

Issue Paper Number **09-004**



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

Amendments to Property Tax Rules 192, 193, and 371

I. Issue

Should the State Board of Equalization (Board) authorize publication of amendments to Property Tax Rule 192, *Mandatory Audits*, Property Tax Rule 193, *Scope of Audit*, and Property Tax Rule 371, *Significant Assessment Problems*?

II. Alternative 1 - Staff Recommendation

Staff recommends that the attached proposed amendments to Property Tax Rule 192, *Mandatory Audits*, Property Tax Rule 193, *Scope of Audit*, and Property Tax Rule 371, *Significant Assessment Problems*, be adopted and authorized for publication (see Attachment A).

III. Other Alternative(s) Considered

None

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. In compliance with this duty, the Board has adopted Property Tax Rules relative to the business personal property audit programs within the county assessors' offices.

Assembly Bill 550 (Ch. 297, Stats. of 2008) amended Revenue and Taxation Code section 469 and became effective on January 1, 2009. This bill changed the requirements for what was commonly known as a *mandatory audit* by county assessors. The bill deleted the requirement that an assessor must audit every four years taxpayers that own, claim, possess, or control locally assessable trade fixtures and business tangible personal property with a full value of at least \$400,000. Instead, an audit program must be established by county assessors consisting of a "significant number of audits" as specified in Revenue and Taxation Code section 469.

V. Discussion

Staff of the Property and Special Taxes Department, County-Assessed Properties Division, initiated a project to amend Property Tax Rules 192, 193, and 371 to clarify the amendments to Revenue and Taxation Code section 469. Interested parties were provided with proposed draft language for the rules on May 20, 2009 (Letter To Assessors 2009/022) and invited to participate in the rulemaking effort. All comments received were incorporated into the revised drafts (Attachment A). On July 9, 2009, the California Assessors' Association, Executive Ad Hoc Committee—Mandatory Audit Level, advised that the revised rule language was acceptable.

VI. Alternative 1 - Staff Recommendation

Adopt and authorize for publication amendments to Property Tax Rule 192, *Mandatory Audits*, Property Tax Rule 193, *Scope of Audit*, and Property Tax Rule 371, *Significant Assessment Problems*. The primary focus of the proposed amendments is to reflect changes to Revenue and Taxation Code section 469.

A. Description of Alternative 1

Staff recommends that the attached proposed amendments to Property Tax Rule 192, *Mandatory Audits*, Property Tax Rule 193, *Scope of Audit*, and Property Tax Rule 371, *Significant Assessment Problems*, be adopted and authorized for publication (see Attachment A). Proposed amendments to the rules include:

1. Changing the title of Property Tax Rule 192 to eliminate the word "mandatory" from the title.
2. Adding language to define terms used in recently amended Revenue and Taxation Code section 469.
3. Deleting language that requires county assessors to audit every four years taxpayers that own, claim, possess, or control locally assessable trade fixtures and business tangible personal property with a full value of at least \$400,000.
4. Adding language that clarifies the new "significant number of audit" procedures required by Revenue and Taxation Code section 469.
5. Adding language to Rule 193 to clarify that a county assessor cannot forego an audit if in the fiscal year first selected for audit no escape was found but an overassessment did occur.
6. Adding language to provide examples of the new audit procedures.

B. Pros of Alternative 1

Amendments to Property Tax Rules 192, 193, and 371 will provide clarification for county assessors regarding new audit procedures required by the amendments to Revenue and Taxation Code section 469.

C. Cons of Alternative 1

None

D. Statutory or Regulatory Change for Alternative 1

Action by the Board to adopt changes to Property Tax Rules 192 and 193 will amend Title 18 of the California Code of Regulations, chapter 1, subchapter 2, sections 192 and 193. Action by the Board to adopt changes to Property Tax Rule 371 will amend Title 18 of the California Code of Regulations, chapter 1, subchapter 4, section 371.

E. Operational Impact of Alternative 1

None

F. Administrative Impact of Alternative 1

1. Cost Impact

Development of Property Tax Rules is within the scope of the statutory duties of the County-Assessed Properties Division and will be absorbed by existing staff.

2. Revenue Impact

None

G. Taxpayer/Customer Impact of Alternative 1

None

H. Critical Time Frames of Alternative 1

None

VII. Other Alternatives

A. Description of Alternative

N/A

Preparer/Reviewer Information

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Current as of: August 28, 2009

Rule 192. ~~MANDATORY AUDITS. SELECTION.~~

Reference: Sections 106, 469 and 470, Revenue and Taxation Code.

Authority: Section 15606, Government Code.

(a) DEFINITIONS. For purposes of this regulation:

(1) "Personal property" means all property except real property.

(2) "Business tangible personal property" means personal property used in a profession, trade, or business, and shall include vessels and/or aircraft if used in a profession, trade, or business.

(3) "Trade fixtures" means any fixtures that are used in connection with a trade or business.

(4) "Farming" is a business. When conducting an audit pursuant to this section of a farming or ranching operation, the assessor must determine whether any racehorses taxable to the same taxpayer pursuant to Part 12 of Division 1 of the Revenue and Taxation Code have been underreported or escaped assessment.

(5) "Significant number of audits" means at least 75 percent of the fiscal year average of the total number of audits the assessor was required to have conducted from the 2002–03 fiscal year to the 2005–06 fiscal year, inclusive, on those taxpayers in the county that had a full value of four hundred thousand dollars (\$400,000) or more of locally assessable trade fixtures and business tangible personal property.

(6) "Taxpayers with largest assessments" means taxpayers that have the largest assessments of locally assessable trade fixtures and business tangible personal property in the county for the applicable year of audit selection.

(b) GENERAL PROVISIONS. ~~(a) HOLDINGS EQUALING OR EXCEEDING THE MINIMUM IN FOUR CONSECUTIVE YEARS.~~ The assessor must annually conduct a significant number of audits of the books and records of ~~When a~~ taxpayers engaged in a profession, trade or business ~~who~~ owns, claims, possesses, or controls locally assessable trade fixtures and business tangible personal property in ~~the any~~ county which according to the assessor's records, has a combined full value that equals or exceeds the amount specified by Section 469 of the Revenue and Taxation Code for each of four consecutive lien dates, the assessor shall complete an audit of the taxpayer's books and records to encourage the accurate and proper reporting of property.

~~(1) at least once within the four fiscal years following the first of such four consecutive lien dates, and~~

~~(2) at least once thereafter within each four-year period following the latest fiscal year covered by the preceding audit until relieved of this responsibility by subdivision (b) of this section.~~

~~Upon completion of an audit of the taxpayer's books and records, the taxpayer shall be given the assessor's findings in writing with respect to data that would alter any previously enrolled assessment.~~

(c) SIGNIFICANT NUMBER OF AUDITS. If the computation of the significant number of audits, as defined in subdivision (a)(5), does not result in a whole number, the number must be rounded before calculating the number of audits that must be performed on taxpayers selected from the pool of taxpayers with the largest assessments and the number of audits that must be performed on taxpayers selected from the pool of all other taxpayers in the county.

(1) Fifty percent of the significant number of audits must be performed on taxpayers selected from the pool of taxpayers with largest assessments.

(A) This pool of taxpayers must be selected from a list of taxpayers in the county, ranked in descending order by the total locally assessed value of both trade fixtures and business tangible personal property.

(B) The qualified number of those taxpayers for inclusion in the pool must be that number equal to 50 percent of the significant number of audits multiplied by four.

(C) All taxpayers in the pool must be audited at least once within each four-year period following the latest fiscal year covered by a preceding audit and the audit may combine multiple fiscal years.

(D) The assessor is relieved of the requirement to audit the taxpayer at least once every four years if the assessor determines that the taxpayer's assessments are no longer large enough for inclusion in the pool. If such is determined, then the next ranking taxpayer not currently within the pool of taxpayers with the largest assessments must be added to the pool.

(E) The assessor is not required to audit a taxpayer that is fully exempt from property taxation under other provisions of law for purposes of the requirements of this section. Therefore, a taxpayer fully exempt from property taxation must not be included in the pool of taxpayers with the largest assessments.

(2) The remaining 50 percent of the significant number of audits must be selected by the assessor from among the pool of all taxpayers.

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(A) These audits must be selected in a fair and equitable manner.

(B) These audits may be based on evidence of underreporting as determined by the assessor.

(3) If the significant number of audits is an odd number, the assessor must determine how to split the odd number audit.

~~(b) **HOLDINGS FALLING BELOW THE MINIMUM.** After such a taxpayer's holdings fall below the amount specified by Section 469 of the Revenue and Taxation Code on any one lien date, the assessor shall not be required to audit the taxpayer's books and records for that lien date and subsequent lien dates until the taxpayer's holdings again equal or exceed the amount specified by Section 469 of such code on four consecutive lien dates.~~

~~(c) **FARMING.** For purposes of this rule, farming is a business. The assessor, when making an audit pursuant to this section of a farming or ranching operation, shall determine whether any racehorses taxable to the same taxpayer pursuant to Part 12 of Division 4 of the Revenue and Taxation Code have been underreported or escaped assessment.~~

~~(d) **DEFINITIONS.** "Holdings" means the taxable value of locally assessable fixtures and the full cash value of locally assessable business personal property in the county.~~

~~A "fiscal year" is the governmental fiscal year of July 1 through June 30. "Fixtures" means any fixtures whose use or purpose directly applies to or augments the process or function of a profession, trade, or business.~~

~~(ed) **OTHER AUDITS.** Nothing herein shall be construed to prohibit an assessor from auditing the books and records of any taxpayer or for any period for which audits are not required by paragraph (a) more frequently than once every four years.~~

(e) **EXAMPLES.** The following hypothetical examples illustrate the audit selection process.

Example 1: Prior to January 1, 2009, a county with a total number of mandatory audits of 800 during the 2002-2003 fiscal year to the 2005-2006 fiscal year was required to conduct 200 audits ($800 \div 4$) per year. This county's significant number of audits that must be conducted annually is 150 ($75\% \times 200$). Of the 150 annual significant number of audits, 75 ($50\% \times 150$) must be from the pool of the taxpayers with the largest assessments, and 75 ($50\% \times 150$) must be selected from among the pool of all other taxpayers in the county. The number of taxpayers with the largest assessments that must be audited on a four year cycle is 300 ($150 \times 50\% \times 4$).

Example 2: Prior to January 1, 2009, a county with a total number of mandatory audits of 61 during the 2002-2003 fiscal year to the 2005-2006 fiscal year was required to conduct 15 audits ($61 \div 4 = 15.25$, rounded) per year. This county's significant number of audits that must be conducted annually is 11 ($75\% \times 15.25 = 11.4375$, rounded). Of the 11 annual significant number of audits, 5.5 ($50\% \times 11$) must be from the pool of the taxpayers with the largest assessments, and 5.5 ($50\% \times 11$) must be selected from among the pool of all other taxpayers in the county. The county assessor must determine how to split the odd number audit. The number of taxpayers with the largest assessments that must be audited on a four-year cycle is 22 ($11 \times 50\% \times 4$). Therefore, during a four-year cycle, the county assessor would be required to audit five from the pool of taxpayers with the largest assessments in the county and six from among the pool of all other taxpayers in the county each year for two years; and six from the pool of taxpayers with the largest assessments in the county and five from among the pool of all other taxpayers in the county each year for the remaining two years.

History: Adopted April 10, 1968, effective May 12, 1968.
Amended January 8, 1969, effective February 12, 1969.
Amended December 12, 1969, effective January 11, 1970.
Amended March 24, 1971, effective April 25, 1971.
Amended October 18, 1973, effective November 25, 1973.
Amended December 15, 1976, effective January 21, 1977.
Amended July 31, 1980, effective November 19, 1980.
Amended July 27, 1982, effective February 10, 1983.
Amended and effective May 29, 1996.

Amended December 22, 1997, effective January 21, 1998.

Rule 193. SCOPE OF AUDIT.

Reference: Sections 469, 502, 503, 531, 531.3, 531.4, 532, and 532.1, Revenue and Taxation Code.

Authority: Section 15606, Government Code.

(a) When auditing a taxpayer under the requirements of ~~section Rule 192,~~ an assessor may audit for only one of the fiscal years within the period specified in section 532 of the Revenue and Taxation Code if no discrepancy or irregularity is found in the fiscal year selected for audit unless one of the provisions of subdivision (b) apply.

(b) When a discrepancy or irregularity is found in the fiscal year first selected for audit, the assessor shall audit the remaining fiscal years for which the statute of limitations has not ~~run~~ expired unless ~~he~~ the assessor documents in the audit report his/her conclusion both that:

(1) the discrepancy or irregularity in the fiscal year first selected is peculiar to that fiscal year; and

(2) the discrepancy or irregularity did not ~~permit the assessment of~~ disclose:

(A) an escape assessment under the provisions of Revenue and Taxation Code sections 469, 502, 503, 531.3, or 531.4; or

(B) an error that resulted in property being incorrectly valued or misclassified that caused the property to be assessed at a higher value than would have been on the roll if the error had not occurred. The error that caused the property to be assessed at a higher value than would have been on the roll must be of "material value" as defined in Rule 305.3. under the provisions of sections 502, 503, 531.3 or 531.4 of the Revenue and Taxation Code.

(b) (c) If property of a taxpayer who meets the requirements of ~~section Rule 192~~ is selected by the California State Board of Equalization (Bboard) as an assessment sample item as part of its assessment practices surveys, the assessor of the county surveyed may consider the Board's audit findings of ~~the board's Assessment Standards Division~~ as the fulfillment of ~~section Rule 192,~~ providing no discrepancy or irregularity exists between the findings and the corresponding property statement or report and providing ~~he~~ the assessor maintains a copy of such findings in his/her files. If the assessor determines that the findings disclose a discrepancy or irregularity between the taxpayer's books and records and the corresponding property statement or report, ~~he~~ the assessor shall ascertain the cause and audit all years within the statute of limitations ~~applicable to escape assessments.~~

(e) (d) Nothing herein shall be construed to prohibit an assessor from auditing or reauditing any or all statements or reports for which the statute of limitations has not ~~run~~ expired or to define the circumstances in which property that has escaped assessment can be added to the roll.

(e) The statute of limitations may be extended through the execution of a mutually agreed upon waiver pursuant to Revenue and Taxation Code section 532.1.

History: Adopted April 10, 1968, effective May 12, 1968.
Amended December 12, 1969, effective January 11, 1970.
Amended January 16, 1985, effective February 15, 1985.

Rule 371. SIGNIFICANT ASSESSMENT PROBLEMS.

Reference: Section 75.60, Revenue and Taxation Code.

Authority: Sections 15643 and 15606, Government Code.

(a) For purposes of Revenue and Taxation Code ~~§~~section 75.60 and Government Code ~~§~~section 15643, “significant assessment problems” means procedure(s) in one or more areas of an assessor’s assessment operation, which alone or in combination, have been found by the Board to indicate a reasonable probability that either:

- (1) the average assessment level in the county is less than 95 percent of the assessment level required by statute; or
- (2) the sum of all the differences between the ~~b~~Board’s appraisals and the assessor’s values (without regard to whether the differences are underassessments or overassessments), expanded statistically over the assessor’s entire roll, exceeds 7.5 percent of the assessment level required by statute.

(b) For purposes of this regulation, “areas of an assessor’s assessment operation” means, but is not limited to, an assessor’s programs for:

- (1) Uniformity of treatment for all classes of property.
- (2) Discovering and assessing newly constructed property.
- (3) Discovering and assessing real property that has undergone a change in ownership.
- (4) Conducting ~~mandatory~~ audits in accordance with Revenue and Taxation Code ~~§~~section 469 and ~~Property Tax Rule 492~~.
- (5) Assessing open-space land subject to enforceable restriction, in accordance with Revenue and Taxation Code ~~§~~sections 421 et. seq.
- (6) Discovering and assessing taxable possessory interests in accordance with Revenue and Taxation Code ~~§~~sections 107 et. seq.
- (7) Discovering and assessing mineral-producing properties in accordance with Property Tax Rule 469.
- (8) Discovering and assessing property that has suffered a decline in value.
- (9) Reviewing, adjusting, and, if appropriate, defending assessments for which taxpayers have filed applications for reduction with the local assessment appeals board.

(c) A finding of “significant assessment problems,” as defined in this regulation, would be limited to the purposes of Revenue and Taxation Code ~~§~~section 75.60 and Government Code ~~§~~section 15643, and shall not be construed as a generalized conclusion about an assessor’s practices.

History: Adopted February 4, 1997, effective May 16, 1997.