

Issue Paper Number 05-008



BOARD OF EQUALIZATION  
**KEY AGENCY ISSUE**

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

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## **ASSESSMENT OF STRUCTURES REPAIRED OR REBUILT FOLLOWING DAMAGE OR DESTRUCTION IN A DISASTER**

### **I. Issue**

Should the Board of Equalization issue to county assessors instructions to revise existing procedures for calculating the factored base year value of a structure that has been restored following damage or destruction from a disaster?

### **II. Staff Recommendation**

Staff recommends that the Board not issue such instructions; instead, the Board should allow its existing guidance to stand.

### **III. Other Alternative(s) Considered**

The Board could issue instructions to revise the existing procedures.

## IV. Background

### *Factored Base Year Values and Declines in Value*

Article XIII A and its implementing legislation provide that the annual assessment of a parcel of real property is to reflect the lower of (1) its base year value, adjusted each year by an inflation factor not to exceed 2 percent, or (2) its current market value. In general, for any particular assessment year, the lower of these two figures establishes the property's taxable value. These same authorities provide, in accordance with constitutional amendments enacted by Proposition 8, that a property's assessed value may be reduced to reflect declines in value from damage, destruction, or any other cause.<sup>1</sup>

A property's base year value, annually adjusted by the inflation factor, is known as its *factored base year value*. Since a property's assessed value is always the lower of this figure or the property's current market value, the factored base year value places a ceiling on the property's assessed value. That is, regardless of any increases in the property's market value, its taxable value cannot be higher than its factored base year value. For example, if the property had a current market value of \$400,000, and its factored base year value was \$300,000, its taxable value would be the lower of the two figures, or \$300,000. Conversely, if the property had a current market value of \$400,000, but its factored base year value was \$500,000, its taxable value would be \$400,000.

### *Disaster Relief*

Other statutory provisions afford relief to an owner of property that has been damaged or destroyed in a disaster.<sup>2</sup> Under these provisions, the owner receives an immediate, temporary reduction in taxable value. The reduction in *assessed* value is in the same proportion as the loss in *market* value caused by the damage or destruction. In the case where a structure is totally destroyed, the assessed value of that structure is reduced to zero.

When a damaged structure is repaired or a destroyed structure rebuilt, the disaster relief provisions prescribe a procedure by which the temporary reduction is lifted, and a new taxable value established. This new taxable value is defined as the lower of (1) the property's current market value or (2) its prior factored base year value.<sup>3</sup> With respect to the re-enrollment of a structure's prior factored base year value, the current disaster relief provisions implement the procedure recommended in a 1979 report by the Task Force on Property Tax Administration (Task Force), a broad-based group of state and local policymakers, property tax administrators, and taxpayers. The Task Force was formed by the Assembly Revenue and Taxation Committee to study the impact of Proposition 13 upon local assessment procedures.

The result is that the property owner is afforded temporary relief during the time that the structure is in a damaged or destroyed state. Once the structure is repaired or rebuilt, the property owner is, for assessment purposes, returned to the same position that he or she would have held had the damage or destruction never occurred. Under section 170, the rebuilt structure must be "substantially equivalent" to the structure prior to the damage or destruction. Any reconstruction that is more than that which is substantially equivalent to the structure prior to the damage or destruction is deemed new construction, and is assessed at current market value as of the date of completion.

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<sup>1</sup> Article XIII A, section 2, California Constitution; Revenue and Taxation Code section 51.

<sup>2</sup> Revenue and Taxation Code section 170.

<sup>3</sup> Revenue and Taxation Code section 170, subdivision (h)(3).

### ***Supplemental Assessments***

Other statutory provisions provide that, upon the completion of new construction to real property, the additional market value created by the new construction forms the basis for a new base year value, which is assigned to the portion of the property that was newly constructed. The additional market value is also reflected in a one-time "supplemental assessment," which results in an additional tax bill. This bill, the supplemental tax bill, is pro-rated to reflect the time remaining in the fiscal year following the completion of the new construction.

Under the supplemental assessment statutes, just as an addition to real property results in a pro-rated tax *bill*, so does the removal of a structure result in a pro-rated tax *refund*. For supplemental assessment purposes, Board staff advice has been that the provision for removals also applies to a structure that has been completely destroyed by fire, with the result that victims of such calamities will receive pro-rated refunds.<sup>4</sup>

### ***Mr. Williamson's Theory***

In 2003 many homes in San Bernardino County were damaged or destroyed by wildfires. Because of "red tape" or other reasons, many homeowners there have been unable to quickly repair or rebuild their homes. County Assessor Don Williamson, in granting disaster relief to these homeowners, has taken the position that the annual inflation factor that would otherwise be applied to the damaged property's base year value should in effect be suspended (actual mechanism to be explained below) during the interim years before repair or rebuilding has been completed. In support of his position, Assessor Williamson has relied on (1) language in the State Constitution relating to declines in value, (2) the statutes implementing that language, and (3) the supplemental assessment statutes.

As to the Constitution, Mr. Williamson argues that the amendment to article XIII A known as Proposition 8 allows an assessor to refigure the factored base year value upon reconstruction following a disaster. Specifically, Mr. Williamson refers to article XIII A, section 2(b), which states that the base year value "may be reduced to reflect substantial damage, destruction, or other factors causing a decline in value." Mr. Williamson's view is that this language (as well as its implementing statute, Revenue and Taxation Code section 51, subdivision (b)) means that the inflation factoring should be modified if a structure is destroyed.

As to the supplemental assessment statutes, Mr. Williamson concludes that the provision that results in a pro-rated refund of taxes upon the removal of a structure (or the destruction of a structure by fire) also requires the establishment of a new base year value for the former structure. Where the structure is completely destroyed, Mr. Williamson argues, this new base year value is zero. Under Mr. Williamson's theory, the required annual inflation adjustment, inasmuch as it is applied to a figure of zero, has no arithmetical effect on the assessed value of the structure that is restored to the assessment roll once the structure has finally been repaired or rebuilt.

### ***Staff's Position***

Staff disagrees with Mr. Williamson's theory. First, staff's view is that the disaster relief provisions are clear in requiring that the annual inflation adjustment be applied each year to the prior base year value of the now destroyed structure, not to a newly established base year value of zero. It is the factored base year value that is eventually restored to the assessment roll once repair or rebuilding is complete.

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<sup>4</sup> Revenue and Taxation Code section 75.10; Letter To Assessors 86/09.

Staff also disagrees with Mr. Williamson's theory about the provision in the State Constitution that states that the base year value "may be reduced to reflect substantial damage, destruction, or other factors causing a decline in value." Staff refers to an appellate court decision that clarified that this language requires that the inflation factoring must be applied to the property's *original* base year value, "rather than a base calculated on any intervening downward reassessment...."<sup>5</sup>

Finally, staff disagrees with Mr. Williamson's use of the supplemental assessment statutes to support his position. First, the supplemental assessment statutes do not govern the establishment of base year values, except for supplemental assessment purposes. The establishment and calculation of base year values is governed by Revenue and Taxation Code sections 50 and 51. Further, while supplemental assessment statutes do require (for supplemental assessment purposes) a recalculation of the base year value for the property that *remains* following the loss of a structure, they do not suggest for any purpose that the now nonexistent structure should be assigned a temporary base year value of zero.<sup>6</sup>

## V. Staff Recommendation

### A. Description of the Staff Recommendation

Staff recommends that the Board allow its existing guidance on this issue to stand. Specifically, as to the application of section 170, we refer to existing advice contained in Assessors' Handbook Section 501, *Basic Appraisal*, which provides that "[w]hen the repair is complete, the property's factored base year value is restored to the assessment roll...."<sup>7</sup> Since in this context the meaning of the term "factored base year value" is understood to mean the property's factored base year prior to the damage or destruction, adjusted every year by the inflation factor, the guidance in the handbook is consistent with Board staff's longstanding position.

### B. Pros of the Staff Recommendation

- The Board's existing advice is consistent with the provisions of section 170 and the recommendation of the Task Force, which explained in its 1979 report, entitled *Property Tax Assessment: Implementation of Proposition 13*, that upon reconstruction following a disaster, the factored base year value to be re-enrolled should include inflation factoring for the years in the interim between the disaster and the reconstruction. The report contains an example that illustrates for a hypothetical property the effect of a value change due to a disaster and subsequent reconstruction. The report explained: "the prior base year value is reapplied, *with accumulated inflation factors....*" (Emphasis added.) See Attachment A.
- The Board's existing advice is consistent with a recent appellate court decision that reaffirmed the theory behind the longstanding practice of applying inflation factoring every year to a structure's original base year value.<sup>8</sup>
- Mr. Williamson is not supported by the California Assessors' Association in his view that the factored base year value to be enrolled upon completion of reconstruction should not include factoring for the years between the disaster and the reconstruction.

<sup>5</sup> *County of Orange v. Bezaire* (2004) 121 Cal.App.4<sup>th</sup> 117

<sup>6</sup> Revenue and Taxation Code section 75.10; Letter To Assessors 86/36.

<sup>7</sup> AH 501, January 2002, pp. 140-141.

<sup>8</sup> *County of Orange v. Bezaire, supra.*

- The Board's existing advice preserves equity between similarly situated taxpayers. Under Mr. Williamson's view, a property owner receiving disaster relief is not merely returned to the position that he would have held if the disaster had never occurred; rather, that property owner's position is made better, from a property tax perspective, than it would have been (and better than that of a neighbor who did not receive such treatment) since the inflation adjustments to his property's base year value will have been suspended between the time of the disaster and the reconstruction.

**C. Cons of the Staff Recommendation**

None

**D. Statutory or Regulatory Change**

None

**E. Administrative Impact**

None

**F. Fiscal Impact**

**1. Cost Impact**

None

**2. Revenue Impact**

None

**G. Taxpayer/Customer Impact**

None

**H. Critical Time Frames**

None

**VI. Alternative 1**

**A. Description of Alternative 1**

The Board could issue instructions to county assessors clarifying that the annual inflation factor that would otherwise be applied to a damaged property's base year value should be suspended during the interim years before repair or rebuilding has been completed. Such instructions would be in accord with Mr. Williamson's position that the supplemental assessment statutes require that a lost structure be assigned a temporary base year value of zero, to which inflation factoring would be applied, until such time as reconstruction is complete.

**B. Pros of Alternative 1**

This alternative would result in additional property tax relief for taxpayers whose property has been destroyed by a disaster.

### **C. Cons of Alternative 1**

- The alternative would be inconsistent with provisions of section 170 and the recommendation of the Task Force.
- The theory behind the alternative rests on interpretations of (1) the constitutional provisions related to declines in value, (2) the supplemental assessment statutes, and (3) the disaster relief provisions that are not shared by the members of Task Force, Board staff, or the California Assessors' Association. Applying Mr. Williamson's logic to the provision under section 170 that states that the "new taxable value" of the rebuilt structure is the lower of its current market value or its factored base year value, the value to be enrolled upon reconstruction would continue to be zero, since that is Mr. Williamson's "factored base year value."
- The alternative would create inequities between similarly situated taxpayers.

### **D. Statutory or Regulatory Change**

Amendments to section 170 would be required in order to make the alternative consistent with statutory provisions.

### **E. Administrative Impact**

Alternative 1, if implemented by all county assessors' offices, would cause considerable administrative impact in the form of procedural and computer software changes.

### **F. Fiscal Impact**

#### **1. Cost Impact**

The staff routinely drafts proposed guidelines, and any associated costs are accommodated within the Board's existing budget. There are no additional costs.

#### **2. Revenue Impact**

See attached Revenue Estimate.

### **G. Taxpayer/Customer Impact**

Alternative 1 would result in lower assessed values for taxpayers whose property has been destroyed by a disaster. Additionally, the alternative would create inequities between similarly situated taxpayers.

### **H. Critical Time Frames**

None

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