

Memorandum

To: Honorable Jerome E. Horton, Chairman
Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, First District
Senator George Runner, Second District
Honorable John Chiang, State Controller

Date: November 7, 2013

From: Randy Ferris
Chief Counsel



Subject: Report on Administrative Taxpayer Relief Following the California Supreme Court's Decision in *Elk Hills Power, LLC v. Board of Equalization* November 19-20, 2013 Board Meeting – Chief Counsel Matters – Item M

On August 12, 2013, the California Supreme Court issued its decision in *Elk Hills Power, LLC v. Board of Equalization* (2013) 57 Cal.4th 593 (*Elk Hills*). This case involves the property tax valuation of a power plant, whose construction and operation required the utilization and application of Emission Reduction Credits (ERCs). For the taxable years 2004 to 2008, the Board used the replacement cost approach (RCLD) to assess the unitary value of the plant. For the taxable years 2006 to 2008, the Board also relied on the income approach (CEA) to assess the unitary value of the plant.

The Supreme Court concluded that, with respect to the RCLD, the estimated cost of replacing the ERCs should not be included as a separate line item in the Board's replacement cost calculation.¹ Conversely, however, with respect to the CEA, the Court concluded that the Board was not required to deduct any costs or value attributable to the ERCs.

As a result of *Elk Hills*, certain similarly situated taxpayers may have claims for adjustments to their unitary value for the cost of ERCs included in their RCLD value indicators for lien date 2013 and for prior open years, to the extent that the RCLD was given weight.

¹ The Supreme Court, however, further clarified that, if the Board does not add the replacement cost of ERCs to its replacement cost valuation, then it need not deduct any amount from RCLD, since that would produce an unwarranted windfall for the taxpayer. (*Elk Hills, supra*, 57 Cal.4th at p. 617, fn. 11.)

Staff Recommended Reduction of Unitary Value – 2013 Taxable Year

For lien date 2013, subject to Board approval, Staff will reduce unitary value by removing the estimated costs of the applied ERCs from the RCLD value indicators either by: (1) recommending the granting of the petition, in part, to the extent of the ERCs included in the RCLD value indicators and the weight given to RCLD in the valuation, provided a petition was filed; or (2) if a petition was not filed, by recommending the cancellation of the unpaid portion of an assessment related to the costs of the applied ERCs included in the RCLD value indicators to the extent given weight in the valuation.

Refund Action in Court – Open Pre-2013 Taxable Years

For taxable years prior to 2013, taxpayers may file a tax refund action in court within four years after the latest of the dates that the Board mailed its notice of decision or its written findings and conclusions on the petition. (Rev. & Tax. Code, § 5148.) Such an action, however, may only be filed if the taxpayer has exhausted all administrative remedies by filing a timely petition that raises the ERC issue. (Rev. & Tax. Code, §§ 5148, subds. (e)(1), (f), (g)(1), 741.) The Supreme Court of California in *Steinhart v. County of Los Angeles* (2010) 47 Cal.4th 1298 (*Steinhart*), and the Supreme Court of the United States in *Jimmy Swaggart Ministries v. Board of Equalization of California* (1990) 493 U.S. 378 (*Swaggart*), both held that the requirement of exhausting administrative remedies applies even when the taxpayer challenges the legality of a tax under statutory or constitutional grounds.

Specifically, in *Steinhart*, the California Supreme Court held that under the governing tax refund action statutes, the taxpayer had to apply for reassessment reduction even though her claim “present[ed] a pure question of law,” and also that the taxpayer was required to exhaust administrative remedies despite her argument that the tax had been “illegally assessed or levied.” (*Steinhart, supra*, 47 Cal.4th at pp. 1309-1312.) Similarly, in *Swaggart*, the Supreme Court of the United States declined to reach the merits of appellant’s claim – despite appellant’s contention that the State’s imposition of use tax liability was unconstitutional and violated both the Commerce and Due Process Clauses – because the courts below had properly ruled that the claim was procedurally barred due to appellant’s failure to raise the constitutionality argument in its claim before the Board. (*Swaggart, supra*, 493 U.S. at pp. 397-398.)

Staff Audit – Open Pre-2013 Taxable Years

The State-Assessed Properties Division (SAPD) may exercise its audit authority to conduct a limited audit of taxpayers for open periods to remove the costs of ERCs from the RCLD value indicators. (See Gov. Code, § 15618; see also Rev. & Tax. Code, §§ 861, 864.) Because, as explained above, taxpayers who did not file petitions have no judicial remedy, such an audit would be limited to those taxpayers who have filed timely petitions in which ERCs were raised as an issue. An SAPD audit, as compared to a refund action, would result in significant time, efficiency, and administrative cost savings for the Board, the counties and taxpayers.

If an excessive assessment is identified, the overpayment would result in a roll-forward credit for taxable year 2014 in lieu of refunds. The statute of limitations for roll-forward credits on audits is four years from the date of the assessment (Rev. & Tax. Code, §§ 864, subd. (b), 4876); and

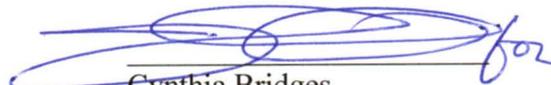
the date the assessment was made for taxpayers who filed petitions is the date the Board decided the petition. Accordingly, the audit period currently open is taxable years 2009 through 2012.² Taxable years prior to 2009 are barred by the statute of limitations.

Some taxpayers argue that, because the inclusion of ERCs in RCLD value indicators was deemed “illegal” in *Elk Hills*, not providing relief simply because of the failure to file a petition is inequitable. However, as discussed in detail above, no legal authority exists which would authorize staff to provide relief if a timely petition raising such issue was not filed. In fact, it is well-settled that, without exhaustion of administrative remedies, no refund action is available. (See *Steinhart, supra* [a taxpayer must exhaust its administrative remedies before bringing a property tax refund action in superior court]; *Plaza Hollister Ltd. Partnership v. County of San Benito* (1999) 72 Cal.App.4th 1, 34 [the timely filing of a proper claim for refund is a statutory prerequisite to a refund action]; *Osco Drug, Inc. v. County of Orange* (1990) 221 Cal.App.3d 189 [because it had filed a refund claim for only 1984, appellant was not entitled to refunds for 1981 through 1983, even though the 1981 base year value was lowered].) Accordingly, if a petition for reassessment has not been filed, administrative remedies have not been exhausted. (Rev. & Tax. Code, § 5148, subd. (e).)

Of course, a remedy to any perceived inequity may be fashioned by the Legislature. The Legislature has enacted such legislation in the past. For example, section 6909 was enacted to enable persons who paid the Smog Impact Fee, subsequently determined to be unconstitutional, to receive a refund of that fee even if the claim for refund would otherwise have been outside the statute of limitations. Also, the Legislature enacted section 62.1, subdivision (b)(4) to prohibit certain escape assessments and cancel taxes legally owed as a result of an assessor’s discovery of changes in ownership of portions of certain mobile home parks.

If you need more information or have any questions, please contact Robert Tucker, Assistant Chief Counsel, at (916) 322-0437 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

Approved:


Cynthia Bridges
Executive Director

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² For taxable year 2009, absent the filing of waivers to extend the statute of limitations, the Board must approve the audit by November 20, 2013, since the next Board hearing will be held on December 17, 2013, which is past the four-year statute of limitations.