



January 14, 2014

Ms. Sherrie Kinkle, Tax Administrator
State Board of Equalization
Delivered via e-mail to Sherrie.Kinkle@boe.ca.gov

RE: Assessors' Handbook on New Construction

Dear Ms. Kinkle:

CalTax has objections to portions of the proposed Assessors' Handbook on New Construction. To date, we have not made these objections public, as we prefer to work collegially with board staff in the interested parties' process. To avoid any misunderstanding, however, we want you to know that we will be making our concerns public when the proposed handbook is submitted to the board.

In short, portions of this handbook recommend that assessments on homes and other structures be increased when only a "portion" of a structure is remodeled. We believe this to be illegal, as it is inconsistent with statute, is unconstitutionally vague, will result in double taxation and will be harmful to the economy.

It is illegal

Contrary to board rule (Rule 473), the statute governing new construction does not permit adding to the Proposition 13 base-year value of property the value of remodeling a portion of a structure. Section 70(a) and (b) of the Revenue and Taxation Code read:

"(a) Newly constructed" and "new construction" means

1. Any addition to real property, whether land or Improvements, including fixtures, since the last lien date; and
2. Any alteration of land or of any improvement, including fixtures, since the last lien date that constitutes a major rehabilitation thereof or that converts the property to a different use

(b) Any rehabilitation, renovation or modernization that converts an improvement or fixture to the substantial equivalent of a new improvement or fixture is a major rehabilitation of that improvement or fixture."

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This is the language that was suggested by the Task Force on Property Tax Administration. The Task Force, which I chaired, was formed by the Assembly after the passage of Proposition 13 to develop a plan for implementing the property tax provisions of the initiative. The phrase "or portion thereof" does not appear in subdivision (a) or (b) of current statute, which is the same as the Task Force recommendation.

One cannot read "or portion thereof" into Section 70(a) and (b), because the Legislature clearly knew how to distinguish when "a portion thereof" would trigger a reassessment, as it used the phrase as a modifier in Section 70(c), relating to property destroyed or damaged by a disaster.

Section 70(c) reads as follows (emphasis added):

"Notwithstanding subdivisions (a) and (b), where real property has been damaged or destroyed by misfortune or calamity, "newly constructed" and "new construction" does not mean any timely reconstruction of the real property, or portion thereof, where the property after reconstruction is substantially equivalent to the property prior to damage or destruction. Any reconstruction of real property, or portion thereof, that is not substantially equivalent to the damaged or destroyed property, shall be deemed to be new construction and only that portion that exceeds substantially equivalent reconstruction shall have a new base year value determined pursuant to Section 110.1."

The Task Force drafted this language to capture the intent of the majority not to assess remodeling, unless it converts the entire structure to the equivalent of new. I explained the language to the Assembly Revenue and Taxation Committee, including the intent, and it was included without change in legislation carried by the Committee Chair, Assemblyman Willie Brown. As the committee's chief consultant, I accompanied Assemblyman Brown at each hearing to aid Mr. Brown in explaining the proposal.

As I recall, some of the reasons for the limits on new construction assessment were:

The Task Force wanted to limit the number of different base years attached to a single property that would occur if a reassessment of a portion of a structure was permitted.

The Task Force wanted to encourage property owners to renovate and remodel properties without fear of a reassessment. If remodeling a portion of a structure triggers a reassessment, it would have a chilling effect on the remodeling business.

The Task Force did not believe that the value added by remodeling a portion of a structure could be determined with great accuracy. The cost approach for determining value would not be appropriate, as the value of a structure usually is not increased commensurately with the cost of the remodeling. This is common knowledge in the remodeling business. To use the sales factor correctly, one would have to find a

comparable structure with a sale before and after the same remodeling. The income approach also would not get us to the added value of any of the remodeled portion of a dwelling.

At the time the language was drafted, the Task Force was critical of the Board of Equalization's interpretation of "new construction" that the board adopted (as Rule 473) on August 22, 1978, after passage of Proposition 13. The Task Force rejected that approach. In response, board staff submitted a minority report, signed by Larry Augusta*, opposing the Task Force recommendation. The board recommended that the definition of new construction should be left to board rule. Apparently, the board implemented this suggestion in its minority report, despite the passage of legislation and this is why the current board rule defining "new construction" is inconsistent with statute. In this new handbook, the staff is following board rule, instead of statute. We do not know of any authority that allows the board to trump a statute with a regulation.

It is unconstitutionally vague

On page 9, the term "portion or portion thereof" is defined as a "component of an individual structure or a fixture that is easily recognized. It is part of an individual structure or fixture that is designed for independent or separate use such as a bathroom or a kitchen in a residence..." From this, no homeowner can figure out what home improvements will be assessed and what will not. Replacing toilets may or may not be reassessable. If kitchen appliances and cabinets are not reassessable (page 27), how is a component of a structure designed for separate use, such as a kitchen, reassessable? (page 9) Further, by exempting certain items on page 27, one can infer that all other items, such as replacing furnaces or wall heaters, or everything else will create a reassessment.

It will result in double taxation

The current Proposition 13 base-year values of kitchens and bathrooms recommended for reassessment in this document are already included the base-year value of homes. If the value of the new construction of a portion of property is to be added to the assessed value, the original value of such improvements must be removed from the original base-year value of the structure. Otherwise, the original components and the new components both will be taxed. How do you propose to remove the value of the original components from base year values, particularly since the board is aware that assessments are made on appraisal units, not individual components? We believe that it will be impossible to separate the value of the components of the original appraisal unit value of a structure and, as a result, the recommendations in this handbook will sanction double taxation.

*Note: Larry Augusta, Margaret Shedd, Bob Gustafson and Jeff Reynolds were the official representatives of the State Board of Equalization on the Task Force. Other participants were Vern Walton and Walt Senini.

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It will be harmful to the economy

When the word gets out that the State Board of Equalization is recommending that assessors increase the value of homes and other structures when a "portion thereof" is remodeled, there will be a drop in remodeling. It will have a direct and negative effect on the remodeling business. This drop in business may result in worker layoffs, and less income tax and sales tax revenue. I hope you will agree that this is undesirable.

For these reasons, CalTax believes this handbook is fatally flawed and should not be adopted.

Sincerely,

A handwritten signature in black ink that reads "David R. Doerr". The signature is written in a cursive style with a large, stylized 'D' and 'R'.

David R. Doerr
Chief Tax Consultant