

Issue Paper Number 00-041



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

MANDATORY AUDITS VERSUS ALL AUDITS PROPERTY TAX RULE 305.3

I. Issue

Should Property Tax Rule 305.3 interpret the equalization provisions of Revenue and Taxation Code section 469 as applying only to mandatory audits, or should the rule interpret those provisions as applying to all audits conducted by a county assessor?

II. Staff Recommendation

Staff recommends that Property Tax Rule 305.3 interpret the equalization provisions as applying only to mandatory audits, that is, those audits required by section 469 at least once each four years for taxpayers engaged in a profession, trade, or business who own, claim, possess or control locally assessable trade fixtures and business tangible personal property with a full value of \$400,000 or more.

III. Other Alternative(s) Considered

The Rule should interpret the equalization provisions of section 469 as applying to all audits conducted by a county assessor's office. (California Taxpayers' Association proposal)

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IV. Background

Under Government Code section 15606, subdivision (c), the Board is given the power and duty to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Pursuant to that authority, the Board directed staff to draft a new section 305.3 of Title 18 of the California Code of Regulations, Subchapter 3, Local Equalization Property Tax Rules, to interpret provisions of Revenue and Taxation Code section 469 relating to assessment appeal rights and appeals boards' jurisdiction to equalize escape assessments resulting from audits performed pursuant to that section.

Revenue and Taxation Code section 469 requires that a county assessor audit at least once each four years the assessable trade fixtures and business tangible personal property with a full value of \$400,000 or more owned, claimed, possessed or controlled by a taxpayer engaged in a profession, trade, or business. Section 469 further provides in the fourth paragraph:

If the result of an audit for any year discloses property subject to an escape assessment, then the original assessment of all property of the assessee at the location of the profession, trade, or business for that year shall be subject to review, equalization and adjustment by the county board of equalization or assessment appeals board pursuant to Chapter 1 (commencing with Section 1601) of Part 3 of this division, except in those instances when the property had previously been equalized for the year in question.

The paragraph was added by 1978 legislation amending section 469. Prior to the amendment, a taxpayer could only appeal escape assessments following an audit. In a letter to Governor Edmund G. Brown, Jr., dated August 31, 1978, the sponsors of the amendment (the Taxation Section of the California State Bar) expressed the intent of the legislation as follows:

The bill would allow a business taxpayer of property tax to have his entire assessment for a particular year at a business premises to be reviewed and equalized when the assessor by reason of an audit proposes an escape assessment. The bill is needed because many taxpayers do not protest assessments when the overall assessment at a business premises seems fair, even though some components are over-assessed and some under-assessed. Then, years later the assessor by reason of audit, proposes an escape assessment for the under-assessed component. Under the present law, the taxpayer has no redress for the over-assessed component at the late date of the proposed escape assessment.

Thus, the amendment was intended to address situations where:

- A taxpayer was satisfied with an overall property assessment, even while recognizing that he/she was not in agreement with the assessor's allocation to various parts of the overall assessment.
- Subsequently, the assessor conducted an audit that resulted in an escape assessment, thereby increasing the overall assessment for the property for a particular year.
- Following the audit, the taxpayer could only challenge the escape assessment even though the taxpayer had previously recognized that the assessment allocations were incorrect.

A difference of opinion over the application of the foregoing provision has led to the proposal for a new Property Tax Rule to interpret and to make specific its language. Property Taxes Department staff and Legal Division staff drafted proposed Property Tax Rule 305.3 after receiving input from the California

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Association of Clerks and Election Officials, California Assessors' Association, County Councils' Association of California, California Taxpayers' Association, and industry representatives.

On February 25, 2000, staff held a meeting in Sacramento with interested parties for discussions in an effort to reach agreement on as many issues as possible. Staff and interested parties were unable to reach agreement on several key issues and, therefore, it was decided that the rule writing process would be accomplished in two stages.

First, each unresolved issue and the parties' positions on each issue would be presented to the Property Tax Committee for decision. Second, the rule would be redrafted in accordance with the Board's positions on the issues, and then resubmitted to interested parties for review and comment. The redrafted Property Tax Rule would then be presented to the Property Tax Committee for approval of the language.

At the Property Tax Committee meeting on April 5, 2000, the Board was asked to decide five major unresolved issues. However, at the request of some interested parties, the Members decided at the April 5 meeting to delay the rulemaking process until November 1, 2000 because the case of *Heavenly Valley v. El Dorado County Board of Equalization* was pending before the court of appeal. At issue in the case is the proper interpretation of some aspects of the equalization provisions of Revenue and Taxation Code section 469. The oral arguments in the *Heavenly Valley* case are now set for hearing on November 13, 2000.

As instructed at the April 5 Property Tax Committee meeting, staff now requests direction on five major issues surrounding the equalization provisions of section 469 of the Revenue and Taxation Code which will be presented in this issue paper and four other issue papers.

V. Staff Recommendation

Property Tax Rule 305.3 should specify that the equalization provisions apply only to mandatory audits.

A. Description of the Staff Recommendation

A county assessor has the legal authority pursuant to Revenue and Taxation Code sections 441, 442, 469, and 470 and Corporations Code section 1506 to conduct audits of taxpayers' business books and records for property tax purposes. However, section 469 requires that an assessor audit at least once each four years the books and records of a taxpayer engaged in a profession, trade or business who owns, claims, possesses or controls tangible business personal property and fixtures with a full cash value of \$400,000 or more. The specific language makes clear that the Legislature intended that only mandatory audits should be conducted pursuant to section 469. Thus, because section 469 specifically authorizes and governs only mandatory audits, the equalization provisions and other provisions of that section are applicable only for escape assessments resulting from mandatory audits.

Furthermore, the legislative history of section 469 indicates an intent that the equalization provisions would apply only to mandatory audits. Section 469 was added to the Revenue and Taxation Code in 1966 as a single paragraph setting forth the conditions under which an assessor was required to conduct an audit. Section 469 was later amended to add the equalization provisions while similar equalization provisions were not added to the other audit statutes, Revenue and Taxation Code sections 441, 442, 470 or Corporations Code section 1506. Thus, the Legislature saw a need to provide specific statutory authority for mandatory audits and, when it added the equalization provisions, intended that they should apply only to mandatory audits as prescribed by section 469.

In addition, section 1605 prescribes filing requirements/procedures for a reduction in an assessment made outside of the regular assessment period, including escape assessments. Section 1605, subdivision (e), sets forth the equalization provisions of section 469 and specifically states that those provisions are applicable to audits conducted pursuant to section 469. Section 1605 does not reference audits conducted pursuant to any other code sections.

B. Pros of the Staff Recommendation

An interpretation that the equalization provisions of section 469 apply only to mandatory audits conducted pursuant to section 469 accords with the intent of the Legislature, and will confirm a long-standing Board staff position. All case law interpreting section 469 involves issues arising from mandatory audits.

C. Cons of the Staff Recommendation

The staff recommendation would result in unfair treatment of those small business taxpayers whose tangible business personal property and fixture have a value less than \$400,000 and, therefore, whose property is not subject to mandatory audit. Those taxpayers may appeal only the value of property subject to escape assessment, but may not seek the equalization of the original assessment of all property, as is the case for taxpayers with property and fixtures over the \$400,000 value threshold. Thus, those small business taxpayers are not afforded the same remedy for possible value misallocation made in the original assessment which the equalization provisions were intended to provide.

D. Statutory or Regulatory Change

Action by the Board to adopt a Property Tax Rule interpreting the equalization provisions of section 469 will add section 305.3 to Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

None

2. Revenue Impact

None

G. Taxpayer/Customer Impact

Adoption of a Property Tax Rule interpreting the equalization provisions of section 469 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

H. Critical Time Frames

There is no critical time frame for adoption of a Property Tax Rule interpreting section 469 since a county assessor conducts audits pursuant to section 469 on an ongoing basis. The 60-day period for filing an application appealing the result of an audit disclosing property subject to an escape assessment commences on receipt of the proper notice of the escape assessment. Consequently, the equalization provisions of section 469 provide for the filing of an application for an equalization hearing before a local board of equalization or county assessment appeals board throughout the year.

VI. Alternative 1

A. Description of the Alternative (California Taxpayers' Association proposal)

The equalization provisions of section 469 should be interpreted as applying to all audits conducted by a county assessor's office. That is, the second, third, fourth and fifth paragraphs of section 469 apply to audits conducted pursuant to Revenue and Taxation Code sections 441, 442, 469, and 470 and Corporations Code section 1506. The alternative eliminates the unequal treatment of taxpayers subject to mandatory audits and those subject to nonmandatory audits by affording all taxpayers the right to appeal all property except that property previously equalized.

By limiting the application of the equalization provisions to mandatory audits, an assessor has an incentive to perform a superficial mandatory audit with a no change result and later conduct a nonmandatory audit that discloses property subject to escape assessment. In that event, the taxpayer would have the right to appeal only the property for which an escape assessment has been made.

It makes no sense that some or all of the protections afforded by section 469 should apply only to mandatory audits. The language and structure of section 469 confirms that the legislature intended all provisions of section 469 except the first paragraph to apply to all audits. The second paragraph of section 469 requires that "upon completion of an audit" the taxpayer shall be given the assessor's findings. Paragraph four specifies that the taxpayer is afforded an appeal right if the "result of an audit for any year discloses property subject to escape assessment."

This alternative would promote a liberal construction of a taxpayer's right to file an application with an appeals board to challenge the assessment of his/her property.

B. Pros of the Alternative

This alternative eliminates the disparity in treatment between taxpayers subject to mandatory audits and those subject to nonmandatory audits by applying the equalization provisions of section 469 to all audits. All taxpayers who are audited by a county assessor, regardless of the value of their assessable trade fixtures and business tangible personal property, would have the same opportunity to file an application for equalization of all property at the location of the business, trade or profession when the result of the audit disclosed property subject to escape assessment.

C. Cons of the Alternative

This alternative would not be consistent with the legislative intent and plain language of section 469 which indicate that all provisions of section 469 apply for mandatory audits of taxpayers with personal property and fixtures above the stated value threshold. Furthermore, section 1605, subdivision (e), prescribes application filing requirements/procedures and incorporates the provisions of section 469, which provisions apply only to mandatory audits. The application filing requirements for appeals of escape assessments disclosed by audits conducted pursuant to Revenue and Taxation

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Code sections 441, 442, 470 and Corporations Code section 1506 are set forth in section 1605, subdivision (a), whereby the assessee may appeal the escape assessment only.

D. Statutory or Regulatory Change

Action by the Board to adopt a Property Tax Rule interpreting the equalization provisions of section 469 will add section 305.3 to Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact**1. Cost Impact**

None

2. Revenue Impact

None

G. Taxpayer/Customer Impact

Adoption of a Property Tax Rule interpreting the equalization provisions of section 469 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

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