate that assessors anticipate about a four-fold increase in appeals activity.

This is consistent with the fact that under a current market value system many more revaluations are performed in any particular year than in an acquisition value system. (Under Proposition 13 the vast majority of properties are simply indexed two percent for inflation.) Obviously, where there are revaluations, there are appeals of those revaluations. Further, as indicated above, many of the properties that are revalued under Proposition 13 are simply enrolled at the purchase price agreed to by buyer and seller. Such valuations generate few appeals.

If the entire conversion to a current market value system occurs in one particular assessment year, rather than in phases, then obvioulsy we can expect an especially heavy appeals workload for that assessment year.

▸Property Characteristics Records

As indicated above, in a current market value system a majority of properties in a neighborhood are appraised based on sales information from relatively few properties. The properties that have not sold are compared to those that have, and adjustments are made to account for differences in physical and other characteristics. Obviously such comparisons are less meaningful, and thus the adjustments derived from the comparisons less reliable, without current detailed records of the physical characteristics of both sold and unsold properties.

Under Proposition 13's acquisition value system, property characteristics are less important than under a current market value system; since properties are reappraised individually rather than as part of a comprehensive neighborhood survey, assessors rely less on the quality of their property characteristics records than they did prior to 1978.

Assessors' responses to a question about the quality of their property characteristics records indicate that in most counties such records are less than acceptable. Further, most assessors seem to believe that rectifying this deficiency is a long-term problem. Nearly all counties who rated their records as less than acceptable indicated that it would take at least two years to raise those records to an acceptable level. Fourteen of the 40 assessors responding estimated that it would take at least four years to achieve acceptable characteristics records.

▸Computer-Assisted Appraisal Programs

For an assessor's office, a current market value system means a mass appraisal system. That is, if all properties are to be assessed at current market value, frequent appraisals must be performed for each property. A mass appraisal operation can be enhanced by the use of various computer-assisted appraisal techniques, such as sales ratio studies, multiple regression programs, and neighborhood trending.

Once California moved to an acquisition value system, the need for computer-assisted appraisals diminished. This fact remained in spite of the obvious increases in the availability of computer technology over the past 13 years.

Responses to the questionnaire show that nearly all assessors currently complete their appraisals without benefit of computer-assisted appraisal techniques. Consequently, assuming that such techniques will need to be implemented in the event a current market value system is adopted, there will be a transition period while assessor's offices acquire such systems and learn to apply them. While this will present a short-term problem in converting to a current market value system, over the long-term the availability of computer technology probably means that assessors will find that they need fewer appraisers per appraisal than in the pre-1978 era.

ADMINISTRATIVE IMPLICATIONS FOR THE BOARD OF EQUALIZATION

California Government Code sections 15606 et seq. set forth the powers and duties of the Board of Equalization with respect to property tax administration.

Among other duties, the Board is charged with the following: prescribing rules and regulations to govern assessors and local boards of equalization; preparing and issuing instructions for assessors designed to promote uniformity of assessment practices throughout the state; providing instruction, advice, and direction to assessors as to their duties under the law; and conducting periodic surveys of each county's assessment practices.

Long-Term Implications

Over the long term (i.e., once administrators and taxpayers have adapted to the new system), there are several implications for the Board.

▸Assessment Practices Surveys

Under the provisions of Government Code section 15640, the Board is required to make surveys of the procedures and practices employed by each county assessor. Each survey must include a sampling of assessments sufficient in size and dispersion to insure adequate representation of the different classes of property in the county. Until 1978, the Board conducted these surveys on a three-year cycle for assessment sampling purposes, with overall office surveys accompanying every second sampling.

With current resources, the Board conducts its periodic surveys of each county's assessment practices on a five-year cycle for both sampling and office purposes. This is probably sufficient in an acquisition value environment, where once a property is reappraised (i.e., undergoes change in ownership), that appraisal will likely form the basis for the property's assessment for several years to come, even if a new assessor is elected.

If a current market value system is adopted, the Board's surveys of county assessment practices should be stepped up for two reasons. First, section 18 of Article XIII of the state constitution requires the Board to measure annually all county assessment levels and, if necessary, make adjustments. Although

this section became ineffective under the acquisition value system, it remains law, and a return to a current market value system would presumably revitalize its meaning.

The second reason for increasing the frequency of the Board's surveys is that assessors will be revaluing property much more frequently under a current market value system. It follows that assessment practices should be reviewed more frequently.

Accordingly, we recommend a return to the pre-1978 system of performing a triennial appraisal sample of each county, with office surveys performed on a six-year cycle. During non-appraisal sample years, statistical measures would be used to estimate total county assessment ratios.

▸Instructions and Advice

Since 1978, a large portion of the Board's advisory letters to assessors have centered on Proposition 13 issues; applying the change in ownership and new construction statutes continues to be an unresolved problem 13 years after the acquisition value system was first adopted. At the same time, with the concentration of the Board's technical resources on Proposition 13 issues, the need for updating the varied and numerous sections of the Assessors' Handbook has gone largely unmet.

Over the long-term, operating under a current market value system may mean, depending on the specifics of the system, that the Board's technical services staff will be less occupied by non-appraisal issues. The Assessors' Handbook would be the logical beneficiary of such a shift in resources.

Short-term Implications

If the acquisition value system is replaced with a current market value system, the importance of all of the Board's property tax functions will be elevated in the short-term. That is, not only will the Board be expected to guide assessors through what will likely be a difficult transition period, but the voters will need assurance that in the course of converting to a new system their interests are being protected.

Of course, the Board has performed this dual responsibility historically, including the transition period after Proposition 13 was adopted in 1978. But any conversion from the current acquisition value system (voted in by about a 2 to 1 margin) to a current market value system promises to be more difficult, both mechanically and politically, than ever before.

The mechanics of converting to a current market value system might at first glance appear straightforward. After all, we were there once before, and it would seem simple enough to resurrect the previous regulations, guidelines, and instructions, modifying them just enough to reflect whatever wrinkles the new system brings.

But it is important to remember that an invalidation of Proposition 13 by the U.S. Supreme Court would come at a time when a majority of voters appear content with the present system. Indeed, many voters probably believe, perhaps justifiably, that their status as homeowners depends on Proposition 13.

Thus, as indicated above, the Board has to be poised to implement regulations, guidelines, and instructions which accomplish two ends: minimizing the chaos of converting to a current market value system, while at the same time being sensitive to the interests of taxpayers.

RECOMMENDATIONS FOR INTERIM ADMINISTRATION

In 1978, the Assembly Committee on Revenue and Taxation directed that a task force be formed to study the then existing property tax statutes in light of Proposition 13. The task force included several county assessors, county tax counsels, private attorneys, Board staff, legislative staff, and other interests. In January 1979, after three and one-half months of meeting every 10 to 14 days, the task force presented to the committee its recommendations for changes to the existing law.

It may be that in 1992 a similar effort will be appropriate following an overruling decision by the Supreme Court. However, as in 1978, there will likely be a transition period during which the Board of Equalization will be expected to provide guidance to county assessors.

In 1978 the Board adopted a set of rules on an emergency basis to guide assessors through the interim period before permanent legislation was enacted in 1979. The Board will be prepared to take similar action in 1992 if that is appropriate.

While specific regulatory language cannot be suggested until sometime after the Court's decision, we can begin to prepare for a smooth transition by making recommendations about the general nature of what will be required to assure orderly and uniform assessment practices until permanent implementation of the new system is complete.

Moratorium on Implementing the New System

We have already noted the possibility that the Court will not provide any direction as to implementation of a new system. It may well be that implementation issues will have to be solved at the state level. Thus, assuming that the state will have some latitude as to the timing and manner of implementation, we should consider delaying the new system until some point beyond the 1992-93 assessment year.

We indicated earlier that, without a moratorium, the timing of the court's decision could mean that a year's worth of Proposition 13 assessments will be rendered obsolete. Of course, by itself this fact does not justify delaying implementation of the new system. After all, taxing agencies are expected to adjust to less profound changes in the law on an annual basis, even if the changes sometimes make for difficult transitions.

However, it has to be understood that a hurried conversion to a current market value system from an acquisition value system has the potential of being far more hazardous administratively than the reverse situation faced in 1978.

Specifically, responses to the questionnaire indicate that assessors in 1992 do not have the resources, in terms of systems and trained staff, to perform meaningful market value appraisals in time for completion of their 1992-93 assessment rolls. Indeed, only seven of the forty assessors responding to the questionnaire indicated that they could complete a current market value roll by August 1, 1992.[7]

This contrasts with 1978, when assessors had within their offices the information needed for rolling back assessments to 1975 levels, and the conversion was relatively smooth. But in 1992, having to convert immediately to a current market value system would be a little like trying to print a newspaper story without all the facts. You either guess at the facts, fabricate them, or wait until you've gathered them legitimately. If a current market value system is adopted, it is important that assessors be allowed time to gather their facts.

While a moratorium would afford assessors more of an opportunity to prepare for current market value appraisals, there is a potential downside to delaying implementation of the new system. That is, depending on the year of implementation, California's elected officials could face political pressures which would have the potential of compromising a uniform conversion to current market value.

Suspend the Statutory Requirement that Underassessed Property be Assessed on Discovery.

Currently, the law requires that property which has been underassessed be assessed properly upon discovery of the underassessment. Once the proper assessments are made, bills for prior years' underassessments are issued by the tax collector.

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[7]It should be noted that even those assessors who are prepared to issue a current market value roll in 1992 would probably do so with the understanding that the accuracy of individual assessments within that roll would be rather scattered.

Generally, the assessor has four years to make the proper assessments, known as escape assessments.

If the Supreme Court invalidates acquisition value assessments, and assessed values are established at market levels, one result could be that assessors would be required to levy escape assessments for those properties which in prior years have been assessed at less than market value. For the many property owners still having an acquisition year of 1975, the escape assessment could be many times their original tax bill for the years of underassessment. Even those property owners who acquired their property only a few years ago could experience large escape assessments. Obviously, if such escape assessments are required, there could be a catastrophic effect on the finances of many homeowners and businesses.

To avoid this unpalatable situation, consideration should be given to proposing constitutional amendments that would suspend the provisions for escape assessments for any underassessments that would result from a Supreme Court invalidation of Proposition 13.[8] Of course, any legislation suspending the statute of limitations on escape assessments must be clear in preserving the requirement of assessment on discovery for any underassessments not directly attributable to Nordlinger v. Hahn.

Fund More Frequent Assessment Practices Surveys by the Board

We have already indicated that a current market value system merits shorter cycles between assessment practices surveys; specifically, we recommended a cycle of no more than three years.

But in the immediate aftermath of what would be a politically unpopular overruling decision, taxpayers will want to be assured that the new system is being implemented fairly. Thus, it makes sense that an even shorter survey cycle, say two years, be implemented. Once assessors have adapted to the new system, we can revert to a longer cycle, but close monitoring of assessment practices by the state will be important in the transition period.

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[8]Legislation has been proposed in the Assembly (AB 851). However, Board staff's view is that the effectiveness of such legislation without benefit of a constitutional amendment is subject to challenge.

Central Property Tax Database

This paper tries to outline administrative issues that will arise in the event the Supreme Court invalidates the acquisition value system. And while we believe that we can predict fairly well problems which are solely administrative in nature, there are weaknesses in this state's ability to prepare for a possible upheaval of the present property tax system. Specifically, when it comes to analyzing the effect of the property tax on narrow categories of property types or taxpayers, we are limited in our ability to measure accurately, or in some cases to even estimate approximately, the fiscal impact of possible alternatives to our present system.

The limitation on the state's ability to analyze the effect of its own property tax system is caused by several factors. Primarily, however, the problem is that counties have relative autonomy insofar as deciding what assessment data is necessary to collect and maintain. Specifically, the variability in the counties' systems for collecting data about acquisition dates (base-years) makes it currently infeasible to analyze the property tax in these terms.

Probably the best (or worst) illustration of California's inability to analyze its property tax system is the lack of information about the effect of Proposition 13 itself on different classes of taxpayers. Specifically, we cannot reliably estimate what share of the tax burden is shouldered by long-time homeowners as opposed to recent purchasers. (This limitation applies equally to other property types.)

Of course, the above-described limitations on our ability to analyze the fiscal impact of the property tax, whether it be the present system or a potential alternative system, came to the forefront only after it became clear that there was a serious threat to Proposition 13. And regardless of whether Proposition 13 remains intact, we should seek to climb out of that predicament. But if Proposition 13 is invalidated, and an alternative system is adopted, California would have the opportunity to wire the new system for a central database while the system itself is still in the framing stages. We shouldn't pass on that opportunity.

Strive for Fairness, but also Simplicity

Presumably, if the Supreme Court invalidates the acquisition value system they will do so because they deem that it is unfair; i.e., because it doesn't satisfy the taxpayer's guarantee of equal protection under the laws. It follows that any new system would have to meet that constitutional guarantee.

But in implementing a new system, we should remember something from the history of Proposition 13. Specifically, any new system should be made as simple as possible, with few if any exceptions to the general rule that all property shall be assessed at fair market value.

With Proposition 13, California has managed to create a property tax system that is easily digested by the vast majority of taxpayers. That is, the purchaser of real property knows that his tax bill will reflect the value of the property at the time of purchase, and that there will be no untoward increases in his future tax bills.

However, hiding under this veil of predictability is a system which may never be consistently administered. The difficulties are inherent in the original language of Proposition 13; the well-intentioned authors of this measure couldn't have known when they used seemingly fundamental terms like "change in ownership" and "new construction" that neither the Board of Equalization, the Legislature, nor the courts would be able to solve the complex issues that would arise in trying to define these terms.

Thus, we have seen that many of the taxpayers who voted in the acquisition value system remained satisfied only so long as it was to their advantage as individual taxpayers. That is, so long as they did not suffer a reappraisal, the system worked. The proliferation of exceptions to the original meaning of change in ownership and new construction indicates that when the acquisition value system works against these voters (e.g., when people over 55 purchase a replacement home), they act to carve out exceptions for themselves. And with each newly created exception, the system is made more complex.

Of course, one of the duties of the Board of Equalization is to promote uniformity in statewide assessment practices. We have learned from Proposition 13 that uniformity in taxation is achieved far more easily under a simple taxing system.

State Direction on Specific Issues

Thus far we have discussed the general nature of what we think will be necessary for an orderly transition to a current market value system. Following is a list of more specific recommendations for interim administration of a new system.

▸Legislated Effective Date

So that all assessors implement a new system simultaneously (i.e., in the same assessment year), a statutory or judicial directive as to the timing of implementation is important. Without a specific binding ruling as to the specific assessment roll for which a new system must be in place, there is a danger of having different assessors implementing the new system at different times. As indicated above, Board staff recommends that implementation be delayed beyond 1992.

▸Repeal Supplemental Assessment Statutes

Supplemental assessments were designed to speed the collection of property tax increases attributable to acquisition value reassessments. Although supplemental assessments probably would continue to have legal effect even if a current market value system is adopted, there are several reasons why the Legislature should consider a repeal of the supplemental assessment statutes.

First, since supplemental assessments are triggered by change in ownership or new construction, administrators would continue to have many of the problems associated with interpreting these terms consistently. Thus, to the extent that supplemental assessments remain intact after an overruling decision, so does the complexity of the system being overturned.

Second, to continue with supplemental assessments would mean a continuation of unequal treatment of similarly situated taxpayers. This could occur especially under a system of cyclical reappraisals, where each neighborhood is reappraised, say, once every third year. With supplemental assessments, we could be faced with the same sort of inequities among neighbors that exist under Proposition 13.

▸Repeal Other Statutes Exclusively Accommodating Acquisition Value Assessments

The statutes associated with implementation of Proposition 13 should be reviewed and repealed where necessary to ensure uniform treatment of the state's taxpayers after a conversion. In some cases, amendments limiting the effect of the statute will serve better than a total repeal.

▸Adopt a One-time Phase-in for Increases to Individual Assessments

Whatever the makeup of a new system, we must remember the reasons Proposition 13 came about in 1978. In a nutshell, taxpayers were fed up with large annual increases in their property tax bills. In order to assure that the taxpayer is not subjected to the same kind of treatment as before Proposition 13, the Legislature should be prepared to develop whatever constitutional amendments are necessary to avoid the problems that drove voters to enact Proposition 13.

The basic flaw in the pre-1978 system was this: the magnitude of increases in property tax bills correlated directly with the increases in the market value of the property. We saw that in a highly inflationary real estate market, with no ceiling on revenue increases, this situation was politically unworkable.

Probably the only way to ensure that taxpayers do not revolt against the new system as they did in 1978 is to place some sort of temporary ceiling on increases to particular assessments from one year to the next. That way, property owners could have the equity of a current market value system and still keep the predictability that they obviously demanded when they approved Proposition 13.

▸Provide Funding for Additional Assessment Appeals Hearing Officers

Generally, assessment appeals are handled either by an assessment appeals board or by a county board of supervisors meeting as a board of equalization. All but a few counties rely exclusively on one or the other of these bodies to process their appeals.

However, the Legislature has provided for a less formal appeal process, designed mainly for homeowners. Thus, at the county's option, procedures may be adopted which authorize hearings before assessment hearing officers. Although hearing officers are used by only a handful of counties currently, the anticipated increase in appeals activity after an overruling decision would warrant increased utilization of this process.

Specifically, in order that the expected increase in the numbers of appeals are handled expeditiously, the possibility should be recognized that additional hearing officers will have to be hired and trained. Obviously, such an increase in the number of hearing officers will have to be funded in some way.

▸Develop or Modify Programs to Provide Tax Relief to Homeowners and Senior Citizens

Homeowners

The Homeowners' Exemption has remained at $7,000 of assessed value per qualifying dwelling for 20 years. When the exemption was increased to $7,000 for the 1973 lien date, it fully exempted many of the most modest homes in the state and provided significant relief to all but the most expensive homes. With the relief provided by Proposition 13, there has been little incentive to increase the exemption.

If there is a return to market value, the Legislature should increase the Homeowner's Exemption to a level commensurate with the relief provided 20 years ago. The level of exemption should be set by an inflation index (1972-1992) and should, by statute, be revised periodically to adjust for future inflation. A significant increase in the Homeowner's Exemption would relieve if not eliminate an increase in post-13 taxes for most low-income homeowners.

Senior Citizens

There are two existing state programs that provide property tax relief to senior citizens who cannot afford to pay property taxes on their homes: one is a tax relief program administered by the Franchise Tax Board, and the other is a tax postponement program administered by the Controller's Office. Both of these programs serve to protect senior citizens from losing their homes due to property taxation. Since neither of these is a Board of Equalization program, we make no specific recommendations regarding the programs. However, we believe they should be reviewed to determine whether the limitations on the programs, such as the household income limitation, are appropriate for

today's price levels and other factors. The programs should be modified if necessary to provide protection for senior citizens, and their availability should be widely publicized.

▸Enact Statutes to Control Property Tax Revenues and Rates

Although precise data are not available, a return to a current market value system could result in a statewide assessed value increase of approximately 50 per cent, over and above the normal increase that would be expected due to new construction and other growth. Although the rate of increase will not be uniform from county to county, it nevertheless suggests a massive tax windfall.

A tax windfall can be avoided by appropriate reductions to the property tax rate. Section 20 of Article XIII empowers the Legislature to provide for maximum property tax rates for local governments.[9]

An effective way to provide for a maximum property tax rate is to set limits on the amount of property taxes that may be collected by school districts, counties, and other local agencies. After delivery of the assessment roll, the county auditor would calculate the maximum property tax rate (but in any case subject to the 1 percent limit required by section 1 of Article XIII A), and the county board of supervisors would adopt either that maximum rate or may adopt a lower rate.

A substantial reduction in the tax rate would reduce taxes for taxpayers whose property is currently assessed at or near market value, would provide tax neutrality for taxpayers whose property is currently assessed at the average ratio of assessed value to full value, and would cushion the impact of increased assessments for taxpayers whose properties enjoy relatively old base year values.

We have pointed out that there will be a substantial increase in costs for assessors' offices and assessment appeals boards, there may be increased costs for the property tax functions of the Board of Equalization, and there may be other increased costs related to

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[9]A property tax rate authorized by the Legislature could not exceed the one-percent limit required by Section 1 of Article XIIIA.

a change to a current market value system. These increased costs should be very minor in relation to the total amount of property taxes to be collected, but in light of the severe restraints on both local and state governments, it is not reasonable to expect government to absorb significant new responsibilities without adequate resources.

▸Direct the State Board of Equalization to Adopt Emergency Regulations as Needed

The State Board of Equalization is presently required by law to provide regulations governing assessors and county boards of equalization (including assessment appeals boards). These regulations ("rules"), contained in Title 18 of the California Code of Regulations, are critical for achieving uniformity in assessment practices among California's 58 counties. In order to protect the public and other interested parties from arbitrary or unnecessary rules, adoption or amendment of a rule is a somewhat complex, time-consuming procedure.

The Legislature should provide that in the event the Supreme Court requires an alteration to California's property tax system, the State Board of Equalization is expressly authorized to adopt and amend regulations on an emergency basis to provide certainty and uniformity in the tax assessment process.

▸Develop a Public Information Program to Explain to the Public the Need For and the Fairness of the New Tax Program

The public will naturally have grave concerns about property taxes in the event the Supreme Court invalidates the assessment provisions of Proposition 13. Taken to the extreme, such concerns could cause people to avoid purchasing a home, could discourage business and industry from moving to or expanding their operations in California, and could lead to a poorly-devised but appealing initiative to replace Proposition 13 with a system that has serious flaws.

The Board of Equalization believes that the Legislature, with the assistance of Board staff, county assessors and responsible public groups (such as industry associations and taxpayer coalitions), can devise a property tax assessment system that is fair, that provides adequate revenue to schools and government, and, most

importantly, that is not unduly burdensome on the taxpayers. The public needs to be assured that such a system is being implemented. The public needs to have a well-publicized, clear explanation of how the new system will work and how their tax bills will be affected by the change.

Thus, our final recommendation is that the state promote (fund) a public relations campaign that would inform taxpayers of the positive aspects of the new system.