

Rulemaking File Index

Title 18. Public Revenue

Proposed Property Tax Rules 462.060, 462.100, 462.160, 462.180, and 462.260
Amendment

Change in Ownership - Trusts,

1. *Original Petition dated March 21, 2011 from Mr. Stephen H. Bennett*
2. *Addendum to Petition, March 22, 2011*
3. *Addendum to Petition, March 24, 2011*
4. *Addendum to Petition, March 30, 2011*
5. *Addendum to Petition, April 1, 2011*
6. *Confirmation of Petition Receipt, April 15, 2001*
7. *Confirmation of Annotation Receipt, April 15, 2001*
8. *Public Comment from Richard Girgado, Deputy County Counsel, County of Los Angeles, April 18, 2011*
9. *Addendum to Petition, April 21, 2011*
10. *Addendum to Petition, April, 21, 2011*
11. *Chief Counsel Memo, Item J1 April 26, 2011*

The following items are exhibited:

- Chief Counsel Memo dated April 13, 2011
 - Chief Counsel Memo dated January 14, 2011
12. *Reporter's Transcript, Chief Counsel Matters, Item J1, April 26, 2011*
 13. *Confirmation of withdrawal of depublication, May 3, 2011*
 14. *Denial Letter, May 20, 2011*
 15. *Notice to OAL*
 - Form 400 and notice, May 20, 2011
 - Notice
 - CA Regulatory Notice Register 2011, Volume No. 20-Z
 16. *Letter from Stephen H. Bennett, May 24, 2011.*
 17. *Reply to May 24, 2011 Letter from Bradley Heller, May 25, 2011.*
 18. *Letter from Stephen H. Bennett, Date May 24, 2011, signed May 31, 2011.*



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March 21, 2011

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MAR 23 2011

Board Proceedings

Rick Bennion
Chief, Board Proceedings Division
State Board of Equalization
450 N Street
Sacramento, CA 95814

Re: Petitions to 1) Amend BOE Rules 462.060, 462.100, 462.160,
462.180, and 462.260 for Due Process, and 2) Depublish Annotations
that Apply Change In Ownership Law Retrospectively

Dear Mr. Bennion:

I. Introduction

I respectfully petition BOE to amend various BOE Rules to prohibit assessors from violating the due process rights of real property taxpayers who acquired their interests in real property prior to the enactment of Part 0.5 of the Property Tax Division of the Revenue & Taxation Code.

I also separately petition BOE to compel its legal staff to depublish all annotations that apply Part 0.5 retrospectively.

Part 0.5 was first enacted in the late 1970s following Proposition 13. At the time Part 0.5 was enacted, real property ownership was already held in a number of ways (e.g., leaseholds, irrevocable trusts, life estates, estates for years, in corporations, in partnerships, etc) by a variety of beneficial owners (e.g., lessors, lessees, life estate holders, trust income beneficiaries, trust remainder beneficiaries, shareholders, partners, etc), collectively referred to hereinafter as "**Pre-Enactment Owners**".

There is nothing in any of the sections in Part 0.5 of the Property Tax Division of the Revenue and Taxation Code, or in any of BOE Rules 460-467, to lead anyone to believe the legislature or this board intended any statute or rule to apply retrospectively.¹ In fact, the contrary is true. Our country's common law, as endorsed by the US Supreme

¹ "A statute is said to have a retroactive or retrospective effect when it is construed so as to relate back to a previous transaction and give the transaction a legal effect different from that which prevailed under the law when it occurred." *Industrial Indem. Co. v. Teachers' Retirement Bd.* (1978) 86 Cal. App. 3d 92, 97.

Court in an opinion written by Justice Rehnquist², mandates that any new statute or regulation must be applied only prospectively, not retrospectively.

When a county assessor applies Part 0.5 retrospectively (i.e., against the interests of a **Pre-Enactment Owner**), the assessor deprives the **Pre-Enactment Owner** of his or her right to due process guaranteed by the US Constitution. When BOE legal staff interprets Part 0.5 as applying retrospectively, legal staff misinterprets Part 0.5.

II. Erroneous BOE Annotations

A. BOE Has Erroneously Advised Assessors and Taxpayers that Property Tax Statutes Apply Retrospectively

There would be no need for this petition if BOE in its annotations over the years had correctly advised assessors and property taxpayers that Part 0.5 must be applied only prospectively, not retrospectively.

However, in its annotations BOE has never given any such advice.

To the contrary, in each BOE annotation where BOE considers the interests of a **Pre-Enactment Owner**, BOE misinterprets—either expressly or impliedly—Part 0.5 as applying retrospectively against the interests of the **Pre-Enactment Owner**. Examples include, but are not limited to:

220.0325, 220.0326, 220.0338, 220.0332.005 [BOE erroneously applies Part 0.5 retrospectively against the interests of property owners who leased property to tenants in 1962, 1961, 1958, and 1940, respectively]

220.0780 and 220.0786 [BOE erroneously applies Part 0.5 retrospectively against the interests of trust remaindermen who acquired their vested interests in 1974 and 1962, respectively].

² “The principle that statutes operate only prospectively ... is familiar to every law student. (citations) This Court has often pointed out that the first rule of construction is that legislation must be considered as addressed to the future, not to the past.... The rule has been expressed in varying degrees of strength but always of one import, that a *retrospective operation will not be given to a statute which interferes with antecedent rights* ... unless such be the unequivocal and inflexible import of the terms, and the manifest intention of the legislature. (citations) ... The presumption is very strong that a statute was not meant to act retrospectively, and it ought never to receive such a construction if it is susceptible of any other.” *U.S. v. Security Indus. Bank* 459 U.S. 70, 79-80, 103 S.Ct. 407, 413 (U.S., 1982) [italics and boldface added]

B. Petitioner Has Requested that BOE Depublish All Erroneous Annotations

At this board's meeting on January 27, 2011, petitioner requested BOE board members to instruct, and the members did then instruct, BOE legal staff to depublish all legally-flawed annotations.

In subsequent communications between petitioner and BOE legal staff, primarily by e-mail, petitioner asked legal staff to depublish each annotation listed above, as well as all other annotations in which BOE erroneously advises assessors and real property taxpayers that Part 0.5 is applied retrospectively against the interests of **Pre-Enactment Owners**.

C. BOE Legal Staff Refuses to Depublish Annotations by Erroneously Interpreting the Steinhart Opinion

On 3/18/11 BOE legal staff refused to depublish the annotations listed above by arguing that the annotations are consistent with the California Supreme Court opinion in *Steinhart*.

Respectfully, petitioner contends BOE legal staff erroneously interprets *Steinhart*.

In annotations 220.0780 and 220.0786 BOE opines that a remainderman's interest does not vest for property tax purposes, and no change in ownership occurs, when the governing instrument first becomes irrevocable. In *Steinhart*, our high court found otherwise.

BOE must accept the findings in *Steinhart* as correct. BOE should realize that it can no longer contend that a remainderman's taking of actual possession constitutes a reassessable change in ownership. Why? Two reassessments of the remainderman's interest on two different dates violates the remainderman's constitutional right to due process as codified by our legislature's ban on "double taxation" in R&T §102.

A proper interpretation of *Steinhart* and R&T §102 should compel BOE to depublish all annotations.

III. Proposed Amendment to Rule 462.060 – Life Estates and Estates for Years

Following is petitioner's proposed amendment to Rule 462.060 in strike-out and underscore format:

(a) Life estates. The creation of a life estate in real property is a change in ownership at the time of transfer unless the instrument creating the life estate reserves such estate in the transferor or the transferor's spouse. However, the subsequent transfer of such a life estate by the transferor or the transferor's spouse to a third party is a change in ownership. Upon termination of such a reserved life estate, the vesting of a right of possession or enjoyment of a remainderman (other than the transferor or the transferor's spouse) is a change in ownership.

(b) Estate for years. The creation of an estate for years for a term of 35 years or more in real property is a change in ownership at the time of transfer unless the instrument creating the estate for years reserves such estate in the transferor or the transferor's spouse. However, the subsequent transfer of such an estate for years by the transferor or the transferor's spouse to a third party is a change in ownership. Upon the termination of a reserved estate for years for any term, the vesting of the right to possession or enjoyment of a remainderman (other than the transferor or the transferor's spouse) is a change in ownership. The creation or transfer of an estate for years for less than 35 years is not a change in ownership.

(c) Notwithstanding any provision in property tax law to the contrary, due process prohibits an assessor from reassessing trust real property as a change in ownership upon termination of a life estate or estate for years if the life estate or estate for years commenced prior to the effective date of Part 0.5 of the Property Tax Division of the Revenue & Taxation Code.

IV. Proposed Amendment to Rule 462.100 - Leases

Following is petitioner's proposed amendment to Rule 462.100 in strike-out and underscore format:

462.100. Change in Ownership – Leases

(a) The following transfers of either the lessee's interest or the lessor's interest in taxable real property constitute a change in ownership of such real property:

(1) Lessee's Interest:

(A) the creation of a leasehold interest in real property for a term of 35 years or more.

(B) the transfer, sublease, or assignment of a leasehold interest with a remaining term of 35 years or more.

(C) the termination of a leasehold interest which had an original term of 35 years or more.

(2) Lessor's Interest:

(A) The transfer of a lessor's interest in taxable real property subject to a lease with a remaining term of less than 35 years.

(B) The transfer of a lessor's interest in taxable real property subject to multiple leases, one or more of which is for a remaining term of less than 35 years and one or more of which is for a remaining term of 35 years or more, in which case there is a change in ownership of the portion of the property subject to the lease(s) with a remaining term of less than 35 years.

(b) The following transfers of either the lessee's interest or the lessor's interest in taxable real property do not constitute a change in ownership of such real property.

(1) Lessee's interest:

(A) The creation of a leasehold interest in real property for a term of less than 35 years.

(B) The transfer, sublease, or assignment of a leasehold interest with a remaining term of less than 35 years (regardless of the original term of the lease).

(C) The termination of a leasehold interest which had an original term of less than 35 years.

(2) Lessor's interest:

(A) The transfer of a lessor's interest in real property subject to a lease with a remaining term of 35 years or more, whether to the lessee or another party.

(c) Once a change in ownership of taxable real property subject to a lease has been deemed to have occurred, the entire property subject to the lease is reappraised (i.e., the value of both the lessee's interest and the reversion).

(d) The calculation of the term of a lease for all purposes of this section shall include written renewal options.

(e) It shall be conclusively presumed that all homes (other than mobilehomes subject to Part 13 of Division 1 of the Revenue and Taxation Code) eligible for the homeowners' exemption which are on leased land have written renewal options on the lease of such land of at least 35 years, whether or not such renewal options in fact exist in any contract or agreement.

(f) Due process. Notwithstanding any provision in property tax law to the contrary, when a lease was entered into prior to the effective date of Part 0.5 of the Property Tax Division of the Revenue & Taxation Code, due process prohibits an assessor from treating any termination, transfer, or assignment of such lease as a reassessable change in ownership.

V. Proposed Amendment to Rule 462.160 - Trusts

The proposed amendment to Rule 462.160 is intended to achieve two goals:

The first goal is to prohibit an assessor from retrospectively applying Part 0.5 of the Revenue & Taxation Code against the interests of a trust beneficiary those interests were vested prior to the effective date of Part 0.5.

The second goal is to prohibit an assessor who has reassesses real property as a change in ownership upon the receipt by a trust remainderman of a vested interest after the effective date of Part 0.5 from reassessing that remainderman's interest a second time. Two reassessments of the remainderman's interests on two different dates violates the remainderman's constitutional right to due process as codified by our legislature's ban on "double taxation" in R&T §102.

Following is petitioner's proposed amendment to Rule 462.160 in strike-out and underscore format:

(a) Creation. General Rule. The transfer by the trustor, or any other person, of real property into a trust is a change in ownership of such property at the time of the transfer.

(b) Exceptions. The following transfers do not constitute changes in ownership:

(1) Irrevocable Trusts.

(A) Trustor-Transferor Beneficiary Trusts. The transfer of real property by the trustor to a trust in which the trustor-transferor is the sole present beneficiary of the trust. However, a change in ownership of trust property does occur to the extent that persons other than the trustor-transferor are or become present beneficiaries of the trust unless otherwise excluded from change in ownership.

Example 1: M transfers income-producing real property to revocable living Trust A, in which M is the sole present beneficiary. Trust A provides that upon M's death, Trust A becomes irrevocable, M's brother B becomes a present beneficiary, and income from the trust property is to be distributed to B for his lifetime. Upon M's death, 100% of the property in Trust A, representing B's present beneficial interest, undergoes a change in ownership.

Where a trustee of an irrevocable trust has total discretion ("sprinkle power") to distribute trust income or property to a number of potential beneficiaries, the property is subject to change in ownership, because the trustee could potentially distribute it to a non-excludable beneficiary, unless all of the potential beneficiaries have an available exclusion from change in ownership.

Example 2: H and W transfer real property interests to the HW Revocable Trust. No change in ownership. HW Trust provides that upon the death of the first spouse the assets of the deceased spouse shall be distributed to "A Trust", and the assets of the surviving spouse shall be distributed to "B Trust", of which surviving spouse is the sole present beneficiary. H dies and under the terms of A Trust, W has a "sprinkle" power for the benefit of herself, her two children and her nephew. When H dies, A Trust becomes irrevocable. There is a change in ownership with respect to the interests transferred to the A Trust because the sprinkle power may be exercised so as to omit the spouse and the children as present beneficiaries for whom exclusions from change in ownership may apply, and there are no exclusions applicable to the nephew. However, if the sprinkle power could be exercised only for the benefit of W and her children for whom exclusions are available, the interspousal exclusion and the parent/child exclusion would exclude the interests transferred from change in ownership, provided that all qualifying requirements for those exclusions are met.

Example 3: Same as Example 2 above, except that "A Trust" is without any sprinkle power. When H dies, A Trust becomes irrevocable. Since A

Trust holds the assets for the benefit of W, the two children, and the nephew in equal shares, with any of W's share remaining at her death to be distributed to the two children and the nephew in equal shares, there is a change in ownership only to the extent of the interests transferred to the nephew, providing that the parent/child exclusion of Section 63.1 and the interspousal exclusion of Section 63 apply to the interests transferred to the two children and to W respectively. Upon the death of W, there is a change in ownership to the extent of the interests transferred to the nephew, although the parent/child exclusion of Section 63.1 may exclude from change in ownership the interests transferred to the two children. If A Trust had included a sprinkle power, instead of specifying the beneficiaries of the trust income and principal, then as in Example 2, none of the exclusions would apply.

(B) 12 Year Trustor Reversion Trusts. The transfer of real property or ownership interests in a legal entity holding interests in real property by the trustor to a trust in which the trustor-transferor retains the reversion, and the beneficial interest of any person other than the trustor-transferor does not exceed 12 years in duration.

(C) Irrevocable Trusts Holding Interests in Legal Entities. The transfer of an ownership interest in a legal entity holding an interest in real property by the trustor into a trust in which the trustor-transferor is the sole present beneficiary or to a trust in which the trustor-transferor retains the reversion as defined in subdivision (b)(1)(B) of this rule. However, a change in ownership of the real property held by the legal entity does occur if Revenue and Taxation Code section 61(i), 64(c) or 64(d) applies because the change in ownership laws governing interests in legal entities are applicable regardless of whether such interests are held by a trust.

Example 4: Husband and Wife, partners in HW Partnership who are not original coowners, transfer 70 percent of their partnership interests to HW Irrevocable Trust and name their four children as the present beneficiaries of the trust with equal shares. Husband and Wife do not retain the reversion. Under Revenue and Taxation Code section 64(a) the transfer of the partnership interests to HW Irrevocable Trust is excluded from change in ownership because no person or entity obtains a majority ownership interest in the HW Partnership.

(2) Revocable Trusts. The transfer of real property or an ownership interest in a legal entity holding an interest in real property by the trustor to a trust which is revocable by the trustor. However, a change in ownership does occur at the time the revocable trust becomes irrevocable unless the trustor-transferor remains or

becomes the sole present beneficiary or unless otherwise excluded from change in ownership.

(3) Interspousal Trusts. The transfer is one to which the interspousal exclusion applies. However, a change in ownership of trust property does occur to the extent that persons other than the trustor-transferor's spouse are or become present beneficiaries of the trust unless otherwise excluded from change in ownership.

(4) Parent-Child or Grandparent-Grandchild Trusts. The transfer is one to which the parent-child or grandparent-grandchild exclusion applies, and for which a timely claim has been made as required by law. However, a change in ownership of trust property does occur to the extent that persons for whom the parent-child or grandparent-grandchild exclusion is not applicable are or become present beneficiaries of the trust unless otherwise excluded from change in ownership.

(5) Proportional Interests. The transfer is to a trust which results in the proportional interests of the beneficiaries in the property remaining the same before and after the transfer.

(6) Other Trusts. The transfer is from one trust to another and meets the requirements of (1), (2), (3), (4), or (5).

(c) Termination. General Rule. The termination of a trust, or portion thereof, constitutes a change in ownership at the time of the termination of the trust.

(d) Exceptions. The following transfers do not constitute changes in ownership:

(1) Prior Change in Ownership. Termination results in the distribution of trust property according to the terms of the trust to a person or entity who received a present interest (either use of or income from the property) when the trust was created, when it became irrevocable, or at some other time. However, a change in ownership also occurs when the remainder or reversionary interest becomes possessory if the holder of that interest is a person or entity other than the present beneficiary unless otherwise excluded from change in ownership.

Example 5: B transfers real property to Trust A and is the sole present beneficiary. Trust A provides that when B dies, the Trust terminates and Trust property is to be distributed equally to R and S, who are unrelated to B. B dies, Trust A terminates, and the transfers of the Trust property to R and S result in changes in ownership, allowing for reassessment of 100 percent of the real property.

(2) Revocable Trusts. Termination results from the trustor-transferor's exercise of the power of revocation and the property is transferred by the trustee back to the trustor-transferor.

(3) Trustor Reversion Trusts. The trust term did not exceed 12 years in duration and, on termination, the property reverts to the trustor-transferor.

(4) Interspousal Trusts. Termination results in a transfer to which the interspousal exclusion applies.

(5) Parent-Child or Grandparent-Grandchild Trusts. Termination results in a transfer to which the parent-child or grandparent-grandchild exclusion applies, and for which a timely claim has been filed as required by law.

(6) Proportional Interests. Termination results in the transfer to the beneficiaries who receive the same proportional interests in the property as they held before the termination of the trust.

(7) Other Trusts. Termination results in the transfer from one trust to another and meets the requirements of (1), (2), (3), (4), (5), or (6) of subdivision (b).

(e) For purposes of this rule, the term "trust" does not include a Massachusetts business trust or similar trust, which is taxable as a legal entity and managed for profit for the holders of transferable certificates which, like stock shares in a corporation, entitle the holders to share in the income of the property. For rules applicable to Massachusetts business trusts or similar trusts, see Section 64 of the Revenue and Taxation Code and Rule 462.180, which address legal entities.

(g) Due Process. Notwithstanding any provision in property tax law to the contrary, due process prohibits an assessor from reassessing trust real property as a change in ownership upon a remainderman's taking of actual possession of that property after the effective date of Part 0.5 of the Property Tax Division of the Revenue & Taxation Code if either 1) the remainderman's legal right to take such possession vested prior to the effective date, or 2) at the time of vesting the assessor reassessed the remainderman's interest as a change in ownership under Part 0.5.

VI. Proposed Amendment to Rule 462.180 – Legal Entities

Following is petitioner's proposed amendment to Rule 462.180 in strike-out and underscore format:

(a) Transfers of Real Property to and by Legal Entities. General Rule. The transfer of any interest in real property to a corporation, partnership, limited liability company, or

other legal entity is a change in ownership of the real property interest transferred. For purposes of this rule, "real property" or "interests in real property" includes real property interests and fractional interests thereof, the transfer of which constitute a change in ownership under Sections 60 and following applicable sections of the Revenue and Taxation Code and under the applicable change in ownership provisions of the Property Tax Rules.

(b) Exceptions. The following transfers do not constitute changes in ownership of the real property:

(1) **Affiliated Corporation Transfers.** Transfers of real property between or among affiliated corporations, including those made to achieve a corporate reorganization if:

(A) the voting stock of the corporation making the transfer and the voting stock of the transferee corporation are each owned 100 percent by one or more corporations related by voting stock ownership to a common parent, and

(B) the common parent corporation owns directly 100 percent of the voting stock of at least one corporation in the chain(s) of related corporations.

Image

SIMPLE EXAMPLE

A transfer of real property by P, A, B, or C to any of the other three corporations would not be a change in ownership.

Example 1: Any transfer by C (wholly owed by A and B) to B (wholly owned by A and P) would not be a change in ownership because of those relationships and because P owns 100% of A.

If real property is transferred between non-affiliated corporations, only the property transferred shall be deemed to have undergone a change in ownership.

(2) **Proportional Transfers of Real Property.** Transfers of real property between separate legal entities or by an individual to a legal entity (or vice versa), which result solely in a change in the method of holding title and in which the proportional ownership interests in each and every piece of real property transferred remain the same after the transfer. (The holders of the ownership interests in the transferee legal entity, whether such interests are represented by stock, partnership interests, or other types of ownership interest, shall be defined as "original co-owners" for purposes of determining whether a change in ownership has occurred upon the subsequent transfer of the ownership

interests in the legal entity.) This subdivision shall not apply to a transfer of real property which is also excluded from change in ownership pursuant to subdivision (b)(1) (transfers between or among affiliated corporations).

Examples of Transfers of Real Property in Legal Entities:

Example 2: A transfer of real property from A and B, as equal co-tenants, to Corporation X where A and B each take back 50 percent of the stock. No change in ownership. However, if A and B each take back 49 percent of the stock and C receives 2 percent of the stock then there will be a change in ownership of the entire property.

Example 3: A transfers Whiteacre to Corporation X and B transfers Blackacre (equal in value to Whiteacre) to Corporation X. A and B each take back 50 percent of the stock. Change in ownership of 100 percent of both Whiteacre and Blackacre.

Example 4: Corporation X owns Blackacre and Whiteacre (both are of equal value). A & B each own 50% of Corporation X's shares. X transfers Whiteacre to A and Blackacre to B. Change in ownership of 100% of both Blackacre and Whiteacre. However, if Corporation X transfers Whiteacre and Blackacre to both A and B as joint tenants or as equal tenants in common, there is no change in ownership.

Example 5: A transfer of real property from Corporation X to its sole shareholder A. No change in ownership, even if A is an "original co-owner", because interests in real property, and not ownership interests in a legal entity, are being transferred.

(c) Transfers of ownership interests in legal entities. General Rule. The purchase or transfer of corporate stock, partnership interests, or ownership interests in other legal entities is not a change in ownership of the real property of the legal entity, pursuant to Section 64(a) of the Revenue and Taxation Code.

(d) Exceptions. The following transfers constitute changes in ownership, except as provided in (d)(4) which is an exclusion from change in ownership:

(1) Control. When any corporation, partnership, limited liability company, Massachusetts business trust or similar trust, other legal entity or any person:

(A) obtains through a reorganization or any transfer, direct or indirect ownership or control of more than 50 percent of the voting stock in any corporation which is not a member of the same affiliated group of corporations as described in (b)(1), or

(B) obtains through multi-tiering, reorganization, or any transfer direct or indirect ownership of more than 50 percent of the total interest in partnership or LLC capital and more than 50 percent of the total interest in partnership or LLC profits, or

(C) obtains through any transfer direct or indirect ownership of more than 50 percent of the total ownership interest in any other legal entity.

Upon the acquisition of such direct or indirect ownership or control, which may include any purchase or transfer of 50 percent or less of the ownership interest through which control or a majority ownership interest is obtained, all of the property owned directly or indirectly by the acquired legal entity is deemed to have undergone a change in ownership.

(2) Transfers of More than 50 Percent. When on or after March 1, 1975, real property is transferred to a partnership, corporation, limited liability company, or other legal entity and the transfer is excluded from change in ownership under Section 62(a)(2) of the Revenue and Taxation Code, and the "original co-owners" subsequently transfer, in one or more transactions, cumulatively more than 50 percent of the total control or ownership interests, as defined in subdivision (d)(1), in that partnership, corporation, limited liability company or legal entity, there is a change in ownership of only that property owned by the entity which was previously excluded under Section 62(a)(2). However, when such transfer would also result in a change in control under Section 64(c) of the Revenue and Taxation Code, then reappraisal of the property owned by the corporation, partnership, limited liability company, or other legal entity shall be pursuant to Section 64(c) rather than Section 64(d).

For purposes of this subdivision ((d)(2)), interspousal transfers excluded under Section 63 of the Revenue and Taxation Code, transfers into qualifying trusts excluded under Section 62(d) of the Revenue and Taxation Code, and proportional transfers excluded under Section 62(a)(2) of the Revenue and Taxation Code shall not be cumulated or counted to determine a change in ownership.

Examples of Transfers of Interests in Legal Entities:

Example 6: A and B each own 50 percent of the stock of Corporation X. Corporation X acquires Whiteacre from Corporation Y, an unaffiliated corporation in which neither A nor B has interests, and Whiteacre is reappraised upon acquisition. A transfers 30 percent of Corporation X's stock to C, and B later transfers 25 percent of Corporation X's stock to C. Upon C's acquisition of 55 percent of Corporation X's stock, there is a change in control of Corporation X under Section 64(c) and a reappraisal of Whiteacre.

Example 7: Spouses H and W acquire as community property 100% of the capital and profits interests in an LLC which owns Blackacre. Each of H and W is treated as acquiring 50 percent of the ownership interests as defined in subdivision (c) and Revenue and Taxation Code section 64(a). Since the selling members of the LLC are not original co-owners (because they did not transfer the property to the LLC under the Section 62(a)(2) exclusion), no change in control of the LLC would occur under section 64(c) and no change in ownership of Blackacre under section 64(d).

Example 8: A and B, hold equal interests as tenants in common in Greenacre, a parcel of real property. A and B transfer Greenacre to Corporation Y and in exchange A and B each receive 50 percent of the corporate stock. No change in ownership pursuant to Section 62(a)(2). Pursuant to Section 64(d), A and B become original coowners. A transfers 30 percent of Corporation Y's stock to C (A's child), and B then transfers 25 percent of Corporation Y's stock to D (B's grandchild). Change in ownership of Greenacre upon B's transfer to D. Parent/child and grandparent/grandchild exclusions are not applicable to transfers of interests in legal entities. However, if the same transfers were made by A and B to their respective spouses, no change in ownership pursuant to Section 63 and Rule 462.220.

(3) Cooperative Housing Corporation. When the stock transferred in a cooperative housing corporation ("stock cooperative" as defined in subdivision (m) of Section 1351 of the Civil Code) conveys the exclusive right to occupancy of all or part of the corporate property, unless:

(A) the cooperative was financed under one mortgage which was insured under Sections 213, 221(d)(3), 221(d)(4), or 236 of the National Housing Act, as amended, or was financed or assisted pursuant to Sections 514, 515, or 516 of the Housing Act of 1949 or Section 202 of the Housing Act of 1959, or was financed by a direct loan from the California Housing Finance Agency, and

(B) the regulatory and occupancy agreements were approved by the respective insuring or lending agency, and

(C) the transfer is from the housing cooperative to a person or family qualifying for purchase by reason of limited income.

(4) Proportional Interest Transfers. Transfers of stock, partnership interests, limited liability company interests, or any other interests in legal entities between legal entities or by an individual to a legal entity (or vice versa) which result solely in a change in the method of holding title and in which proportional ownership interests of the transferors and transferees, in each and every piece of property represented by the interests transferred, remain the same after the transfer, do not constitute

changes in ownership, as provided in subdivision (b)(2) of this rule and Section 62(a)(2) of the Revenue and Taxation Code. This provision shall not apply to a statutory conversion or statutory merger of a partnership into a limited liability company or other partnership (or a limited liability company into a partnership) when the law of the jurisdiction of the converted or surviving entity provides that such entity remains the same entity or succeeds to the assets of the converting or disappearing entity without other act or transfer and the partners or members of the converting or disappearing entity maintain the same ownership interest in profits and capital of the converted or surviving entity that they held in the converting or disappearing entity.

Examples of Excluded Proportional Interest Transfers:

Example 9: General Partnership (GP), which owns Whiteacre and in which A and B hold equal partnership interests, converts to Limited Partnership (LP) under the Revised Uniform Partnership Act of 1994 (California Corporations Code section 16100 et seq.). As a result of the conversion, A and B each hold 50 percent of the LP interests in capital and profits. No change in ownership of Whiteacre upon the conversion, because, under Section 16909 of the Corporations Code, there is no transfer of Whiteacre. Section 62(a)(2) of the Revenue and Taxation Code does not apply. However, if A and B were "original coowners" in GP, they remain "original coowners" in LP.

Example 10: Following the conversion in Example 9, A and B each transfer 30 percent of their capital and profits interests in LP to Limited Liability Company (LLC), which is owned equally by A and B. Each retain an equal 20 percent interest in LP. No change in ownership of Whiteacre pursuant to Section 62(a)(2) because A and B own 100 percent of both LP and LLC and their respective proportional interests remain the same after the transfer. Neither section 64(c) nor section 64(d) of the Revenue and Taxation Code applies to this transfer, although A and B become "original coowners" with respect to their interests in LLC.

Example 11: A limited partnership (LP), which owns Blackacre and in which C and D hold equal partnership interests, changes its form to a limited liability company (LLC), in which C and D hold equal membership interests, by statutory merger under the California Revised Limited Partnership Act (California Corporations Code section 15611 et seq.) and the Beverly-Killea Limited Liability Company Act (California Corporations Code section 17000 et seq.). No change in ownership of Blackacre upon the change in form because under section 17554 of the California Corporations Code, there is not a transfer of property from LP to LLC. Section 62(a)(2) of the Revenue and Taxation Code does not apply. However, if C and D were "original coowners" in LP, they remain "original coowners" in LLC.

(e) Partnerships.

(1) Transfers of Real Property by Partnerships. General Rule. Except as provided by (b)(2) where the proportional ownership interests remain the same, when real property is contributed to a partnership or is acquired, by purchase or otherwise, by the partnership there is a change in ownership of such real property, regardless of whether the title to the property is held in the name of the partnership or in the name of the partners with or without reference to the partnership. Except as provided by (b)(2) where the proportional ownership interests remain the same, the transfer of any interest in real property by a partnership to a partner or any other person or entity constitutes a change in ownership.

(2) Except as provided in (d)(1)(B) and (d)(2), the addition or deletion of partners in a continuing partnership does not constitute a change in ownership of partnership property.

(f) Due Process. Notwithstanding any provision in property tax law to the contrary, due process prohibits an assessor from treating a partner in a partnership or a shareholder in a corporation as an "original transferor" if the partner or shareholder transferred real property to the partnership or corporation prior to the effective date of Part 0.5 of the Property Tax Division of the Revenue & Taxation Code.

VII. Proposed Amendment to Rule 462.260 – Date of Change in Ownership

Following is petitioner's proposed amendment to Rule 462.260 in strike-out and underscore format:

For purposes of reappraising real property as of the date of change in ownership of real property, the following dates shall be used:

(a) Sales.

(1) Where the transfer is evidenced by recordation of a deed or other document, the date of recordation shall be rebuttably presumed to be the date of ownership change. This presumption may be rebutted by evidence proving a different date to be the date all parties' instructions have been met in escrow or the date the agreement of the parties became specifically enforceable.

(2) Where the transfer is accomplished by an unrecorded document, the date of the transfer document shall be rebuttably presumed to be the date of ownership change. This presumption may be rebutted by evidence proving a different date to be the

date all parties' instructions have been met in escrow or the date the agreement of the parties became specifically enforceable.

- (b) Leases. The date the lessee has the right to possession.
- (c) Inheritance (by will or intestate succession). The date of death of the decedent.
- (d) Trusts.
 - (1) Revocable. The date the trust becomes irrevocable.

Example 1: A creates an inter vivos revocable trust that becomes irrevocable upon A's death. The date of trust in ownership is the date of A's death.

- (2) Irrevocable.

(A) The date the property is placed in trust.

Example 2: A's estate plan provides that upon A's death, property is transferred to an irrevocable testamentary trust. The date of change in ownership is the date of A's death.

Example 3: A transfers to an irrevocable inter vivos trust. The date of change in ownership is the date of the transfer.

(B) The effective date of the immediate right to present possession or enjoyment of a remainder or reversion occurs upon the termination of a life estate or other similar precedent property interest.

Example 4: A creates an irrevocable trust, granting A's wife, B, a life estate in the beneficial use of the property with a remainder to C and D who are unrelated to A and B. The creation of a life estate in B is a transfer subject to the interspousal exclusion from change in ownership. Upon B's death, however, a change in ownership occurs because on that date C and D have an immediate right to the present possession and enjoyment of the remainder.

Note: Refer to Section 462.160 for trust transfer exceptions.

(e) Due Process - Part 0.5 of the Property Tax Division of the Revenue & Taxation Code has no retrospective effect on any owner's real property rights.

VIII. No Waiver of Government Code Section 11340.7

Petitioner does not waive Government Code Section 11340.7.

IX. Conclusion

A. BOE Should Grant the Petition to Amend Rules 462.060, 462.100, 462.160, 462.180, and 462.260 for Due Process

As described above, there are many **Pre-Enactment Owners**. Examples of such **Pre-Enactment Owners** include, but are not limited to, 1) a trust remainderman who acquired his ownership prior to the enactment of Part 0.5 of the Revenue & Taxation Code, 2) a partner in a partnership, or a shareholder in a corporation, who contributed real property to the partnership or corporation prior to the enactment of Part 0.5, and 3) a property owner who leased his property prior to the enactment of Part 0.5.

Each of these **Pre-Enactment Owners** possessed vested property rights prior to the enactment of Part 0.5. When an assessor applies Part 0.5 retrospectively against the vested interests of a **Pre-Enactment Owner**, the assessor violates the owner's due process rights.

This board is duty bound to protect the interests of all **Pre-Enactment Owners** by prohibiting assessors from violating those owners' right to due process. By granting this petition, this board will fulfill its duty.

Petitioner respectfully asks the board members to grant this petition.

B. BOE Should Depublish All Annotations That Apply Change in Ownership Law Retrospectively

As petitioner argued earlier, there is nothing in the change in ownership property tax statutes or this board's rules that leads anybody to believe the legislature and this board intended those statutes and rules to apply retrospectively.

Petitioner respectfully asks the board members to order the depublishation of annotations 220.0325, 220.0326, 220.0338, 220.0332.005, 220.0780, 220.0786 and all others where BOE erroneously concludes, either expressly or impliedly, that Part 0.5 of the Property Tax Division of the Revenue & Taxation Code is applied retrospectively.

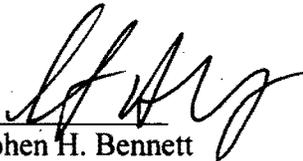
Very truly yours,



Stephen H. Bennett

PROOF OF SERVICE

I am employed in the County of Orange, State of California. I am over the age of eighteen (18). My business address is 26400 La Alameda #200, Mission Viejo, California 92691. I declare under penalty of perjury that I served the petition on the interested parties whose names and addresses appear on the next page, by placing a true copy thereof enclosed in a sealed envelope and mailing on March 21, 2011.



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From: Stephen Bennett
To: Ruwart Carole (Legal)
Subject: U.S. v Carlton
Date: Tuesday, March 22, 2011 11:38:22 AM

Carole,

Thank you for referring me to the US Supreme Court case U.S. v. Carlton (1994) 512 U.S. 26. That case, I believe, stands for the following proposition:

When a legislature enacts a retrospective tax statute, the retrospective application will not violate due process if such application is supported "by a legitimate legislative purpose furthered by rational means."

My arguments remain:

There is no language in Sections 60 and 61 to lead anyone to believe that the legislature intended those sections to apply retrospectively.

In any event, applying Sections 60 and 61 retrospectively does not satisfy any "legitimate legislative purpose furthered by rational means".

As I said on the phone, this is interesting stuff.

Steve

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Article

***291 BACK FROM THE DEAD: THE RESURGENCE OF DUE PROCESS CHALLENGES TO RETROACTIVE TAX LEGISLATION**

Robert R. Gunning [FNa1]

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***292 INTRODUCTION**

At what point does retroactive tax legislation become intolerable [FN1] and transgress constitutional limitations? Over the years, appellate courts have employed differing formulations of the criteria used to determine when a retroactive tax measure has gone too far. Although a bright-line test has yet to definitively emerge, tax measures with retroactivity periods of one year or less consistently have been upheld. Conversely, a number of tax measures containing periods of retroactivity greater than one year have been invalidated under the Due Process Clause.

In the seminal 1994 Supreme Court decision *United States v. Carlton*, [FN2] the Court held that an amendment intended to retroactively close a loophole in recently enacted federal estate tax legislation was constitutional. [FN3] Like much of the retroactive federal tax legislation that has survived constitutional scrutiny, the period of retroactivity was relatively modest (approximately one year in length). [FN4] The majority opinion declined to articulate a bright-line standard or set forth concrete, objective criteria to use in evaluating due process challenges to retroactive tax measures.

Many commentators therefore reasonably believed that *Carlton* served as the death knell for due process limitation on retroactive tax legislation. [FN5] In a concurring opinion in *Carlton*, however, Justice*293 O'Connor observed that the governmental interest in revising tax laws must at some point give way to the "taxpayer's interest in finality and repose," and that a "period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise ... serious constitutional questions." [FN6] Since *Carlton* was decided, several state courts have relied on Justice O'Connor's concurring opinion to invalidate retroactive state and local tax measures under the Due Process Clause. [FN7] In each of these decisions, the period of retroactivity exceeded two years. [FN8] These state court decisions indicate that due process limitation on retroactive tax legislation is alive and well. The question remains: where and how to draw the line?

Consistent with Justice O'Connor's analysis, this article proposes that a presumptive line be drawn at the year preceding the legislative session in which the subject tax law is enacted. This outcome would preserve the ability of legislative bodies to promptly remedy perceived loopholes and errors in recently enacted legislation without a concomitant loss in revenue. At the federal level, it would also account for practical issues associated with the development and enactment of tax legislation. This presumption would ensure some reasonable level of finality for taxpayers and further prohibit legislation that unduly restricts taxpayer rights and remedies.

Such a one-year presumption should be rebuttable, however. For instance, under established precedent, the Due Process Clause prohibits the retroactive imposition of "wholly new taxes," regardless of the length of the look-back period. [FN9] On the other hand, tax jurisdictions should retain the ability to surmount the presumption when they can demonstrate compelling circumstances for the period of retroactivity, such as an inability to have acted sooner.

Part I of this article describes the various constitutional challenges that have been launched against retroactive tax measures. In general, only substantive due process challenges have met with any level of success. In Part II, the article traces the history of twentieth-century due process challenges to retroactive tax measures, culminating in the landmark *Carlton* decision. Although the *294 formulation of the due process test evolved, *Carlton* clarified that to pass constitutional muster, a retroactive tax must (1) be levied for a legitimate, legislative purpose and (2) possess a modest period of retroactivity ("modesty doctrine"). [FN10] Part III of the article discusses the post-*Carlton* landscape. Several state courts have invalidated state and local tax measures with retroactivity periods greater than a year, while federal courts generally have upheld federal tax measures, most of which possessed retroactivity periods of less than a year. In Part IV, the article contends that tax legislation containing retroactivity periods greater than one year in length should be presumptively invalid under *Carlton's* modesty doctrine. Lastly, Part V of the article applies this test to California's 2004 tax amnesty legislation and concludes that the retroactive penalty provisions in the legislation are unconstitutional under the Due Process Clause.

I. CONSTITUTIONAL CHALLENGES TO RETROACTIVE TAX LEGISLATION

The United States Constitution neither expressly authorizes nor prohibits retroactive tax legislation. [FN11] In general, a retroactive statute is one that "takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past."

[FN12] Retroactive tax measures have run the gamut from wholly new taxes, increased tax rates, broadened tax bases, elimination of deductions and exemptions, restriction of taxpayer remedies, and enhanced penalties--all applied to prior transactions or conduct. [FN13]

Although the Constitution does not expressly prohibit retroactive tax measures, taxpayers have mounted a variety of legal challenges*295 to such legislation since the eighteenth century. As discussed below, most of these efforts have failed. Taxpayers have met with little success in contending that retroactive taxation violates the Ex Post Facto, Contract, Equal Protection, and Takings Clauses of the Constitution. However, taxpayers have enjoyed modest success in asserting that retroactive tax statutes violate the Due Process Clause.

A. The Ex Post Facto Clause

The Ex Post Facto Clause of the Constitution prohibits Congress from passing any "bill of attainder or ex post facto law." [FN14] The Constitution also provides "that no state shall pass any ex post facto law." [FN15] In 1798--with refreshing candor--Justice Chase observed in *Colder v. Bull* [FN16] that this constitutional language "necessarily requires some explanation; for naked and without explanation, it is unintelligible, and means nothing." [FN17] The opinion proceeded to explain that an ex post facto law is one that "shall not be passed concerning, and after the fact, or thing done, or action committed." [FN18] On its face, the Ex Post Facto Clause therefore would seem to prohibit any tax statute that retroactively changes the legal or financial consequences of a prior transaction or activity.

In *Calder*, however, the Supreme Court concluded that the clause does not apply to civil statutes. [FN19] Relying on English common law, the Court held that the Ex Post Facto Clause was intended to protect individuals from punishment imposed by such laws, and it therefore determined that the clause prohibited only retrospective criminal punishment. [FN20] Accordingly, the use of the *296 Ex Post Facto clause as a constitutional restriction on retroactive tax legislation was rejected in the earliest days of the Republic. [FN21]

B. The Contract Clause

Contract Clause challenges to retroactive tax legislation likewise have fared with scant success. The Contract Clause prohibits states from passing any law "impairing the [o]bligation of [c]ontracts." [FN22] State constitutions often contain similar provisions. [FN23] In Contract Clause challenges to retroactive tax legislation, taxpayers have contended that existing legislation has created a contract between the state and its taxpayers, [FN24] or alternatively, that the retroactive application of a tax statute has impaired existing contracts with third parties. [FN25] In retroactively amending the legislation to the taxpayer's detriment, the state impairs the contract it created with its citizens or that existed between private parties.

Aside from the *Lochner* era, [FN26] when strict scrutiny was applied to economic measures, these Contract Clause challenges to retroactive tax legislation consistently failed because courts reject the notion that the prior law created a contract between the taxpayer and the state or that the retroactive application of tax legislation impaired existing contracts. [FN27] Absent a clear indication that the legislature intended to bind itself contractually, the presumption is that "a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise." [FN28] Moreover, even if a taxpayer can demonstrate the legislature's intent to create private contractual and vested rights, to prove a violation of the Contract Clause, the taxpayer further must show that the amendment substantially*297 impaired the taxpayer's rights and was not supported by a significant and legitimate public purpose. [FN29]

C. The Equal Protection Clause

The Equal Protection Clause precludes a state from denying “to any person within its jurisdiction the equal protection of the laws.” [FN30] Its use to invalidate retroactive taxation was severely curtailed by a Supreme Court decision in 1938. In *Welch v. Henry*, [FN31] the taxpayer contended that a 1935 act of the Wisconsin State Legislature imposing a tax on corporate dividends received by the taxpayer in 1933, at rates and with deductions different from those applicable in that year to other types of income, violated the Equal Protection Clause. [FN32]

The 1933 legislation provided that dividends received from corporations whose principal business was attributable to Wisconsin were deductible from gross income. [FN33] By taking advantage of this deduction, the taxpayer reported no taxable net income for tax year 1933 when he filed his income tax return in 1934. [FN34] In an emergency tax measure enacted in 1935, the legislature eliminated all but \$750 of deductions on such dividends, with the deduction amendment retroactive to the 1933 and 1934 tax years. [FN35] The taxpayer asserted that the legislature's retroactive amendment, singling out a class of dividends for treatment different from other forms of income, violated his right to equal protection. [FN36]

Applying the rational basis test, the Court rejected the taxpayer's argument that the legislation violated the Equal Protection Clause. The Court held that the amended tax law was not a denial of equal protection simply because it was retroactive and that it “has never been thought that such changes involve a denial of equal protection if the new taxes could have been included in the earlier act when adopted.” [FN37] In leaving the equal protection door only slightly ajar, the Court observed that a taxing statute *298 does not deny equal protection unless it amounts to “hostile or oppressive discrimination” against the taxpayer. [FN38] To date, no United States Supreme Court decision has upheld an equal protection challenge to a retroactive tax statute. [FN39]

D. The Takings Clause

Taxpayers have mounted several challenges to retroactive tax measures under the Takings Clause. [FN40] This clause prohibits the taking of private property for public use without just compensation. [FN41] With one exception, courts consistently have held that Congress's general exercise of its taxing power does not violate the Fifth Amendment's prohibition on takings without just compensation. [FN42] The levying of taxes does not constitute an unconstitutional taking unless the taxation is so “arbitrary as to constrain the conclusion that it was not the exertion of taxation, but a confiscation of property.” [FN43]

Based on this stringent standard, taxpayer challenges to retroactive federal tax legislation under the Takings Clause generally have been defeated on the basis that Congress routinely enacts tax legislation with short and limited periods of retroactivity as a practical necessity. [FN44] Similarly, a takings challenge to a state's retroactive reduction in the amount of tax refunds failed on the theory that taxpayers did not have a vested right to the amount of the tax refund. [FN45]

*299 II. THE DUE PROCESS CLAUSE THROUGH UNITED STATES V. CARLTON

In contrast to other constitutional challenges to retroactive taxation, due process challenges have met with mixed success in the federal and state courts. The Fifth Amendment of the Constitution provides that no person shall “be deprived of life, liberty, or property, without due process of the law.” [FN46] While this amendment applies only to federal action, the Fourteenth Amendment applies due process protection to state action.

Due process challenges largely succeeded in the *Lochner* [FN47] era of exacting review of economic legislation. In

the 1930s, the post-*Lochner* era Supreme Court generally rejected due process challenges to retroactive taxation. As will be seen, however, the vast majority of the post-*Lochner* litigation challenged tax measures with retroactivity periods of one year or less.

A. Successful Due Process Challenges During the Lochner Era

In the era of strict review of economic legislation, the Court applied an actual notice test to retroactive tax legislation. Through three decisions issued in the 1920s, the Court invalidated retroactive estate tax measures because the taxpayers did not have notice of the changing tax laws at the time they made decisions pertaining to their estates.

In *Nichols v. Coolidge*, [FN48] a federal estate tax statute sought to retroactively include as part of two married decedents' gross estates the value of property that the wife had transferred to others prior to passage of the federal statute. [FN49] There was no evidence that the decedent had transferred her property to others in contemplation of death. [FN50] In holding that the retroactive application of this estate tax provision violated the taxpayer's due process rights under the Fifth Amendment, the Supreme Court noted that the "arbitrary, whimsical, and burdensome character of the challenged tax is plain enough." [FN51] Although thin in analysis, the decision appears to rest on the notion that the estate tax was a new *300 tax and that its retroactive imposition to past conduct was arbitrary and capricious. [FN52]

Two other cases similarly held that the retroactive nature of the nation's first estate and gift tax statutes violated the Due Process Clause. [FN53] Both of these decisions involved the gift tax, which was to apply retroactively to prior transactions. As this tax was a "wholly new tax" imposed on transactions that were not taxable when they occurred, the Supreme Court struck the tax under the Due Process Clause. [FN54] Although not overruled, the continuing vitality of these decisions has been questioned in subsequent Supreme Court decisions. [FN55] To the extent the *Nichols* line of cases survive, they are limited to cases involving "wholly new taxes," rather than amendments to existing tax schemes that retroactively impact prior transactions. [FN56]

B. Unsuccessful Due Process Challenges

Following the *Lochner* era, the Supreme Court consistently upheld retroactive federal tax legislation against due process challenges. In sustaining the legislation, the Court employed a variety of criteria, or at minimum, different formulations of the same legal standard. In the early 1930s, the Court rejected several taxpayer challenges by simply holding that all retroactive taxation was not unconstitutional. [FN57] Presumably, the Court applied some form of the palpably arbitrary test from the *Nichols* line of cases. From 1938 until 1984, the Court employed a "harsh and oppressive" standard in measuring the constitutionality of retroactive tax legislation. [FN58] Then, from 1984 to the 1994 *Carlton* decision, the Court shifted to an analysis of whether there was a "legitimate purpose" behind the retroactive tax legislation. [FN59] Critically, all of the retroactive tax cases that were before the Court during this 1930–1994 time period addressed federal tax legislation with a look-back period of less than two years, and in almost all cases, less than one. [FN60] *301 In most instances, the subject legislation sought to cure a defect or close a loophole that existed in legislation enacted in the previous legislative session.

1. Denial of Taxpayer Challenges Under the Palpably Arbitrary Test

The Court's movement away from the strict review of economic legislation in the context of retroactive taxation is perhaps best illustrated by a 1931 Court decision upholding the retroactive increase in the estate tax rate to a gift made in contemplation of death. [FN61] In *Milliken v. United States*, [FN62] the decedent gave his children corporate stock in

December 1916. [FN63] When the donor died in 1920, the tax commissioner included the stock shares in the decedent's estate as a gift made in contemplation of death. [FN64] The tax rate applied to the gift was the tax rate from the Revenue Act of 1918, which was higher than the rate in the comparable revenue act from 1916. [FN65] The issue, therefore, was whether the application of the higher tax rate, retroactive from 1918 to December 1916, violated the Due Process Clause.

In denying the petitioners' challenge, the Court first contrasted the *Nichols* line of decisions because they involved gifts made and vested before passage of the statute imposing the gift tax. [FN66] In those cases, the donors had no notice that the subject of the gift would be subject to taxation at all. In contrast, the Court reasoned, the *Milliken* donor had notice that the gift made in contemplation of death would be subject to taxation, albeit at a lower rate. [FN67] The Court held that a tax is not necessarily arbitrary and invalid because it is retroactively applied and determined that it was not enough for the taxpayer to show that the gift was made before passage of the statute. [FN68] In sustaining the application of the higher tax rate to the gift transaction, the Court also relied on the underlying policy of the 1918 legislation to equalize taxation of *302 gifts made in contemplation of death with testamentary dispositions. [FN69] That intent, the Court concluded, would be undercut if gifts made in contemplation of death after the 1916 act were taxed more favorably than transfers from the donor at death. [FN70]

2. The Harsh and Oppressive Test

In continuing its movement away from strict review of economic legislation, the Court formulated a new test in *Welch v. Henry* in 1938. [FN71] The taxpayer asserted that the Wisconsin statute denied him due process of law because, in 1935, it imposed a tax on income received in 1933. [FN72] In upholding the tax against this due process challenge, the Court first relied on *Milliken's* basic premise that a tax is not necessarily unconstitutional because it is retroactive. [FN73] The Court next distinguished the *Nichols* line of gift-tax cases on the basis that those decisions "rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event." [FN74] Effectively incorporating an element of actual notice into the due process test, the Court reasoned that in the gift-tax cases, the donor may have refrained from making the gift had the donor anticipated the tax. [FN75]

The *Welch* Court then proceeded to subtly formulate a new test, which would be applied by the Court for nearly 50 years, by stating that in "each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so 'harsh and oppressive' as to transgress the constitutional limitation." [FN76] Applying this rather nebulous "harsh and oppressive" test, the Court first analyzed the nature of the tax at issue. Because the tax was an income tax, the Court summarily assumed that a stockholder would not refuse to receive corporate dividends even if the taxpayer knew their receipt *303 would later be subjected to tax at an increased rate. [FN77] The Court thus attempted to distinguish gift taxation, under which donors' actions presumably would be affected by tax consequences, from income taxation, under which taxpayers' actions would not be so impacted. [FN78]

After contrasting the nature of income taxation from gift taxation, the Court analyzed the period of retroactivity to determine if its application was "harsh and oppressive." The Court observed that for more than 75 years, Congress regularly enacted revenue laws to retroactively tax income received during the year preceding the session in which the taxing statute was enacted, and that such "recent transactions" could be subject to retroactive application of tax measures. [FN79] Applying this test to the Wisconsin statute, the Court noted that while the statute was enacted two years after the subject tax year, the Wisconsin State Legislature met only in odd-numbered years. [FN80] Accordingly, the 1935 legislative session was the first opportunity after the tax year in which the income was received to revise the tax laws applicable to 1933 income (reported and paid in 1934). The Court then recognized that while the Wisconsin Supreme Court had

thought that the tax might “approach or reach the limit of permissible retroactivity,” the Court would not say that the retroactive period in fact exceeded such limit. [FN81]

The divided *Welch* opinion represents an important turning point in retroactive tax jurisprudence. The *Welch* majority focused its analysis on the nature of the tax and the period of retroactivity to determine whether the retroactive application of the tax statute was so “harsh and oppressive” as to violate due process. To date, the period of retroactivity criteria lives on in the “modesty doctrine” articulated in *Carlton*. [FN82]

For the next 45 years, the Court heard very few constitutional challenges to retroactive tax legislation. In a 1981 per curiam decision, the Court upheld a retroactive increase in the minimum rate of income taxation and a reduction in the exemption amount. [FN83] This measure, enacted in October 1976 as part of the *304 Tax Reform Act of 1976, [FN84] applied to the 1976 tax year forward. [FN85] The Court observed that it had consistently held that application of income tax statutes to the entire calendar year in which enactment took place did not per se violate the Due Process Clause, and that this type of retroactive application, confined to short and limited periods, was “required by the practicalities of producing national legislation.” [FN86] In essence, the Court held that the period of retroactivity for the income tax was modest and reasonable, and therefore, the tax itself did not transgress due process limitations. [FN87]

In upholding the retroactive application of the increased tax rate, the Court also dismissed the taxpayer's reliance on the *Nichols* line of cases as gift-tax cases impacting gifts that were completely vested before the enactment of the gift tax. [FN88] Contrary to the taxpayer's argument, the 1976 amendments to the income tax did not create a wholly new tax governed by the stricter *Nichols* analysis. Additionally, the Court applied an actual notice criterion and determined that the taxpayer had adequate notice of the proposed change in law. [FN89]

3. The Legitimate Purpose Test

In *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.* [FN90] in 1984, the Court shifted from the “harsh and oppressive” standard to the “legitimate purpose” test. [FN91] While both standards analyze the length of the retroactivity period, the legitimate purpose test looks to whether a legitimate, rational purpose underlies the tax legislation, as opposed to the nature of the tax, which was the second element analyzed under the harsh and oppressive standard.

The Multiemployer Pension Plan Amendments Act of 1980 (“MPPAA”) [FN92] applied withdrawal-liability provisions to employers withdrawing from pension plans during a five-month period prior *305 to the statute's enactment. [FN93] The effective date of the withdrawal-liability provisions was the date on which the guaranty corporation had initially submitted its recommendations to Congress. Congress selected this date to prevent employers from avoiding the adverse consequences of withdrawal liability by withdrawing from plans while the liability was being considered by Congress. [FN94] Following approval in committee, Congress advanced the effective date of the measure by more than a year, as the date contained in earlier versions of the bill had served Congress's deterrent purpose. [FN95] Ultimately, the withdrawal-liability provisions took effect approximately five months before the statute was enacted into law. [FN96]

In analyzing the constitutional challenge, Justice Brennan, writing for a unanimous Court, relied on a 1976 decision [FN97] that applied the legitimate purpose test in upholding the retroactivity of a coal mine health and safety act. [FN98] Under this rather lenient test, [FN99] the government need only show that the retroactive application of the legislation was justified by a rational legislative purpose. [FN100] In *Pension Benefit*, the Court found this standard easily satisfied. There was a rational purpose behind the legislation because Congress was concerned that employers would have a greater incentive to withdraw from the pension funds if they knew that legislation imposing greater liability on withdrawing employers was being considered. Congress, therefore, rationally sought to prevent employers from taking advantage of

lengthy legislative processes and withdrawing funds while Congress debated. [FN101]

The Court also reviewed the period of retroactivity and found that—like other legislation sustained by the Court—it was confined to a short and limited period required by practicalities associated with producing national legislation. [FN102] Therefore, the Court was “loathe to reject such a common practice when conducting the limited judicial review accorded economic legislation” under the *306 Due Process Clause. [FN103] Because the Act was made retroactive for only a five-month period and supported by a rational and legitimate purpose, it withstood the taxpayer’s due process challenge. [FN104]

In rejecting the due process challenge, the Court also turned away from the actual notice test, indicating that notice of the pending legislation was irrelevant to its analysis. [FN105] The taxpayer and amici curiae had contended that the retroactive application of the MPPAA was subject to heightened judicial scrutiny because taxpayers did not have adequate notice of the changing tax ramifications. [FN106] The Court, however, expressed doubts that the retroactive application would be invalid for lack of notice even if it had been suddenly enacted by Congress. [FN107] Nevertheless, by concluding that the employers had adequate notice of the withdrawal liability through congressional debates on the MPPAA, the Court declined to state definitively whether actual notice of the legislation was a relevant factor. [FN108]

A mere two years later, however, the Court reverted to the harsh and oppressive formulation of the due process test in upholding statutory transitional estate and gift tax rules against a due process challenge. [FN109] Congress enacted the transitional rule to bridge old and new regimes of federal taxation of gifts and estates. [FN110] Its purpose was to prevent taxpayers from obtaining a windfall of double exemptions in the four-month interim period. [FN111]

The district court had revived the *Nichols* line of cases, concluding that the interim rules violated due process because they applied to gifts made before the enactment of the amending legislation. [FN112] Justice Marshall, writing for the unanimous Court, reversed and dismissed the value of *Nichols* in deciding the constitutionality of amendments affecting the operation of existing tax laws. [FN113] Once again, the Court confined the more rigorous review *307 employed in *Nichols* and its progeny to the retroactive imposition of wholly new taxes. In contrast, amendments to the estate and gift tax structure were to be reviewed by considering the “nature of the tax” in determining whether its retroactive application was so “harsh and oppressive” as to violate the Due Process Clause. [FN114] Applying this test to the facts, the Court had little trouble upholding the transitional rules, particularly because the petitioners were not financially prejudiced by passage of the act—they simply were unable to avail themselves of a windfall that would have resulted in the absence of the short transitional period created by the legislation. [FN115]

C. United States v. Carlton

In the seminal 1994 *United States v. Carlton* [FN116] decision, the Supreme Court upheld yet another estate tax amendment against a due process challenge. [FN117] The majority concluded that a 1987 amendment to the 1986 Tax Reform Act, [FN118] made retroactive to the Act’s enactment in October 1986, was valid under the Due Process Clause. [FN119] Perhaps most significantly, however, Justice O’Connor issued a concurring opinion that suggested a more objective standard for determining the permissible period of retroactivity. [FN120] In a frequently cited portion of the opinion, she wrote: “A period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions.” [FN121] As discussed in Part IV below, several state courts have relied on this concurring opinion to invalidate state and local tax legislation with extensive periods of retroactivity, thereby reviving the use of the Due Process Clause as a limitation on retroactive tax provisions.

In the Tax Reform Act of 1986, Congress added a new estate tax provision applicable to any estate that filed a timely

return after October 22, 1986 (the date of the Act's enactment). This provision granted a deduction for certain proceeds from the sale of employer securities by an estate to an employee stock ownership plan *308 ("ESOP"). For the sale to qualify for a deduction, the sale had to be made before the date on which the estate tax return was required to be filed, including extensions. [FN122]

Respondent Carlton, the executor of an estate, purchased 1.5 million shares of stock with estate funds on December 10, 1986. [FN123] Carlton sold the stock two days later to an ESOP, for an amount \$631,000 less than the purchase price. [FN124] When he filed the estate tax return on December 29, 1986, Carlton availed the estate of the new ESOP deduction and claimed a deduction for half of the sale proceeds. [FN125] This deduction decreased the estate tax liability by approximately \$2.5 million. [FN126]

In early 1987, recognizing the unintended loophole created by the plain language of the ESOP legislation, the IRS announced that through pending "clarifying legislation," it would permit the ESOP deduction only for estates of decedents who owned the stock before death. [FN127] On December 22, 1987, Congress enacted the amendment, which provided that the securities sold to an ESOP must have been directly owned by the decedent immediately before death to qualify for the deduction. [FN128] This amendment was made retroactive to October 22, 1986, the date of enactment of the 1986 Tax Reform Act. [FN129]

Based on the 1987 legislation, the IRS disallowed Carlton's claimed estate tax deduction. [FN130] Carlton paid the assessment and pursued a claim for refund, contending that the retroactive application of the legislation violated the Due Process Clause. [FN131] A divided panel of the Ninth Circuit Court of Appeals applied a notice test, concluding that Carlton did not have actual or constructive notice of the retroactive amendment of the statute at the time he entered into the transaction and that he thereby reasonably relied to his detriment on the legislation. [FN132] Therefore, the Ninth Circuit *309 majority concluded that retroactive application of the amendment was unconstitutional. [FN133]

1. Justice Blackmun's Majority Opinion

Writing for the Supreme Court majority, Justice Blackmun observed that the Court repeatedly had upheld retroactive tax legislation against due process challenges. [FN134] In an apparent effort to reconcile the different tests applied by the Court over the years, the opinion characterized the harsh and oppressive formulation [FN135] as no different than the legitimate purpose test [FN136] recently applied to tax measures and traditionally used in assessing the constitutionality of economic legislation. [FN137] The Court clarified that the due process test applicable to retroactive tax statutes is, therefore, the same as the test generally applied to retroactive economic legislation--namely, whether the retroactive application of the statute is supported by a legitimate legislative purpose furthered by rational means. [FN138]

Applying this test to the 1987 amendment, the Court first concluded that the retroactive application to October 1986 was supported by a legitimate, non-arbitrary purpose. [FN139] In particular, the retroactive application was intended to cure a drafting defect in the 1986 legislation. [FN140] Through the ESOP deduction, Congress had intended to encourage stockholders to sell their companies to their employees, rather than permit executors to drastically reduce estate tax liability by purchasing stock and immediately reselling it to an ESOP. [FN141] Indeed, the estimated revenue loss without the 1987 amendment was more than 20 times greater than anticipated. [FN142] Congress therefore did not have an improper motive in stemming the revenue loss by retroactively closing the loophole. [FN143]

Critically, in determining whether the statute was supported by rational means, the Court also analyzed the period of retroactivity.*310 The majority concluded that Congress acted promptly and established only a modest period of retroactivity. [FN144] Relying on the Court's prior decisions upholding retroactive tax legislation confined to short periods

“required by the practicalities of producing national legislation,” [FN145] the Court concluded that the period of retroactivity--slightly more than one year--was modest. [FN146] In particular, the Court endorsed the *Welch* Court's prior legislative session test. [FN147] The Court also observed that the amendment had been proposed by the IRS since January 1987, only two months following the effective date of the 1986 legislation. [FN148]

Despite the relatively short period of retroactivity, it was undisputed that Carlton had no actual or constructive notice of the amendment to the ESOP deduction because he sold the stock in December 1986, prior to the IRS notice. [FN149] Critically, however, the Court determined that Carlton's lack of notice of the 1987 amendment and detrimental reliance on the original statute alone were insufficient to create a constitutional violation. [FN150] In an oft-cited statement, the majority opined that “[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code.” [FN151]

The Court confirmed that the *Nichols* approach “has long since been discarded” and, to the extent viable, pertains only to the creation of a wholly new tax. [FN152] Moreover, in rejecting Carlton's argument that retroactive estate and gift tax legislation be analyzed under a stricter test than retroactive income tax legislation, the Court confirmed that the nature of the tax at issue is not dispositive. [FN153] The Court therefore reversed the Ninth Circuit's decision, which had relied exclusively on the notice test, and held that the retroactive application of the 1987 amendments to October 1986 satisfied the Due Process Clause. [FN154]

*311 2. Justice O'Connor's Concurrence

In a concurring opinion, Justice O'Connor criticized the majority's focus on the “curative” nature of the 1987 amendment as support for finding a legitimate purpose. [FN155] Observing that any statute amending an existing law is intended to fix a perceived problem with the existing law, Justice O'Connor concluded that retroactive application of revenue measures are by their nature rationally related to the legitimate governmental purpose of raising revenue. [FN156]

The concurring opinion acknowledged the wholly new tax exception. For instance, the retroactive application of a wholly new tax is arbitrary, even though it would raise revenue. [FN157] As the tax consequences of commercial transactions are relevant and sometimes dispositive considerations in taxpayers' business decisions, it is arbitrary to tax transactions that were not subject to taxation at the time the taxpayer entered into them. [FN158] While the retroactive application of increased tax rates or the elimination of deductions could have similar effects on taxpayers who reasonably relied on the existing legislation, the concurring opinion recognized the Court's precedent, holding that Congress must have some ability to make retroactive adjustments as a means of equalizing revenue and budgetary requirements. [FN159]

Critically, the concurring opinion also suggested that a more objective test be applied to the period of retroactivity. [FN160] Justice O'Connor first noted that “[t]he governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in finality and repose.” [FN161] In every case in which the Court upheld retroactive federal tax statutes against due process challenges, the law applied retroactively for only a relatively short period. Although the retroactivity periods generally were less than one year, [FN162] those periods greater than a year in length were made in the first legislative session following the tax year in question. [FN163] Therefore, Justice O'Connor stated her belief that a retroactivity *312 period longer than the year before the enacting legislative session would raise serious constitutional issues. [FN164] Since the 1987 amendment was enacted the year following the original legislation, given the Court's precedents, Justice O'Connor concurred that the retroactive application of the estate tax amendment did not violate due process.

3. Justice Scalia's Concurrence

Justice Scalia concurred in the judgment based on his belief that the Fifth Amendment's Due Process Clause does not protect substantive due process. [FN165] In dicta, his opinion went further by applying the actual notice and detrimental reliance test, leading to a conclusion that--if there were such a thing as substantive due process--the retroactive application of the 1987 amendment would violate it because Carlton obviously relied on the prior law to the estate's detriment. [FN166] Additionally, Justice Scalia predicted that the majority's reasoning would guarantee that *all* retroactive tax laws would henceforth be valid. [FN167] As will be seen below in Part III, this prediction proved erroneous.

III. POST-CARLTON: THE MODESTY DOCTRINE

A. Retroactivity Periods of Less Than One Year Have Been Upheld

Due process challenges to retroactive federal and state tax legislation consistently have failed in the post-*Carlton* era when the period of retroactivity was one year or less. For instance, shortly after *Carlton* was announced, the Seventh Circuit Court of Appeals upheld the constitutionality of an amendment subjecting loan proceeds received from qualified corporate pension plans to income taxation. [FN168] The period of retroactivity was limited to one month. [FN169] Nonetheless, the taxpayer asserted that the taxation of the loan proceeds in question was a "wholly new tax" and therefore invalid under the *Nichols* line of authority. [FN170] In rejecting the taxpayer's characterization of the tax measure, the court determined that the change in the income tax was reasonably foreseeable at the time the taxpayer obtained the loan proceeds, and therefore, the amendment was not a wholly new tax subject to strict scrutiny. [FN171] Relying on *Carlton*, the Court had little trouble finding that the goals of raising revenue and preventing taxpayers from taking advantage of a prospective change in the law constituted legitimate purposes for the retroactive impact of the legislation. [FN172] Further, the very limited period of retroactivity demonstrated that the legislative purpose was backed by reasonable means. [FN173]

Also at the federal level, two lower federal courts upheld the 1993 Omnibus Budget Reconciliation Act's [FN174] retroactive increase in the estate tax rate. [FN175] The period of retroactivity was eight months. [FN176] Based on *Carlton*, the courts determined that the period of retroactivity was short and limited. [FN177] The courts also relied on *Carlton* in concluding that retroactive tax legislation may be backed solely by the rational, legitimate purposes of raising revenue and promoting taxpayer equity. [FN178] As Justice O'Connor observed, the conclusion essentially validates every retroactive tax measure under the legitimate purpose test. [FN179]

Retroactive state tax measures with relatively short periods of retroactivity also have routinely been upheld since 1994. For instance, the Arizona Legislature's amendment retroactively reducing an alternative fuel tax credit was sustained over the taxpayers' due process challenge. [FN180] The amendment retroactively eliminated a tax credit equal to 30%-50% of the purchase price of the vehicle. [FN181] Under the amendment, the credit was retroactively limited to the total costs of converting a vehicle to alternative fuel. [FN182] The period of retroactivity was eight months. [FN183] Rejecting the taxpayers' argument that the retroactive application of the law violated their due process rights, the Arizona Court of Appeals held that the retroactive application of the tax was backed by the legitimate legislative purpose of closing a loophole under the existing law, and further, that the eight-month period of retroactivity was modest. [FN184]

B. Several Decisions Have Upheld Tax Legislation and Regulations Containing Retroactivity Periods of Greater Than

One Year

Following *Carlton*, several federal and state courts upheld tax legislation containing retroactivity periods greater than one year in length. In most of these cases, the courts either did not fully apply the *Carlton* modesty doctrine or upheld retroactive federal tax regulations, which generally were accorded more lenient due process review than statutes.

For instance, in *Montana Rail Link, Inc. v. United States*, [FN185] the Ninth Circuit Court of Appeals upheld the retroactive application of the Omnibus Budget Reconciliation Act of 1989 ("1989 OBRA") [FN186] to employer contributions made to the Railroad Retirement Tax Act ("RRTA") [FN187] in 1987 and 1988. [FN188] Congress had retroactively barred refund claims by employers that had previously paid RRTA tax on their employer 401(k) contributions. [FN189] Without the period of retroactivity, the railroad workers' retirement funds and benefits would have been jeopardized. [FN190] Indeed, some employees had already received benefits based on the amounts paid into the funds and credited to the accounts for the period in issue. [FN191] Although the petitioners challenged the retroactive*315 application of the 1989 OBRA to their refund claims for tax years 1987 and 1988, the Act retroactively barred refund claims back to 1983, a period of up to six years. [FN192] In upholding the retroactive application of the 1989 OBRA, the Ninth Circuit focused on the harm Congress attempted to prevent in protecting the retirement funds of the railroad workers and concluded that the 1989 OBRA had a legitimate legislative purpose. [FN193]

The court did not, however, strictly apply the second prong of the *Carlton* test. Instead, it reasoned that a shorter period of retroactivity would have benefitted only some of the employees and that a period of retroactivity to 1983 salvaged all employees' retirement funds and reliance on the prior employer contributions. The court therefore concluded that the statute's period of retroactivity bore a rational relationship to the legitimate legislative purpose it was trying to achieve. [FN194]

Additionally, several lower federal court decisions have sustained federal tax regulations containing retroactivity periods longer than one year. However, those decisions emphasized that, contrary to tax statutes, which typically act prospectively, federal tax regulations are often applied retroactively. [FN195] Federal regulations are therefore governed by a more lenient standard of review under the *Carlton* modesty doctrine. For instance, the Third Circuit Court of Appeals upheld a six-year period of retroactivity contained in a Treasury Regulation. [FN196] The Court observed that under the Internal Revenue Code, [FN197] Treasury Regulations were statutorily presumed to operate retroactively. [FN198] Accordingly, a different test applies in determining whether a retroactive federal tax regulation has a modest look-back period. Specifically, courts look to whether the regulation actually effects a change in law or *316 policy, and whether the taxpayer detrimentally and reasonably relied on the prior regulation. [FN199] Many regulations clarify ambiguous statutes and unsettled law, and, therefore, the retroactive application of the regulation may not effect a change in law. Likewise, the existing, ambiguous law is not as likely to produce reasonable, detrimental reliance by the taxpayer. [FN200]

At the state level, at least two courts have upheld tax measures with retroactivity periods greater than one year. In *Monroe v. Valhalla Cemetery Co.*, [FN201] the Alabama Court of Civil Appeals upheld a use tax statute with a retroactivity period of two to three years. [FN202] Several administrative rulings had revealed a loophole in Alabama's sales and use tax law, whereby sales of goods delivered into the state from out-of-state vendors were not subject to the state's use tax. [FN203] In cases where the vendors had insufficient contacts with the state, no state sales tax could be lawfully applied either. [FN204] In 1997, the state enacted legislation that closed the loophole and applied the act retroactively for all open tax years. [FN205] The retroactivity provision therefore prevented taxpayers from seeking certain use tax refunds for the two- to three-year period that would otherwise have been open. [FN206] On appeal, the trial court ruled the two-to three-year period excessive and upheld the taxpayer's due process challenge. [FN207]

In reversing the trial court and rejecting the taxpayer's constitutional challenge, the state appellate court first found that there was a legitimate legislative purpose behind the act and that the legislation merely "clarified" the legislature's intent. [FN208] Second, in summary fashion, the court concluded that the period of retroactivity was modest. The court relied on Alabama precedent that had upheld a tax assessment with a retroactivity period of eight years. [FN209] Additionally, the court was swayed by the fact that without*317 the retroactive application of the legislation, taxpayer refunds for the open period would create a considerable strain on the state budget. [FN210]

More recently (December 2008), in *Enterprise Leasing Co. of Phoenix v. Arizona Dep't of Revenue*, [FN211] the Arizona Court of Appeals upheld a tax statute with a six-year period of retroactivity. In 1994, the Arizona State Legislature authorized a pollution control equipment income tax credit allowed against taxes incurred by a taxpayer when purchasing real or personal property that is used to control or prevent pollution. [FN212] Five years later, the Department of Revenue received its first claim for a credit for equipment attached to a motor vehicle. [FN213] It soon became apparent that the tax credit would cost the state considerably more than expected, and in April 2000, the Legislature amended the statute to provide that the credit does not apply to the purchase of any personal property attached to a motor vehicle. [FN214] In somewhat contradictory terms, the legislation provided that the amendment amounted to a "clarifying change" that (1) was "consistent with the legislature's intent when [the credit was] enacted," (2) was intended "to close loopholes," and (3) was "to apply retroactively to taxable years beginning from and after December 31, 1994." [FN215] In March 2000, the taxpayer filed refund claims, claiming the credit for personal property attached to motor vehicles. [FN216] After the claims were denied, the taxpayer challenged the retroactivity of the legislation under the substantive Due Process Clause.

The Arizona Court of Appeals first characterized the legislation as "curative" in light of the legislative statement that the amendment was a clarification of legislative intent. [FN217] Therefore, the *318 Court reasoned, "the amendment did not retroactively abolish a right." [FN218] Then, relying on the *Carlton* majority opinion, the Court held that, even if the amendment was not curative, it passed constitutional muster because it was supported by a legitimate legislative purpose (fixing a perceived loophole to minimize exposure to refund claims) and was furthered by rational means. [FN219] In upholding the amendment under the modesty doctrine, the Court incorporated actual notice/detrimental reliance and vested rights issues into its analysis and relied on judicial precedent upholding tax measures with retroactivity periods longer than one year. [FN220] The Court also declined to impose a one-year "talismanic cutoff because such a notion arose from Justice O'Connor's concurrence in *Carlton*--not the majority opinion. [FN221] The *Enterprise* Court proceeded to observe that some leeway must exist for retroactivity longer than a year "so long as the legislature acts at the earliest notice or opportunity." [FN222] Because the department of revenue had not received any pollution control equipment tax credit claims for motor vehicles until December 1999, the Court reasoned that the Legislature acted promptly by enacting the amendment in April 2000. [FN223]

C. Several State Cases Have Struck Tax Measures with Retroactivity Periods of Greater Than One Year

In the post-*Carlton* era, at least three state appellate court decisions have held that tax measures with retroactivity periods of greater than one year violated due process. [FN224] Each of these cases cited Justice O'Connor's *Carlton* concurrence and concluded that the tax provisions at issue violated the modesty doctrine.

*319 In *Rivers v. State*, [FN225] the South Carolina Supreme Court invalidated legislation with a retroactivity period of two to three years. [FN226] A 1988 act had retroactively decreased the capital gains tax rate. [FN227] A year later, an amendment retroactively limited the period of the lower tax rate and provided that the refund would be made in two equal annual installments, with the first refund to be issued in 1990. [FN228] Then, in 1991, the legislature amended the

capital gains tax yet again, this time retroactively reducing each refund by 50%. This amendment would have divested taxpayers of the one-half of their refunds they had not already received. [FN229] The litigant taxpayers, who had realized capital gains in the subject period between January 1 and June 22 of 1987, brought suit because the 1991 amendment retroactively eliminated the portion of the 1987 tax year refund they had not yet received. [FN230]

Citing Justice O'Connor's concurrence, the South Carolina Supreme Court held that the 1991 act violated both the federal and state due process clauses because the period of retroactivity was not modest. [FN231] The court determined that depending on whether the calculation of retroactivity went back to the 1989 amendment or the original 1988 legislation, the period of retroactivity was at least two (and possibly three) years in length. [FN232] In holding the legislation unconstitutional, the court observed: "At some point, however, the government's interest in meeting its revenue requirements must yield to taxpayers' interest in finality regarding tax liabilities and credits." [FN233] The *Rivers* Court determined that tipping point had been reached and that, under the facts and circumstances, the retroactivity period was "simply excessive." [FN234] In concluding that the period violated the modesty doctrine, the court qualified its holding by stating that it did not suggest that every retroactivity period of two to three years or more was per se unreasonable. [FN235]

*320 In the 2005 decision *City of Modesto v. National Med, Inc.*, [FN236] the California Court of Appeal held that a city's attempt to retroactively impose revenue apportionment guidelines in an effort to moot out a pending refund claim violated the modesty doctrine. [FN237] A trial court had previously held that the city's business license tax ordinance was unconstitutional as applied to the taxpayer because it imposed tax on business activities occurring outside of the city. [FN238] Following the ruling, the city amended its business license tax ordinance in 2002 to provide for apportionment. [FN239] More than a year later, in September 2003, the city council enacted apportionment guidelines. [FN240] The city sought to retroactively impose the ordinance amendment and the apportionment guidelines to all tax refund claims, including pending claims. [FN241] The retroactive application of the 2002 amendment and the 2003 apportionment guidelines would therefore have had the effect of substantially reducing the tax refund the petitioner would receive for the tax years at issue (1996-2000). [FN242] Then, in 2004, in an attempt to cover the tax deficiency assessment the city had previously issued to the petitioner, the city enacted yet another set of apportionment guidelines, seeking to impose the guidelines retroactively to all pending assessments. [FN243]

The California appellate court held that the city's attempt to retroactively impose the apportionment amendment and guidelines violated *Carlton's* modesty doctrine because the retroactive application was four to eight years in the past. [FN244] The taxpayer had first claimed in February 2000 that the business license tax was unconstitutional. The city did not amend its ordinance to provide for apportionment until August 2002. A year passed before the city enacted its first set of apportionment guidelines, and then another year passed before the city promulgated guidelines in an attempt to impact the pending assessment. [FN245] In an understatement,*321 the court concluded that "the City cannot be found to have acted promptly." [FN246]

Moreover, in addition to finding that the city did not act promptly, the court held that the total period of retroactivity was not modest. The city sought to impose the 2004 guidelines retroactively up to eight years. [FN247] Noting that California courts have upheld the retroactive application of tax laws only where the retroactivity was limited to the current tax year, [FN248] and citing the O'Connor *Carlton* concurrence, the *City of Modesto* Court concluded that the period of retroactivity violated the modesty doctrine.

Lastly, in *Johnson Controls, Inc. v. Rudolph*, [FN249] decided in 2006, the Kentucky Court of Appeals determined that the Commonwealth's efforts to retroactively eliminate taxpayers' pending administrative claims for overpayment of income tax violated the taxpayers' right to due process. [FN250] A 1994 decision of the Kentucky Supreme Court had overturned the Kentucky Revenue Cabinet's policy of not permitting unitary income tax returns. [FN251] The taxpayers

thereafter filed amended income tax returns and sought refunds of taxes overpaid as a result of the Commonwealth's unlawful policy of prohibiting unitary returns. [FN252] These refund claims languished at the administrative level until 2000, when the legislature, alarmed at the growing size of the refund claims, passed H.B. 541, [FN253] which sought to extinguish all refund claims filed from December 22, 1994, to December 31, 1995, that were based on a change from initially filed separate returns to combined returns. [FN254]

*322 The Kentucky Court of Appeals applied *Carlton's* two-part test [FN255] and concluded that the five- to nine-year period of retroactivity in H.B. 541 was excessive. [FN256] The court first concluded that the act was enacted for the legitimate purpose of preventing a significant revenue loss. [FN257] However, the court held that while "no hard and fast rule exists for what is or is not a permissibly modest period of retroactivity ... Justice O'Connor's concurring opinion in *Carlton* sets forth a bright line one-year limitation on the permissible period of retroactivity for a taxation statute." [FN258] The court therefore held that H.B. 541's period of retroactivity violated the modesty doctrine. [FN259] In so holding, the court observed that, had the general assembly enacted the act in 1996--its first session following the 1994 decision the outcome of the appeal "may well have been different." [FN260]

The Commonwealth appealed the *Johnson Controls* decision to the Kentucky Supreme Court, where the case is still pending. [FN261]

IV. TOWARD A BRIGHT LINE -- A ONE-YEAR REBUTTABLE PRESUMPTION

Three state court decisions--*Rivers*, *City of Modesto*, and *Johnson Controls*--invalidated tax measures containing retroactivity periods longer than one year. These decisions have established that *Carlton* did not represent the end of due process as a limitation on retroactive tax legislation, as some commentators believed. [FN262] Indeed, Justice O'Connor's concurrence, cited by all *323 three state courts, revived application of the Due Process Clause to retroactive tax measures by suggesting that retroactive tax legislation that extends beyond the year preceding the enactment of the tax legislation violates taxpayers' rights to substantive due process. This section of the article proposes that Justice O'Connor's analysis become firmly embedded into judicial scrutiny of retroactive tax measures.

A. Tax Legislation Retroactive to the Year Preceding the Passage of the Legislation Is Presumptively Constitutional

With few exceptions, tax measures containing retroactivity periods of roughly one year or less have been sustained over constitutional challenges. The courts have made it clear that no legitimate basis exists to assert that tax legislation applied retroactively is inherently unconstitutional. When the legislation contains a modest look-back period of approximately one year or less, the judiciary has almost universally determined that the period of retroactivity was legitimate and reasonable under the Due Process Clause and therefore was not so harsh as to transgress constitutional limitations. It is therefore reasonable to interpret the jurisprudence as affording a rebuttable presumption of constitutionality to tax legislation applying retroactively to only the calendar year preceding the legislation. [FN263]

Upholding tax legislation with a period of retroactivity of about one year or less gives Congress, as well as state and local legislative bodies, the ability to promptly cure perceived loopholes and defects in tax legislation without suffering a significant loss in revenue. This presumption also accounts for the practicalities of producing national legislation and allows Congress the authority to prevent parties from undermining the ends Congress is attempting to achieve by acting before the legislation takes effect. *324 Although such legislation often undermines taxpayer expectations, the relatively limited period of retroactivity diminishes this unfairness and interference with reasonable expectations. Furthermore, a relatively modest period of retroactivity included in a measure intended to amend recently enacted legislation minimizes

the likelihood that a taxpayer has detrimentally and reasonably relied on the prior version of the law.

This presumption of constitutionality is merely a rebuttable presumption, however. First, a wholly new tax applied retroactively violates due process regardless of the length of the period of retroactivity. Wholly new retroactive taxes were invalidated in the *Nichols* line of authority (invalidating new estate and gift tax provisions applied retroactively). [FN264] The courts have confined the *Nichols* analysis to wholly new retroactive taxes. [FN265] The issue of what constitutes a “wholly new tax” is not entirely clear, however, and courts generally have rejected taxpayer contentions that the tax legislation in question represents such a tax. [FN266] Certainly, a tax that did not previously exist in any form would qualify as a wholly new tax. Wyoming, for instance, currently has no income tax and would therefore not be permitted to retroactively impose such a tax under the wholly new tax doctrine. Likewise, a state legislature or municipality would not be permitted to retroactively impose sales or use tax on transactions that were plainly outside the scope of the tax at the time they occurred.

A second, non-constitutional exception to the presumptive validity of tax measures containing modest periods of retroactivity lies in New Jersey's current application of the common-law “manifest injustice” doctrine to retroactive taxation. [FN267] The doctrine of manifest injustice is “designed to prevent unfair results that do not necessarily violate any constitutional provision.” [FN268] In February 2008, a divided New Jersey Supreme Court struck down a state estate tax amendment with a retroactive period of six months. [FN269] The taxpayers had abandoned their constitutional challenges to the measure during the appeal process, and they instead argued that application of the amendment to the subject estates was unfair and inequitable because the decedents were unable to change *325 their wills and thereby had their reasonable expectations defeated. [FN270] In striking the amendment under the manifest injustice doctrine, the plurality concluded that the public interest in diminishing the loss in revenue was outweighed by the patently reasonable reliance of the decedents on the prior law and that it would be harsh and unfair to apply the amendment retroactively. [FN271]

The dissent observed that other courts, including the United States Supreme Court, applied the doctrine of manifest injustice only in the determination of whether a statute was in fact retroactive. [FN272] Where the legislative intent to apply a law retroactively is clear, a court should apply the law as written, subject to constitutional limitations. [FN273] However, if it is unclear whether a legislative body intended a statute to operate retroactively, the doctrine of manifest injustice requires the statute to apply prospectively only. The doctrine only constitutes a canon of statutory interpretation, reasoned the dissent. [FN274]

The New Jersey judiciary's use of the doctrine of manifest injustice as a substantive legal theory to invalidate retroactive legislation, while novel and enhancing settled expectations, appears at odds with the United States Supreme Court's precedent and the historical use of the doctrine as a canon of statutory construction. [FN275] Accordingly, while the doctrine may continue to be successfully employed in New Jersey to invalidate inequitable retroactive tax legislation, it is unlikely it will be extended to other state or federal courts.

Lastly, it should be noted that retroactive taxation with limited periods of retroactivity may violate state constitutional provisions prohibiting all forms of retrospective legislation. For instance, a Colorado constitutional provision prohibits both *ex post facto* and retrospective civil legislation. [FN276] In general, legislation is retrospective if it “destroys or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past.” [FN277] By their nature, retroactive tax measures *326 create new obligations or impose new duties with respect to transactions or considerations already past. [FN278] Therefore, in states with constitutional provisions prohibiting retrospective legislation, a retroactive tax measure may survive federal substantive due process scrutiny, only to be invalidated as unconstitutional retrospective legislation under state law.

B. Tax Legislation Containing a Period of Retroactivity Extending Beyond the Year Preceding the Legislation Is Presumptively Unconstitutional

On the other end of the spectrum, tax legislation enacted in the post- *Carlton* era containing periods of retroactivity greater than one year often has been invalidated under the Due Process Clause. [FN279]

Admittedly, several post-*Carlton* decisions have upheld retroactive tax legislation containing periods of retroactivity in excess of one year. In *Montana Rail Link*, the Ninth Circuit upheld the retroactive application of the 1989 OBRA, where the period of retroactivity was up to six years. There, however, the court did not rigorously apply the modesty doctrine from *Carlton* and was plainly animated by the need to protect the retirement funds of railroad workers. [FN280] Additionally, in *Monroe*, the Alabama appellate court relied on two 1995 state court decisions in concluding that the two- to three-year period of retroactivity did not violate the Due Process Clause. However, neither of the 1995 state court decisions relied on by *Monroe* applied *Carlton's* modesty doctrine. Moreover, the courts reasoned that the subject legislation clarified the exemption statutes at issue and therefore may not have been retroactive at all. [FN281]

In the pending *Enterprise Leasing* litigation, the Arizona Court of Appeals applied *Carlton's* modesty doctrine and concluded that a six-year period of retroactivity passed constitutional muster. [FN282] Although the court determined it was not bound by Justice *327 O'Connor's one-year analysis, in sustaining the legislation, the court relied on the fact that the Legislature did not become aware of the potential application of the tax credits to motor vehicles until approximately six months before the enactment of the subject legislation. [FN283]

Although the post-*Carlton* decisions do not unanimously provide that tax legislation with retroactive periods exceeding a year are presumptively invalid, the decisions addressing the constitutionality of retroactive tax statutes generally line up on either side of the one-year threshold. [FN284] Further, *Rivers*, *City of Modesto*, and *Johnson Controls* each contain a more robust analysis of the modesty doctrine and are the better reasoned authorities, providing a sound legal and policy basis for a presumptive one-year standard.

In general, retroactive legislation undermines the ability of individuals and companies to act in their own interests, to avoid acting in ways that will harm them, and to plan their conduct "with reasonable certainty of the legal consequences." [FN285] Retroactive legislation therefore has always been considered unfair. [FN286] Retroactive tax legislation is no different. By their nature, retroactive tax measures are considered unjust, as they defeat taxpayers' reasonable reliance on the law as it existed at the time of the action in question. Thus, they should be limited and used sparingly. While the retroactive application of particular tax measures may advance the common good and rectify a previously made error in legislation, tax jurisdictions should be required to act promptly or face the prospect that the retroactivity passes the point that most reasonable people "would think tolerable." [FN287]

Moreover, notions of fundamental fairness and fair dealing warrant the adoption of a rebuttable presumption that tax legislation with a retroactivity period greater than the year preceding the legislation is unconstitutional. In the vast majority of cases up-*328 holding retroactive tax legislation, the legislative body enacted the legislation at the first session following the period in question. In *Welch*, for instance, although the period of retroactivity was between one and two years, the Supreme Court upheld the legislation because the Wisconsin State Legislature met every other year and enacted the legislation at the legislative session immediately following the tax year in question. [FN288]

As Justice O'Connor observed in 1994 and Judge Learned Hand noted in 1930, at some point, taxpayers should achieve finality and be assured that the tax consequences of prior transactions will not change to their detriment. Moreover, retroactive legislation must serve both a legitimate purpose and be reasonably related to its ends. With a presumptive one-year period of retroactivity, legislative bodies have the ability to retroactively correct mistakes and close

loopholes, provided that they act promptly. Presumptively invalidating tax legislation with longer periods of retroactivity helps to ensure that legislative bodies will not unduly delay retroactive amendments to the detriment of taxpayers.

Tax jurisdictions should be permitted the opportunity to surmount the rebuttable presumption, however. The presumption emanates from *Carlton's* second prong of the due process test--whether the legislation was supported by rational means. [FN289] As articulated by Justice O'Connor and the three post-*Carlton* state courts that have struck retroactive tax legislation, such legislation is supported by rational means if it contains a relatively modest period of retroactivity. In *City of Modesto*, the California Court of Appeal observed that the legislative body must act promptly for a retroactive tax measure to be supported by rational means. [FN290]

The presumptive one-year look-back period is an attempt to draw the line in a reasonable location. Of course, what is reasonable depends on the circumstances, and government entities must be afforded the ability to demonstrate that a retroactive tax measure's extension beyond the year preceding the legislation's enactment is reasonable. The desire to stem revenue loss or to solve a budget crisis is not sufficient, as such goals are embedded in *Carlton's* first prong of whether the retroactive tax legislation was enacted for a legitimate purpose. To overcome the one-year presumption, the government should be required to show that it could not have acted sooner.

*329 Furthermore, the government should not be permitted to surmount the presumption by enacting retroactive legislation within a year of an adverse appellate decision. Legislative bodies have either actual or constructive notice when taxpayers commence litigation to challenge a tax measure. If the legislative branch believes that the taxpayers may succeed and open the doors to refund claims for other taxpayers, it should act promptly to rectify any perceived defects in the legislation, rather than await the result of the litigation and then attempt to retroactively slam the door on taxpayer refund claims. [FN291] In short, if a legislature enacts tax legislation that proves to be unconstitutional or otherwise invalid, it should not be permitted to await the result and retroactively cure the defect without providing a remedy to aggrieved taxpayers. On the other hand, if a legislative body can demonstrate that it had no objective reason to be aware of a legal infirmity in tax legislation and that it was unable to have acted sooner, [FN292] it should be permitted to overcome the presumption of unconstitutionality if the tax law's period of retroactivity exceeds one year.

V. CALIFORNIA TAX AMNESTY ACT

In 2004, California enacted a tax amnesty program that offered individual and corporate taxpayers amnesty from penalties and criminal action for certain underpaid sales, use, income, and franchise tax liabilities. [FN293] The amnesty program ran from February 1, 2005, through March 31, 2005, and permitted taxpayers to seek *330 amnesty for any taxable year through and including 2002. [FN294] Any payment made under the amnesty program was purportedly nonrefundable. [FN295]

In addition to offering the carrot of penalty waiver and relief from criminal prosecution, the amnesty program wielded a big stick. Unlike most tax amnesty programs, the California amnesty legislation created and applied a significant new penalty to certain taxpayers who did not participate in the amnesty program, including taxpayers who did not become aware of liabilities until after the amnesty period ended. This penalty is imposed on amounts that were "due and payable" on the last day of the amnesty period, as well as on amounts that become "due and payable" after March 31, 2005. [FN296] The penalty amount is equal to 50% of the interest on tax deficiencies, calculated on the interest due from the original due date of the return to March 31, 2005. [FN297] Additionally, for sales and use taxes, taxpayers who were eligible for the amnesty program but did not participate were subject to penalties at double the normal rate. [FN298] The legislation also provided the State Board of Equalization ("SBOE") with an extended statute of limitations of 10 years to make a deficiency determination. [FN299] For franchise tax purposes, the legislation retroactively increased the accuracy

related penalty for "substantial understatement of income tax" from 20% to 40%. [FN300] As the open audit period on corporate taxpayers often extends many years, a penalty tied to interest amounts could exceed the actual tax liability for the years in question.

To make the penalties even more draconian, the Franchise Tax Board ("FTB") has interpreted this penalty to apply to every income and franchise tax deficiency for taxable years prior to 2003 and existing on March 31, 2005, regardless of whether the deficiency was known (or should have been known) during the amnesty*331 period. [FN301] This interpretation has the effect of imposing retroactive strict liability on taxpayers. Even if a taxpayer were unaware of a prior-year tax deficiency during the two-month amnesty program, if the taxpayer elected not to participate in the program, the legislation sought to retroactively apply a penalty to the tax deficiency in an amount potentially greater than the underlying tax liability.

Moreover, the amnesty program purports to prohibit taxpayers from challenging any amnesty penalty assessments on franchise taxes, whether through a protest after assessment or through a refund claim after payment. [FN302] This absence of remedy and the terms of the program have placed taxpayers in a precarious position. Many alleged tax deficiencies and assessments are the result of a good-faith disagreement between the tax jurisdiction and the taxpayer. For taxpayers who believed that they might have a potential liability for tax years beginning before 2003 (even if they believed in good faith that they did not), the amnesty program essentially asked them to concede the tax, waive all rights to a refund, and pay the tax or be subject to a severe penalty for the years in question. Even worse, taxpayers who were unaware of a potential liability for tax years beginning before 2003 were also subject to application of the penalty for the older years.

Faced with the choice of harsh retroactive penalties or the waiver of appeal and refund rights, many taxpayers made protective payments to the FTB outside the amnesty program, both to avoid penalties and to ensure the legal ability to pursue a refund of the payments if it was later determined that the tax, or any portion of it, was in fact not due. These protective payments greatly exceeded the amnesty program revenue. While the amnesty program collected \$550 million in revenue, taxpayers paid \$3.555 billion in protective payments. [FN303] Because these payments were often made on legitimately disputed items, the state will be required to return many of the protective payments, with interest. [FN304]

*332 The absence of a statutory remedy for recovery of the amnesty penalty plainly violates procedural due process. California's amnesty legislation purports to deprive taxpayers of a predeprivation remedy (ability to challenge an assessment) and a post-deprivation remedy (ability to pay and maintain a refund claim). The failure of the state to provide either form of remedy is a patent violation of procedural due process. [FN305]

More critically for purposes of this article, the legislation violates substantive due process based on the analysis in Part IV. The legislation imposes the amnesty penalty, as of March 31, 2005, on taxpayers that owed a tax for any year beginning before January 1, 2003. [FN306] Particularly for a large corporate taxpayer, whose open tax periods may exceed the standard four-year statute of limitations, the amnesty penalty may increase tax-related liabilities for many years. [FN307] During these years, the amnesty program and concomitant penalty did not exist. In seeking to significantly increase taxpayer liability for these past periods, the amnesty legislation constitutes a retroactive tax measure subject to scrutiny under substantive due process.

In attempting to impose an enhanced penalty on tax years before 2003, the 2004 amnesty legislation seeks to impose a tax-related liability with a period of retroactivity in excess of the year prior to the year the legislation was enacted (2004). Under the test advocated in Part IV, *supra*, the period of retroactivity is excessive, and the legislation presumptively violates substantive due process. Indeed, the amnesty legislation's period of retroactivity is similar in length

to, and in certain circumstances may even exceed, the period of retroactivity that prompted the courts in *City of Modesto* (up to eight years in length) and *Johnson Controls* (up to nine years) to declare the legislation unconstitutional. Moreover, the retroactivity period of the amnesty legislation will in almost every instance exceed the two-to three-year retroactivity period *333 found excessive by the *Rivers* Court. California taxpayers who filed their initial sales, use, income, and franchise tax returns years ago in good faith [FN308] should not be burdened with onerous tax-related obligations that did not exist at the time they filed their returns.

The retroactive application of the amnesty-related penalty is therefore presumptively unconstitutional. Moreover, several exacerbating factors make it unlikely that the state could overcome the presumption. First, unlike the federal legislation upheld in *Carlton*, the tax-amnesty legislation did not seek to close a loophole or correct a drafting error made in prior legislation. Rather, it sought to raise revenue in 2005 by imposing severe penalties on taxpayers who underreported sales, use, income, or franchise tax liability for tax years prior to 2003.

Second, the legislation seeks to apply an increased tax penalty. The Ninth Circuit Court of Appeals has held that legislation which retroactively imposes a tax penalty warrants stricter scrutiny than legislation retroactively increasing tax liability. [FN309] Application of a more searching substantive due process standard to the amnesty legislation enhances the likelihood that it will be struck as unconstitutional.

Third, California courts have already consistently applied a one-year standard to retroactive tax legislation. *City of Modesto* observed that, in general, California courts have upheld the retroactive application of tax laws only where the retroactivity was limited to the current tax year. [FN310] Coupled with the nature of the retroactive tax penalty and its potentially long retroactive reach, it is likely a California appellate court will invalidate the amnesty penalty if challenged under substantive due process.

The FTB and several commentators have expressed the opinion that the amnesty legislation may not be unconstitutional because taxpayers had the opportunity during the amnesty period to correct past reporting mistakes and therefore avoid the amnesty penalty, either through payment under the amnesty program or by making a protective payment outside the amnesty program but within the two-month window. [FN311] Under this view, the amnesty *334 legislation may not be retroactive at all, or if so, retroactive for only a modest period.

This characterization of the amnesty program and penalty fails for at least two critical reasons. First, in denying taxpayers any ability to obtain a refund of tax overpaid to the FTB under the auspices of the amnesty program, the amnesty program does not really afford taxpayers a meaningful choice to avoid retroactive penalties. A taxpayer with a legitimate filing position will understandably be reluctant to concede the tax and delinquent interest at issue and waive any right to litigate the validity of its position. The legal ability to avoid the imposition of the retroactive penalty is therefore a hollow option to those taxpayers possessing a good-faith justification for their filing positions.

Second, the ability of taxpayers to file protective payments outside the amnesty program--therefore retaining the legal ability to seek a refund of overpaid tax while avoiding the nonpayment penalty--does not sufficiently eliminate the harsh and unreasonable nature of the amnesty legislation. The penalty applies to all taxpayers found to have underpaid their income or franchise taxes prior to 2003, even those who had no idea that a potential delinquency existed at the end of the amnesty window. These taxpayers obviously had no reason to make a protective payment during the two-month amnesty period and, therefore, lacked the ability to avoid imposition of the penalty to past reporting periods.

Moreover, even those taxpayers who believe that they will have some potential underpayment liability for prior years will, in general, be uncertain as to the amount of tax liability at issue. It is the rare case when corporate taxpayers can isolate a particular issue and calculate the potential liability with precision. Oftentimes, there are competing issues within

a given return, with some issues potentially offering the ability to offset a deficiency in another area. Accordingly, while a protective payment could partially eliminate the application of the penalty, the penalty will still be imposed retroactively on the assessed balance. Although taxpayers theoretically could grossly overpay the potential liability to insure against the penalty, such a payment would (1) deprive the taxpayer of the use of the funds during the audit and appeal, which often lasts years; (2) create a host of accounting-related issues;³³⁵ and (3) potentially subject the taxpayer to greater tax liability than it actually had. [FN312]

CONCLUSION

Tax legislation that contains a retroactive period greater than one year, such as California's Tax Amnesty Act, passes the point that most reasonable people would consider tolerable. The period of retroactivity is not narrowly tailored to accommodate the competing interests of the state and taxpayers, the latter of whom, at some point, should be free to move on without threat of enhanced tax or penalty consequences for prior transactions. While rigid application of a one-year period is mechanical and overly simplistic, a presumptive one-year period is consistent with judicial precedent, and further, the presumption draws a reasonable line that enhances certainty for tax jurisdictions and taxpayers alike.

[FN1]. Partner, Silverstein & Pomerantz, LLP. J.D. (1993), University of California, Berkeley (Boalt Hall). B.A. (1990) College of William & Mary. *Editor's Note*: Silverstein & Pomerantz, LLP is currently handling the *River Garden* case referenced *infra* in notes 295, 300, 305, & 306.

[FN1]. Judge Learned Hand framed the issue in this manner in evaluating the constitutionality of a retroactive income tax measure. *Cohan v. Comm'r of Internal Revenue*, 39 F.2d 540, 545 (2d Cir. 1930).

[FN2]. 512 U.S. 26 (1994).

[FN3]. *Carlton*, 512 U.S. at 32.

[FN4]. *Id.* at 27.

[FN5]. *See, e.g.*, Ronald Z. Domsy, *Retroactive Taxation: United States v. Carlton—The Taxpayer Loses Again!*, 16 N. ILL. U. L. REV. 77 (1995); Faith Colson, *Constitutional Law Due Process—The Supreme Court Sounds the Death Knell for Due Process Challenges to Retroactive Tax Legislation*, 27 RUTGERS L. J. 243 (1995); Laura Ricciardi, *The Aftermath of United States v. Carlton: Taxpayers Will Have to Pay for Congress's Mistakes*, 40 N.Y.L. SCH. L. REV. 599 (1996).

[FN6]. *Carlton*, 512 U.S. at 38 (O'Connor, J., concurring).

[FN7]. *See infra* Part III(C).

[FN8]. *Id.*

[FN9]. *Carlton*, 512 U.S. at 34.

[FN10]. *Id.* at 32 (Scalia, J., concurring).

[FN11]. Several state constitutions prohibit retroactive legislation, however. *See, e.g.*, TEX. CONST. art. I, § 16

(prohibits retroactive legislation); COLO. CONST. art. II, § 11 (prohibits retrospective legislation).

[FN12]. *Landgraf v. USI Film Prods.*, 511 U.S. 244, 269 (1994) (quoting *Society for the Propagation of the Gospel v. Wheeler*, 22 F.Cas. 756, 767 (C.C.N.H. 1814)).

[FN13]. For examples of these types of retroactive taxation, see parts II-III, *infra*. In interpreting a statute to determine whether the legislature intended it to operate retroactively, there is a presumption against retroactivity. *Landgraf*, 511 U.S. at 265. The presumption against retroactive legislation exists because retroactive legislation typically deprives citizens of legitimate expectations and upsets settled transactions. *General Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992). Nonetheless, a statute will be interpreted to apply retroactively if the text of the statute unambiguously expresses the legislature's intent for it to apply retroactively. *Landgraf*, 511 U.S. at 272-73.

[FN14]. U.S. CONST. art. I, § 9.

[FN15]. U.S. CONST. art. I, § 10.

[FN16]. 3 U.S. 386, 390 (1798).

[FN17]. *Calder*, 3 U.S. at 390.

[FN18]. *Id.*

[FN19]. *Id.*

[FN20]. *Id.* at 389-90. Notably, in a prophetic passage, the Court observed:

Every law that takes away, or impairs, rights vested, agreeably to existing laws, is retrospective, and is generally unjust, and may be oppressive; and it is a good general rule, that a law should have no retrospect; but there are cases in which laws may justly, and for the benefit of the community, and also of individuals, relate to a time antecedent to the commencement.

Id. at 390-91.

[FN21]. However, the Ex Post Facto Clause may be invoked to protect individuals from retroactive tax measures that impose criminal liability or punishment on past transactions.

[FN22]. U.S. CONST. art. I, § 10, cl. 1.

[FN23]. See, e.g., ARIZ. CONST. art. II, § 25.

[FN24]. See, e.g., *Baker v. Ariz. Dep't of Revenue*, 105 P.3d 1180, 1183-84 (Ariz. Ct. App. 2005).

[FN25]. See, e.g., *Coolidge v. Long*, 282 U.S. 582, 605 (1931).

[FN26]. See *infra* Part II(A).

[FN27]. *Baker*, 105 P.3d at 1183-84; cf. *Coolidge*, 282 U.S. at 605 (concluding that retroactive application of an estate tax impaired a trust deed and therefore violated the Contract Clause).

[FN28]. *Nat'l R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry.*, 470 U.S. 451, 465-66 (1985) (quoting *Dodge v. Board of Education*, 302 U.S. 74, 79 (1937)).

[FN29]. *Baker*, 105 P.3d at 1185; *see also* *Energy Reserves Group, Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 411-12 (1983).

[FN30]. U.S. CONST. amend. XIV, § 1.

[FN31]. 305 U.S. 134 (1938).

[FN32]. *Welch*, 305 U.S. at 141.

[FN33]. The Court did not decide whether such a deduction violated the Commerce Clause of the U.S. Constitution.

[FN34]. *Welch*, 305 U.S. at 141.

[FN35]. *Id.* at 141-42.

[FN36]. *Id.* at 142.

[FN37]. *Id.* at 144-45.

[FN38]. *Id.* at 146.

[FN39]. Similarly, lower federal and state courts generally have rejected taxpayers' equal protection challenges against retroactive tax legislation. *See, e.g.*, *Licari v. Comm'r of Revenue*, 946 F.2d 690, 693 (9th Cir. 1991) (legislative classification supported by rational basis); *Johnson Controls, Inc. v. Rudolph*, No. 2004-CA-001566-MR, 2006 Ky. App. LEXIS 132 (Ky. Ct. App. 2006), *review granted by Rudolph v. Johnson Controls, Inc.*, No.2006-SC0416-DG, 2007 Ky. LEXIS 195 (Ky. Oct. 24, 2007) and *Johnson Controls, Inc. v. Burnside*, No. 2007-SC-0819-DG, 2007 Ky. LEXIS 276 (Ky., Dec. 12, 2007).

[FN40]. U.S. CONST. amend. V.

[FN41]. *Id.*

[FN42]. *See* *Brushaber v. Union Pac. R.R. Co.*, 240 U.S. 1, 24-25 (1916); *Coleman v. Commissioner*, 791 F.2d 68, 70 (7th Cir. 1986); *Rivers v. State*, 490 S.E.2d 261, 263 (S.C. 1997). However, in *Nichols v. Coolidge*, 274 U.S. 531, 532 (1927), applying the *Brushaber* test, the Court held that the retroactive application of an amendment to the estate tax amounted to confiscation under the Takings Clause of the Fifth Amendment. No Supreme Court decision since *Nichols* has held that a retroactive tax measure violates the Takings Clause.

[FN43]. *Brushaber*, 240 U.S. at 24; *Quarty v. U.S.*, 170 F.3d 961, 970 (9th Cir. 1999).

[FN44]. *Quarty*, 170 F.3d at 970; *Kane v. U.S.*, 942 F. Supp. 23 (E.D. PA 1996).

[FN45]. *Rivers*, 490 S.E.2d at 263 (citing *Canisius College v. U.S.*, 799 F.2d 18, 25 (2d Cir. 1986)).

[FN46]. U.S. CONST. amend. V.

[FN47]. *Lochner v. N.Y.*, 198 U.S. 45 (1905).

[FN48]. 274 U.S. 531 (1927).

[FN49]. *Id.* at 532.

[FN50]. *Id.* at 540.

[FN51]. *Id.* at 542.

[FN52]. *Id.*

[FN53]. *Blodgett v. Holden*, 275 U.S. 142 (1927); *see also Untermyer v. Anderson*, 276 U.S. 440 (1928).

[FN54]. *Blodgett*, 275 U.S. at 147; *see also Untermyer*, 276 U.S. at 445.

[FN55]. *See, e.g., Carlton*, 512 U.S. at 30-31.

[FN56]. *U.S. v. Hemme*, 476 U.S. 558, 568 (1986).

[FN57]. *See Cooper v. U.S.*, 280 U.S. 409, 411 (1930); *U.S. v. Hudson*, 299 U.S. 498, 501 (1937).

[FN58]. *See, e.g., Welch v. Henry*, 305 U.S. 134 (1938).

[FN59]. *See, e.g., Pension Benefit Guaranty Corp v. R.A. Gray & Co.*, 467 U.S. 717 (1984).

[FN60]. *See, e.g., Welch*, 305 U.S. 134; *Pension Benefit Guaranty Corp.*, 467 U.S. 717.

[FN61]. For similar decisions distinguishing the *Nichols* line of authority, *see Cooper v. U.S.*, 280 U.S. 409, 412 (1930) (upholding income tax measure made retroactive to preceding calendar year); and *U.S. v. Hudson*, 299 U.S. 498, 501 (upholding 35-day period of retroactivity to income tax on sale of silver bullion).

[FN62]. 283 U.S. 15 (1931).

[FN63]. *Milliken*, 283 U.S. at 18-19.

[FN64]. *Id.*

[FN65]. *Id.* at 19.

[FN66]. *Id.* at 20-22.

[FN67]. *Id.* at 24.

[FN68]. *Milliken*, 283 U.S. at 21-22.

[FN69]. *Id.* at 23-24.

[FN70]. *Id.* at 24.

[FN71]. For a factual discussion, *see supra* Part 1(C). The taxpayer also challenged the tax on the grounds that it violated his rights to equal protection of the laws. *Welch*, 305 U.S. at 141.

[FN72]. *Welch*, 305 U.S. at 146.

[FN73]. *Id.*

[FN74]. *Id.* at 147.

[FN75]. *Id.*

[FN76]. *Id.* at 147.

[FN77]. *Welch*, 305 U.S. at 148.

[FN78]. In today's era of income tax planning, this distinction appears naive and rather artificial. *See id.* at 147-48.

[FN79]. *Id.* at 148-50.

[FN80]. *Id.* at 150.

[FN81]. *Id.* at 151.

[FN82]. *Carlton*, 512 U.S. at 32-33.

[FN83]. *U.S. v. Darusmont*, 449 U.S. 292 (1981).

[FN84]. Pub. L. No. 94-455 § 301 (1976).

[FN85]. *Darusmont*, 449 US. at 294-95.

[FN86]. *Id.* at 296-97.

[FN87]. *Id.* at 297-301. In rejecting the taxpayer's challenge, the Court also noted that the taxpayer had ample notice of the increase in the effective minimum rate because it had been under public discussion for almost a year before its enactment. *Id.* at 299. The Court also disagreed with the taxpayer's assertion that the tax was a new tax, as it only increased the tax rate and decreased allowable exemptions. *Id.* at 299-300.

[FN88]. *Id.* at 299.

[FN89]. *Id.* at 299-300.

[FN90]. 467 U.S. 717 (1984).

[FN91]. *Pension Benefit*, 467 U.S. at 717 (1984).

[FN92]. 29 U.S.C. §1001 (1980).

[FN93]. *Pension Benefit*, 467 U.S. at 720.

[FN94]. *Id.* at 723-24.

[FN95]. *Id.* at 724-25.

[FN96]. *Id.* at 728-29.

[FN97]. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976).

[FN98]. *Pension Benefit*, 467 U.S. at 728-29.

[FN99]. The Court contrasted this test from the test used to determine whether a state action impairs preexisting contracts under the Contracts Clause. *Id.* at 733.

[FN100]. *Id.* at 730.

[FN101]. *Id.* at 731.

[FN102]. *Id.*

[FN103]. *Pension Benefit*, 467 U.S. at 731.

[FN104]. *Id.* at 734.

[FN105]. *Id.* at 731-32.

[FN106]. *Id.*

[FN107]. *Id.* at 732. The Court explained that such “sudden” enactment by Congress could arise through a floor amendment or rider. *Id.*

[FN108]. *Pension Benefit*, 467 U.S. at 732.

[FN109]. *Hemme*, 476 U.S. at 568.

[FN110]. *Id.* at 569-70.

[FN111]. *Id.* at 562. The taxpayer contended that the statute was retroactive. The Court did not determine the issue of whether the statutory rules were in fact retroactive in concluding that there was no due process violation. *Id.* at 571. The Court did, however, rely on retroactive tax jurisprudence throughout the opinion.

[FN112]. *Id.* at 564.

[FN113]. *Id.* at 568.

[FN114]. *Hemme*, 476 U.S. at 568-69 (citing *Welch*, 305 U.S. at 147).

[FN115]. *Id.* at 570.

[FN116]. 512 U.S. 26 (1994).

[FN117]. *Carlton*, 512 U.S. at 26.

[FN118]. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

[FN119]. *Carlton*, 512 U.S. at 32.

[FN120]. *Id.* at 36-37 (O'Connor, J., concurring).

[FN121]. *Id.* at 38; *see also infra* Part III(C).

[FN122]. *Carlton*, 512 U.S. at 26. The ESOP provision was codified at 26 U.S.C. § 2057.

[FN123]. *Id.*

[FN124]. *Id.*

[FN125]. *Id.*

[FN126]. *Id.* at 28.

[FN127]. IRS Notice 87-13, 1987-1 C.B. 432 at 442.

[FN128]. *Carlton*, 512 U.S. at 29.

[FN129]. *Id.* The amending legislation was included as part of the Omnibus Budget Reconciliation Act of 1987, § 10411(a).

[FN130]. *Id.*

[FN131]. *Id.* at 27.

[FN132]. *U.S. v. Carlton*, 972 F.2d 1051 (9th Cir. 1992).

[FN133]. *Carlton*, 512 U.S. at 29; 972 F.2d 1051 (9th Cir. 1992).

[FN134]. *Carlton*, 512 U.S. at 30.

[FN135]. *Id.* (citing *Welch*, 305 U.S. at 147, and *Hemme*, 476 U.S. at 568-69).

[FN136]. *See Pension Benefit*, 467 U.S. at 720.

[FN137]. *Carlton*, 512 U.S. at 30.

[FN138]. *Id.* at 30-31.

[FN139]. *Id.* at 32.

[FN140]. *Id.*

[FN141]. *Id.* at 31.

[FN142]. *Carlton*, 512 U.S. at 32.

[FN143]. *Id.*

[FN144]. *Id.*

[FN145]. *Id.* at 33 (citing *Darusmont*, 449 U.S. at 296-97; and *Welch*, 305 U.S. at 150).

[FN146]. *Id.* at 33.

[FN147]. *Carlton*, 512 U.S. at 33.

[FN148]. *Id.*

[FN149]. *Id.* at 28.

[FN150]. *Id.* at 34 (citing *Welch*, 305 U.S. at 134 and *Milliken*, 283 U.S. at 15).

[FN151]. *Id.* at 33.

[FN152]. *Carlton*, 512 U.S. at 34 (citing *Hemme*, 476 U.S. at 568).

[FN153]. *Id.*

[FN154]. *Id.* at 35.

[FN155]. *Id.* at 35 (O'Connor, J., concurring).

[FN156]. *Id.* at 37.

[FN157]. *Carlton*, 512 U.S. at 38 (O'Connor, J., concurring).

[FN158]. *Id.* at 38.

[FN159]. *Id.*

[FN160]. *Id.* at 38.

[FN161]. *Id.* at 37-38 (O'Connor, J., concurring).

[FN162]. *Carlton*, 512 U.S. at 37-38 (citing *Hemme* 476 U.S. at 568 (1 month); *Darusmont*, 449 U.S. at 292 (10 months); and *Hudson*, 299 U.S. at 501 (1 month)).

[FN163]. *Id.* (citing *Welch*, 305 U.S. at 134).

[FN164]. *Id.*

[FN165]. *Id.* at 39.

[FN166]. *Id.* at 39.

[FN167]. *Carlton*, 512 U.S. at 40 (O'Connor, J., concurring).

[FN168]. *Furlong v. Comm'r of Revenue*, 36 F.3d 25 (7th Cir. 1994).

[FN169]. *Furlong*, 36 F.3d at 27 n.2.

[FN170]. *Id.* at 28; Brief of Respondent-Appellee at 13-14, *Furlong v. Comm'r of Revenue*, No. 93-3668 (7th Cir. Mar. 14, 1994).

[FN171]. *Furlong*, 36 F.3d at 27-28.

[FN172]. *Id.* at 28.

[FN173]. *Id.* at 29.

[FN174]. Section 13208 of the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993), Pub. L. No. 103-66, 107 Stat. 312, 469.

[FN175]. *Quarty v. U.S.*, 170 F.3d 961 (9th Cir. 1999); *Kane v. U.S.*, 942 F. Supp. 233 (E.D. Pa. 1996).

[FN176]. *Quarty*, 170 F.3d at 968; *Kane*, 942 F. Supp. at 234.

[FN177]. *Quarty*, 170 F.3d at 968; *Kane*, 942 F. Supp. at 234.

[FN178]. *Quarty*, 170 F.3d at 967-68 (rejecting taxpayer's argument that the increase in the estate tax rate, which was not a curative measure, impacted the determination of whether the legislation had a legitimate purpose); *Kane*, 942 F. Supp. at 234.

[FN179]. *Quarty*, 170 F.3d at 967; *see supra* note 179 and accompanying text.

[FN180]. *Baker*, 105 P.3d at 1183-84.

[FN181]. *Id.* at 1182.

[FN182]. *Id.* The taxpayers had their four motor homes converted to alternative fuels at a combined cost of \$31,000. *Id.* Under the pre-amendment law, the taxpayers were entitled to a tax credit equal to the total cost plus \$92,750, which represented a portion of the purchase price of the vehicles. *Id.* at 1183. After the amendment, the credit amount was limited to \$31,000. *Id.* at 1182.

[FN183]. *Id.* at 1187.

[FN184]. *Id.*

[FN185]. 76 F.3d 991 (9th Cir. 1996).

[FN186]. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, 103 Stat. 2106.

[FN187]. Railroad Retirement Tax Act (RRTA), 26 U.S.C. § 3231 (1983). This act is the Social Security Act equivalent for railroad employees. *Id.*

[FN188]. *Montana Rail*, 76 F.3d at 994-95.

[FN189]. *Id.* at 993.

[FN190]. OBRA § 10206(c)(2)(A)(ii); *Id.* at 993.

[FN191]. *Montana Rail*, 76 F.3d at 993.

[FN192]. *Id.*

[FN193]. *Id.* at 994.

[FN194]. *Id.*

[FN195]. *See, e.g.*, *Tate & Lyle, Inc. v. Comm'r*, 87 F.3d 99 (3d Cir. 1996); *A. Tarricone, Inc. v. U.S.*, 4 F.Supp. 2d 323 (S.D.N.Y. 1998); *E.I. du Pont de Nemours & Co. v. Comm'r*, 41 F.3d 130 (3d Cir. 1994) (upholding 15-year period of retroactive application); *Rutter v. Comm'r*, 760 F.2d 466, 468-69 (2d Cir. 1985) (upholding five-year period of retroactive application).

[FN196]. *Tate*, 87 F.3d at 107.

[FN197]. I.R.C. § 7805(b) (1998). This provision provides: "The Secretary may prescribe the extent, if any, to which any ruling or [regulation] relating to the internal revenue laws, shall be applied without retroactive effect." Congress therefore demonstrated its intent that treasury regulations are to apply retroactively, absent express language otherwise. *Tate*, 87 F.3d at 107. In 1996, Congress amended this statute to limit the Secretary's authority to impose regulations retroactively where the regulations interpreted statutory provisions enacted after 1996. *A. Tarricone, Inc.*, 4 F.Supp. 2d at 326, n.2.

[FN198]. *Tate*, 87 F.3d at 107.

[FN199]. *Id.* at 107-108; *A. Tarricone*, 4 F.Supp. 2d at 326.

[FN200]. *A. Tarricone*, 4 F.Supp. 2d at 326-27.

[FN201]. 749 So. 2d 470, 473 (Ala. Civ. App. 1999), *cert. denied*, 529 U.S. 1022 (2000) (overruled on other grounds, *Patterson v. Gladwin Corp.*, 835 So.2d 137 (Ala. 2002)).

[FN202]. *Monroe*, 749 So.2d at 475.

[FN203]. *Id.* at 472.

[FN204]. *Id.*

[FN205]. *Id.* The new legislation "clarified" that the current law exempted from use tax only that property sold at retail in Alabama on which sales tax had already been paid. Act. No. 97-301, § 2.

[FN206]. *Monroe*, 749 So.2d at 473; § 40-2A-7(c)(2).

[FN207]. *Monroe*, 749 So.2d at 473.

[FN208]. *Id.* at 474.

[FN209]. *Id.* (citing *Smith v. Sears Roebuck & Co.*, 672 So. 2d 794 (Ala. Civ. App. 1995) (court concluded legislation was a clarification); *Maples v. McDonald*, 668 So.2d 790 (Ala. Civ. App. 1995) (same)). Although these cases post-date *Carlton*, neither case cited *Carlton* or the modesty doctrine. *See Smith*, 672 So.2d at 795-800; *Maples*, 668 So.2d at 791-93. Moreover, the constitutional analysis in both cases is thin. *Id.*

[FN210]. *Monroe*, 749 So.2d at 475.

[FN211]. No. 1 CA-TX 06-0017, 2008 Ariz. App. LEXIS 168 (Ariz. Ct. App. Dec. 16, 2008). This opinion is also available on Westlaw, under 2008 WL 5237810, but the page numbers in the following citations are derived from LexisNexis. On January 22, 2009, plaintiff/appellant Enterprise Leasing Co. filed a petition for review with the Arizona Supreme Court. See CLERK OF THE COURT, ARIZONA COURT OF APPEALS, DIVISION ONE, <http://www.cofad1.state.az.us/casefiles/tx/TX060017.pdf> (last visited May 5, 2009).

[FN212]. ARIZ. REV. STAT. ANN. § 43-1170 (1994) (amended 1995, 2000, & 2005).

[FN213]. *Enterprise Leasing*, 2008 Ariz. App. LEXIS 168, at *3.

[FN214]. 2000 Ariz. Sess. Laws 405, at *21. The cost of the credit went from approximately \$2.5 million to \$15 million annually. *Enterprise Leasing*, 2008 Ariz. App. LEXIS 168, at *3.

[FN215]. *Enterprise Leasing*, 2008 Ariz. App. LEXIS 168, at *4 (internal citations omitted).

[FN216]. *Id.* at *4.

[FN217]. *Id.* at *6-*8.

[FN218]. *Id.* at *8. This analysis demonstrates the danger of upholding the constitutionality of “curative” retroactive tax measures. Every retroactive tax measure seeks to cure a perceived defect in existing law. If the “curative” intent is used as a judicial criterion, by attaching the label “curative” and divining the intent of a prior legislature, a legislature can ensure that the measure will pass due process scrutiny.

[FN219]. *Id.* at *8-*12.

[FN220]. *Enterprise Leasing*, 2008 LEXIS 168, at *10-*12.

[FN221]. *Id.* at *13.

[FN222]. *Id.* at *16.

[FN223]. *Id.* at *16-*17.

[FN224]. At the trial court level, on April 17, 2009, the Michigan Court of Claims relied on *Carlton's* modesty doctrine and held that legislation seeking to retroactively invalidate refund claims dating back 11 years “clearly violated” due process. *Gen. Motors Corp. v. Dep’t of Treasury*, No. 07-151-MT (Mich. Ct. Cl. 2009).

[FN225]. 490 S.E.2d 261 (S.C. 1997).

[FN226]. *Rivers*, 490 S.E.2d 261.

[FN227]. *Id.* at 262; Act No. 658, 1988 S.C. Acts 658, Part II § 27. The legislation reduced the tax rate for the period January 1, 1987, through January 31, 1988.

[FN228]. *Rivers*, 490 S.E.2d at 262. The period was reduced to the time between January 1, 1987 and June 22, 1987.

[FN229]. *Id.* Act. No. 171, 1991 S.C. Acts 171, Part II, § 6.

[FN230]. *Rivers*, 490 S.E.2d at 262.

[FN231]. *Id.* at 263-64.

[FN232]. *Id.* at 265.

[FN233]. *Id.*

[FN234]. *Id.*

[FN235]. *Rivers*, 490 S.E.2d at 265 n.4.

[FN236]. 27 Cal. Rptr. 3d 215 (Cal. Ct. App. 2005).

[FN237]. *Modesto*, 27 Cal. Rptr. 3d at 217.

[FN238]. *Id.* at 217. The ordinance's failure to apportion in-city and out-of-city gross receipts violated the requirements of equal protection and due process because the tax discriminated against inter-city business. *Id.* at 219 (citing *City of Los Angeles v. Shell Oil Co.*, 4 Cal.3d 108 (1971)).

[FN239]. *Id.* at 218.

[FN240]. *Id.*

[FN241]. *Id.* at 219.

[FN242]. *Modesto*, 27 Cal. Rptr. 3d at 217, 220.

[FN243]. *Id.* at 221.

[FN244]. *Id.* at 222.

[FN245]. *Id.*

[FN246]. *Id.*

[FN247]. *Modesto*, 27 Cal. Rptr. 3d at 222.

[FN248]. *Id.* (citing *Gutknecht v. City of Sausalito*, 117 Cal. Rptr. 782 (Cal. Ct. App. 1974)).

[FN249]. No. 2004-CA-001566-MR, 2006 Ky. App. LEXIS 132 (Ky. Ct. App. 2006).

[FN250]. 2006 Ky. App. LEXIS 132 at *31 (Ky. Ct. App. 2006) (*review granted by Rudolph v. Johnson Controls, Inc.*, No.2006-SC-0416-DG, 2007 Ky. LEXIS 195 (Ky. Oct. 24, 2007) and *Johnson Controls, Inc. v. Burnside*, No. 2007-SC-0819-DG, 2007 Ky. LEXIS 276 (Ky., Dec. 12, 2007)). *Johnson*, No. 2006 Ky. App. LEXIS 132.

[FN251]. *GTE v. Revenue Cabinet*, 889 S.W.2d 788, 790 (Ky. 1994). A *unitary business* is “[a] business that has subsidiaries in other states or countries and that calculates its state income tax by determining what portion of a subsidiary's income is attributable to activities within the state, and paying taxes on that percentage.” BLACK'S LAW DICTIONARY 1281 (8th ed. 2004). A *unitary tax* is “[a] tax of income earned locally by a business that transacts business through an affiliated company outside the state or country.” BLACK'S LAW DICTIONARY 1223 (8th ed. 2004).

[FN252]. *Johnson Controls*, 2006 Ky. App. LEXIS 132 at *3.

[FN253]. H.B. 541, Gen. Assem., Reg.Sess (Ky.2000).

[FN254]. *Johnson Controls*, 2006 Ky. App. LEXIS 132 at *5. H.B. 541 amended KY. REV. STAT. ANN. § 141.200(9) (West 2005) to provide that “no claim for refund or credit of a tax overpayment for any taxable year ending on or before December 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return, shall be effective or recognized for any purpose.” *Id.* at *5-6. A consolidated return is “[a] return that reflects combined financial information for a group of affiliated corporations.” BLACK’S LAW DICTIONARY 1226 (8th ed. 2004). This legislation would have had the effect of retroactively defeating all such refund claims. *Johnson Controls*, 2006 Ky. App. LEXIS 132 at *5. Legislation passed in 1996 had abolished unitary returns for 1996 and subsequent tax years. *Id.* at *4.

[FN255]. *Johnson Controls*, 2006 Ky. App. LEXIS 132 at *18. The court rejected the state’s argument that there was no modesty doctrine in *Carlton*. *Id.* at *19 n. 32.

[FN256]. *Id.* at *21-22 n. 37.

[FN257]. *Id.* at *19-20.

[FN258]. *Id.* at *21 n. 36.

[FN259]. *Id.* at *24-25. The Court cited *Rivers*, *supra* note 212, and *City of Modesto*, *supra* note 223, with approval.

[FN260]. *Johnson Controls*, 2006 Ky. App. LEXIS 132 at *24.

[FN261]. *See supra* note 237.

[FN262]. Immediately after *Carlton*, many articles, notes, and comments were published, several predicting the unfettered use of retroactive tax measures in the post-*Carlton* era. *See supra* note 3.

[FN263]. The recently proposed “AIG bonus tax” legislation seeks to impose a surtax on certain bonuses paid after December 31, 2008, to any executive earning in excess of \$250,000--if the bonus was paid by a company that received \$5 billion or more in taxpayer dollars from the Troubled Asset Relief Program. JEANNE SAHADI, CNNMONEY.COM, BONUS TAX: FEELS GOOD, BUT IS IT? (March 20, 2009), http://money.cnn.tv/2009/03/19/news/economy/bonus_tax_policy/index.htm; RICHARD A. EPSTEIN, THE WALL STREET JOURNAL ONLINE, IS THE BONUS TAX UNCONSTITUTIONAL? (March 26, 2009), <http://online.wsj.com/article/SB123802257323941925.html>. While one could argue that the surtax is a “wholly new tax,” the period of retroactivity (assuming congressional passage in 2009) would be less than a year and therefore presumptively constitutional under this test. The legislation is potentially subject to other constitutional challenges, such as Bill of Attainder and Equal Protection challenges. *See Epstein, supra*, note 263.

[FN264]. *See supra* Part II(A).

[FN265]. *See, e.g., Carlton*, 512 U.S. at 30-31; *Hemme*, 476 U.S. at 568.

[FN266]. *See, e.g., Darusmont*, 449 U.S. at 299-300.

[FN267]. *Oberhand v. Dir. Div. of Taxation*, 940 A.2d 1202, 1209 (N.J. 2008).

[FN268]. *Id.* at 1210 (citations omitted).

[FN269]. *Id.* at 1211.

[FN270]. *Id.* at 1207, 1211.

[FN271]. *Id.* at 1211.

[FN272]. *Oberhand*, 940 A.2d at 1215 (Long, J., dissenting) (citing *U.S. v. Schooner Peggy*, 5 U.S. (1 Cranch) 103 (1801)).

[FN273]. *Id.* at 1212; *Bradley v. Richmond School Board*, 416 U.S. 696, 711 (1974).

[FN274]. *Oberhand*, 940 A.2d at 1215-16.

[FN275]. *Id.* (Long, J., dissenting) (discussing history of doctrine).

[FN276]. *See supra* note 5 and accompanying text.

[FN277]. *Landgraf*, 511 U.S. at 269 (internal citation omitted).

[FN278]. Although tax legislation is not a promise and does not necessarily create vested rights (*see, e.g., Carlton*, 512 U.S. at 33), it is difficult to argue that tax measures that impose greater liability to prior acts and transactions do not impose new duties or obligations with respect to past transactions. One potential exception is income tax provisions made retroactive to the same calendar year, prior to filing of the return, provided that the taxpayer did not take any action in reliance on the former state of the law.

[FN279]. *See supra* Part III(C).

[FN280]. *See supra* note 193 and accompanying text.

[FN281]. *See supra* note 207 and accompanying text.

[FN282]. *See supra* notes 211-18 and accompanying text.

[FN283]. *See supra* notes 217-23 and accompanying text. The fact that the department had not received a refund claim until such date does not establish that the Legislature had no reason to know of the issue before the claim was filed.

[FN284]. As do the majority of cases decided before *Carlton*. *See supra* Parts III(A)-(C), *cf. Canisius Coll. v. U.S.*, 799 F.2d 18, 26-27 (2d Cir. 1986) (upholding law retroactively validating FICA taxes contributed four years earlier, based on lack of taxpayer reliance and vested interests); *Licari v. Comm'r of Revenue*, 946 F.2d 690, 695 (9th Cir. 1991) (upholding four-year period of retroactivity of enhanced penalties to under-reporting, in part, because penalties already existed at time for intentional under-reporting).

[FN285]. Charles B. Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692 (1960).

[FN286]. *Id.*; Elmer E. Smead, *The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence*, 20 MINN.

L. REV. 775 (1936).

[FN287]. See *supra* note 1 and accompanying text.

[FN288]. See *supra* note 80 and accompanying text.

[FN289]. *Carlton*, 512 U.S. at 32.

[FN290]. *City of Modesto*, 128 Cal. App. 4th at 529.

[FN291]. See *supra* note 183 and accompanying text.

[FN292]. For instance, in the *Enterprise Leasing* litigation, to surmount the presumption of unconstitutionality created by the six-year period of retroactivity, the state could assert that it had no reason to be aware of the motor vehicle loophole in the existing tax credit legislation until the first such credit was claimed in December 1999, only months before the enactment of the amending legislation. See *supra* notes 212-14 and accompanying text. In response, the taxpayer could assert that the text of the original legislation reasonably permitted application of the credit to personal property attached to motor vehicles, and therefore, the legislature should have been aware of the issue. The parties could present evidence at trial regarding the issue of whether the Legislature could have acted sooner.

[FN293]. CAL. REV. & TAX CODE §§ 7072 & 19732 (2004). The amnesty program was created by SB 1100, and signed into law on August 16, 2004. The amnesty portion of the legislation permitted taxpayers to avoid penalties and any criminal prosecution by paying all past due taxes, plus interest. CAL. REV. & TAX CODE § 7072(a). The benefits of the amnesty program were available to all taxpayers with tax liabilities that resulted from the non-filing of returns, underreported income on filed returns, claimed excessive deductions, or any unpaid tax liabilities from previously determined amounts. *Id.* at § 7073(a)-(b). The benefits were not available to taxpayers who were under, or had been given notice that they were under, criminal tax investigation or who had a civil tax proceeding initiated against them. *Id.* at 7072(b).

[FN294]. CAL. REV. & TAX CODE §§ 7071 & 19731 (2009).

[FN295]. CAL. REV. & TAX CODE §§ 7074(d) & 19777.5(c) (2009).

[FN296]. CAL. REV. & TAX CODE §§ 7074(a) & 19777.5(a). The issue of when a tax amount is “due and payable” is currently being litigated in *River Garden Ret. Home v. Franchise Tax Bd.*, No. A123316 (Cal. Ct. App., 1st App. Dist., Div. 4, filed November 6, 2008).

[FN297]. CAL. REV. & TAX CODE §§ 7074(a) & 19777.5(a) (2009). The amount of the penalty is calculated on the interest due from the original due date of the return to March 31, 2005.

[FN298]. CAL. REV. & TAX CODE § 7073(c) (2009). This provision resulted in non-fraud related penalties being increased to 20% of the tax owed.

[FN299]. CAL. REV. & TAX CODE § 7073(d) (2009). The regular statute of limitations for the SBOE to make sales and use tax assessments is three years. CAL. REV. & TAX CODE § 6487 (2009).

[FN300]. CAL. REV. & TAX CODE § 19164(a)(1) (2009).

[FN301]. See *River Garden*, No. A123316; see also Jennifer Carr & Cara Griffith, *California's Amnesty Program - A*

'Gift' Taxpayers Would Prefer Not to Receive, STATE TAX NOTES, July 24, 2006, at 257, p. /16/. The FTB interpreted the statutory language "each taxable year for which amnesty could have been requested" to mean any and all years beginning before January 1, 2003. *Id.* at /4/.

[FN302]. CAL. REV. & TAX CODE § 19777.5(d) and (e) (2009).

[FN303]. Lenny Goldberg, *Amnesty Discussions at FTB Generate New Data*, STATE TAX NOTES, July 18, 2005 at 193. The \$3.5 billion in protective payments was generated from 646 corporate taxpayers with an average of nearly six years per taxpayer in dispute. *Id.*

[FN304]. *See id.*

[FN305]. In the seminal tax remedies case, the U.S. Supreme Court held that states must afford taxpayers with a clear and certain remedy--either pre-deprivation or post-deprivation, under the Due Process Clause of the Fourteenth Amendment. *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990).

[FN306]. CAL. REV. & TAX CODE § 19777.5. Several taxpayers have challenged the constitutionality of the amnesty legislation. For instance, in *River Garden*, No. A123316, among other arguments, the taxpayer has alleged that the amnesty legislation violated both procedural and substantive due process.

[FN307]. Generally, the statute of limitations for franchise tax assessments is four years from the date the return was filed. CAL. REV. & TAX CODE § 19057(a) (2004). In *River Garden*, the amnesty penalty could apply to tax years 1999-2000, resulting in a seven-year period of retroactivity. *River Garden*, No. A123316.

[FN308]. Without the amnesty legislation, California taxpayers who are found to have prepared fraudulent returns lose protection of the statute of limitations and are subject to penalties equal to 75% of the liability. CAL. REV. & TAX CODE §§ 19164(c) & 19087 (2009).

[FN309]. *Licari*, 946 F.2d at 695.

[FN310]. 128 Cal. App. 4th at 529 (citing *Gutknecht*, 43 Cal. App. 3d at 282).

[FN311]. *See, e.g., Jennifer Carr & Cara Griffith, California's Amnesty Program - A 'Gift' Taxpayers Would Prefer Not to Receive* STATE TAX NOTES, July 24, 2006 at 257.

[FN312]. The old adage that possession is nine-tenths of the law often appropriately describes the difficulty in obtaining a recovery of overpaid taxes.
47 Duq. L. Rev. 291

END OF DOCUMENT

From: Stephen Bennett
To: Ruwart, Carole (Legal)
Subject: Legislative history
Date: Wednesday, March 30, 2011 3:35:28 PM

Carole,

Going through the legislative history of Part 0.5, I found the following regarding the 1979 enactment of the change in ownership laws:

Sections 41, 42, 43 of Stats.1979, c. 242, p. 526, 527, provide:

“Sec. 41. (a) Notwithstanding the provisions of Sections 110.1 and 110.6, as added to the Revenue and Taxation Code by Chapter 292 of the Statutes of 1978, and amended by Chapters 332 and 576 of the Statutes of 1978, **the provisions of this act shall be effective for the 1979-80 assessment year and thereafter**, except as provided in Section 42 of this act.” (italics, underline, and boldface added)

Steve

From: Stephen Bennett
To: Ruwart, Carole (Legal)
Subject: Relief Bennett Seeks under Gov't Code 15606
Date: Friday, April 01, 2011 9:53:14 AM

Carole,

In my regulatory petition and depublication request I continue to seek the remedies provided for under 11340.7 and 5700.

I now seek additional relief by asking BOE to fulfill the mandatory duty imposed on BOE by Gov't Code §15606 as follows:

Identify each escape assessment made by county assessors at any time where the assessor applied Part 0.5 of the R&T Code retroactively against property owners who acquired their ownership rights prior to 1979.

Compel the assessors to reverse each such escape assessment as void and unconstitutional pursuant to R&T §51.5(a) (see *Sunrise Retirement Villa v. Dear* (1997) 58 Cal. App. 4th 948).

Steve



STATE OF CALIFORNIA

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Third District, Rolling Hills Estates

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Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Interim Executive Director

April 15, 2011

Mr. Stephen Bennett
Letwak & Bennett
26400 La Alameda #200
Mission Viejo, CA 92691

Re: *Petition to Amend Property Tax Rules 462.060, 462.100, 462.160, 462.180, and 462.260*

Dear Mr. Bennett:

On March 21, 2011, the Legal Department received your above-referenced petition, pursuant to Government Code section 11340.6, to amend Property Tax Rules¹ 462.060, 462.100, 462.160, 462.180, and 462.260.

Pursuant to Government Code section 11340.7, subdivision (b), it has been determined that the action warranted to take on this matter is to schedule it for hearing before the Board on April 26, 2011. The public agenda notice (PAN) for this meeting will be available on the Board's website at www.boe.ca.gov at least 10 days prior to that meeting. The PAN will include a link to a Chief Counsel Memorandum setting forth the Legal Department's recommendation.

If you have any questions or need more information, please contact Tax Counsel III (Specialist) Carole Ruwart at (916) 323-3102.

Sincerely,

Randy Ferris
Acting Chief Counsel

RF:yg

J:/Prop/Non-Prec/Ruwart/11-057.doc

cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70
Ms. Diane Olson MIC:80

¹ References to "Rules" are section references to title 18 of the California Code of Regulations.



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State Controller

KRISTINE CAZADD
Interim Executive Director

April 15, 2011

Mr. Stephen Bennett
Letwak & Bennett
26400 La Alameda #200
Mission Viejo, CA 92691

**Re: Property Tax Annotation Depublication Requests
Assignment No.: 11-050**

Dear Mr. Bennett:

This is to acknowledge receipt of your March 22, 2011 email request to depublish the following Property Tax Annotations (Annotations) under Rule¹ 5700, subdivision (e): 220.0325, 220.0326, 220.0338, 220.0332.005, 220.0780, and 220.0786. On March 23, 2011, you requested that we also depublish Annotations 493.0131 and 220.0785. Finally, in your petition to amend various Property Tax Rules, which was received by the Board on March 21, 2011, you also petitioned "BOE to compel its legal staff to depublish all annotations that apply Part 0.5 retrospectively," and specifically list again Annotations 220.0325, 220.0326, 220.0338, 220.0332.005, 220.0780 and 220.0786.

Your requests have been assigned to me for a response, and pursuant to Rule 5700, subdivision (e), I will notify you as to whether Acting Chief Counsel Randy Ferris approves or denies your requests within 60 days of the receipt of your March 21, 2011 request. Your requests have been given the assignment number 11-050. Please refer to this number if you contact this office for any questions you may have concerning this matter as that helps us locate your file.

Sincerely,

Carole Ruwart
Tax Counsel III (Specialist)

CR:yg
J:/Prop/Nonprect/Ruwart/11-050 AL.doc

cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70

¹ References to "Rules" are section references to title 18 of the California Code of Regulations.



COUNTY OF LOS ANGELES
OFFICE OF THE COUNTY COUNSEL

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ANDREA SHERIDAN ORDIN
County Counsel

April 18, 2011

Honorable Jerome E. Horton, Chairman
State Board of Equalization
450 N. Street
Sacramento, CA 95814

**Re: Board Meeting, April 27, 2011
Chief Counsel Matters – Item J-Rulemaking
Petition to amend the following Property Tax Rules related to
change in ownership: 462.060, 462.100, 462.160, 462.180**

Dear Mr. Horton:

This letter is in opposition to Mr. Stephen Bennett's petition dated March 21, 2011. This opposition will concentrate on section II C of page 3 of Mr. Bennett's petition. Please note that we agree with the analysis, reasoning, and conclusions stated in the Acting Chief Counsel's Memorandum dated April, 13, 2011 ("Chief Counsel's Memorandum").

Mr. Bennett refers to annotations 220.0780 and 220.0786. But after reviewing those annotations, it appears evident that Mr. Bennett misconstrues what they say.

In addition, Mr. Bennett's double taxation argument is misplaced. As explained in the Chief Counsel's Memorandum, there is no double taxation when a separate real property interest is being assessed at a different time.

In *Steinhart v. County of Los Angeles* ("Steinhart") (2010) 47 Cal. 1298,¹ the court based its change in ownership determination under Revenue and Taxation Code sections² 61(h), 62(d), and California Code of Regulations, title

¹ The undersigned, Richard Girgado, successfully argued the *Steinhart* case for the County of Los Angeles in the California Supreme Court.

² All references are to the Revenue and Taxation Code unless otherwise indicated.

18, section 462.160. Section 61(h) triggers a change in ownership when a revocable trust becomes irrevocable. Since that section sufficed to find a change in ownership, the *Steinhart* court felt that inquiry into section 61(g) was beyond the scope of the case, therefore, it did not elaborate on said section. Section 61(g) triggers a change in ownership when there is "Any vesting of the right of possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest . . ."

Certainly the *Steinhart* court did not find any Revenue and Taxation Code sections suspect, nor did it invalidate any regulations under title 18 of the California Code of Regulations. In fact, it stated that "We generally accord 'great weight' to the statutes the Legislature has passed and the regulations the State Board of Equalization has promulgated to implement article XIII A. [Citation]" (*Steinhart, supra*, (2010) 47 Cal. 1298, 1322.)

But under *Phelps v. Orange County Assessment Appeals Bd. No. 1* ("*Phelps*") (2010) 187 Cal.App.4th 653 and *Reilly v. City and County of San Francisco* ("*Reilly*") (2006) 142 Cal.App.4th 480, it is clear that each time there is a new present beneficiary to a trust, there is a change in ownership. This does not equate to "double taxation" because a separate real property interest is being assessed at a different time.

The Chief Counsel's Memorandum correctly explains the court's analysis in *Phelps*. But even before *Phelps*, the *Reilly* court stood for the same proposition.

"Indeed, subdivision (g) of section 61 provides that a change in ownership occurs when there is '[a]ny vesting of the right to possession or enjoyment of a remainder or reversionary interest upon the termination of a life estate or other similar precedent property interest' . . . Consequently, under section 61, subdivision (g), the termination of one life estate followed by the creation of a new life estate is a change in ownership." (*Reilly, supra*, 142 Cal.App.4th 480, 496.)

The *Reilly* court also looked to California Code of Regulations, title 18, section 462.160, subdivisions (b)(1)(A), (2) and (3), and said that the pertinent regulation "provides that a change in ownership occurs not just when certain persons are present beneficiaries upon creation of a trust, but also when certain persons become present beneficiaries after a trust has been created." (*Reilly, supra*, 142 Cal.App.4th 480, 489.) The proposition that there is a change in ownership reassessment when there is a new beneficial owner is not "double taxation."

Honorable Jerome E. Horton, Chairman
Page 3

In addition, the Chief Counsel's Memorandum is correct by pointing out that if a change in ownership occurs on the date of the transfer, it can't be an assessment of a past or future interest.

In conclusion, Mr. Bennett's petition should be denied.

Very truly yours,

ANDREA SHERIDAN ORDIN
County Counsel

By 

RICHARD GIRGADO
Deputy County Counsel
Government Services Division

RG:htb

c: Honorable Michelle Steel, Vice Chair
Honorable Betty T. Yee, First District
Senator George Runner, Second District
Honorable John Chiang, State Controller

From: Stephen Bennett
Sent: Thursday, April 21, 2011 9:30 AM
To: Bennion, Richard; Ruwart, Carole (Legal)
Cc: Moon, Richard (Legal); Bisauta, Christine (Legal)
Subject: Bennett Withdraws All Petitions Except For Rule 462.260

To Mr. Bennion, Ms Ruwart, Mr. Moon, and Ms, Bisauta,

Today (4/21/11) ***I withdraw*** my regulatory petitions to amend Rules 462.060, 462.100, 462.160, and 462.180.

I do not withdraw my regulatory petition to amend Rule 462.260.

By withdrawing all but one of my petitions, I am simplifying the board members' task at the 4/26/11 meeting.

In essence, I ask the BOE board members at the 4/26/11 meeting to then answer only the following question:

Is the language Bennett petitions be added to Rule 462.260 ("Part 0.5 of the Property Tax Division of the Revenue & Taxation Code has no retrospective effect on any owner's real property rights.") a correct interpretation of the legislature's mandate in 1979 when it then wrote that Part 0.5 "...shall be effective for the 1979-1980 assessment year and thereafter"?

Steve

Stephen H. Bennett
Letwak & Bennett
26400 La Alameda #200
Mission Viejo, CA 92691
949-582-2100 Ext 101
949-582-8301

From: Stephen Bennett
Sent: Thursday, April 21, 2011 2:53 PM
To: Ruwart, Carole (Legal); Moon, Richard (Legal)
Cc: Bisauta, Christine (Legal); Bennion, Richard
Subject: Waive Oral Arguments 4/26/11

Carole,

After the lengthy telephone conversation with you regarding my petition, with all due respect I do not believe it will be constructive for me to attend oral arguments 4/26/11. Accordingly, I waive my right to those oral arguments.

I stand on my written petition to amend Rule 460.260 solely by putting the following question to the board members:

Is the language Bennett petitions be added to Rule 462.260 ("Part 0.5 of the Property Tax Division of the Revenue & Taxation Code has no retrospective effect on any owner's real property rights.") a correct interpretation of the legislature's mandate in 1979 when it then wrote that Part 0.5 "...shall be effective for the 1979-1980 assessment year and thereafter"?

Steve

Stephen H. Bennett
Letwak & Bennett
26400 La Alameda #200
Mission Viejo, CA 92691
949-582-2100 Ext 101
949-582-8301

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: April 13, 2011

From: Randy Ferris 
Acting Chief Counsel

Subject: **Board Meeting, April 26-27, 2011**
Chief Counsel Matters – Item J – Rulemaking
Petition to Amend the Following Property Tax Rules Related to Change in Ownership:
462.060 (Life Estates and Estates for Years), 462.100 (Leases), 462.160 (Trusts),
462.180 (Legal Entities), and 462.260 (Date of Change in Ownership)

On March 21, 2011, the Legal Department received Mr. Stephen Bennett's (petitioner's) petition, pursuant to Government Code section 11340.6, to amend Property Tax Rules¹ 462.060, 462.100, 462.160, 462.180, and 462.260.² The petition seeks to amend these Rules to "prohibit assessors from violating the due process rights of real property taxpayers who acquired their interest in real property prior to the enactment of Part 0.5 of the Property Tax Division [titled *Implementation of Article XIII A of the California Constitution*, and referred to throughout this memorandum as Part 0.5] of the Revenue & Taxation Code."³

This matter is scheduled for the Board's consideration at the April 26, 2011 meeting on the Chief Counsel Matters Agenda. At the meeting, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process by ordering publication of the notice pursuant to Government Code section 11346.5; (3) direct staff to commence an interested parties process to consider the requested amendment in part or in whole; or (4) take any other action the Board deems appropriate. Staff recommends that the Board deny the petition in its entirety because, as explained below, petitioner's requested amendments are based on an incorrect understanding of basic tenets of California property

¹ References to "Rule" or "Rules" are section references to title 18 of the California Code of Regulations.

² Government Code section 11340.7 requires a response to a rulemaking petition within 30 days. In this case, petitioner refused to waive the 30-day deadline, necessitating the Legal Department to take "other action" as provided in Government Code section 11340.7, subdivision (b) and inform petitioner before the April 20, 2011 deadline that his petition will be heard on the April 26, 2011 Chief Counsel Matters Agenda.

³ Petition, at p. 1. Petitioner also "separately petition[s] BOE to compel its legal staff to depublish all annotations that apply Part 0.5 retrospectively," and specifically lists Property Tax Annotations 220.0325, 220.0326, 220.0338, 220.0332.005, 220.0780 and 220.0786 in his petition. The Legal Department will respond to petitioner's requests for depublishation separately under Rule 5700.

tax law and they are contrary to judicial precedent and longstanding interpretations of Board staff. Furthermore, petitioner's requested amendments are effectively repetitive of the amendments the petitioner requested be made to Rule 462.160 by petition dated December 31, 2010, which were unanimously denied by the Board on January 27, 2011. Nothing in the current petition supports a different result.

This memorandum sets forth: (1) a general background of property tax law as it pertains to the petition; (2) a discussion of the petition; and (3) staff's recommendation.

I. General Background - Proposition 13

Proposition 13 added Article⁴ XIII A to the California Constitution by voter-approved initiative adopted June 6, 1978, effective July 1, 1978.⁵ Article XIII A, section 2 changed California's ad valorem property taxation scheme from one based on annual fair market value assessment to one based on a property's "full cash value," with reassessment allowed only upon new construction or a "change in ownership." By its own terms, Article XIII A, section 2 set the beginning "full cash value" of all property to be a property's assessed value as shown on the 1975-1976 tax bill.⁶ The value shown on the 1975-1976 tax bill was set as of the 1975 lien date, which was March 1, 1975. Therefore, effective July 1, 1978, all property in California subject to Proposition 13 had a full cash value determined as of March 1, 1975.⁷

To implement Proposition 13, including defining "change in ownership," Part 0.5 was added to Division 1 of the Revenue and Taxation Code effective July 10, 1979.⁸ As relevant here, the statutes contained in Part 0.5 that define "change in ownership" and exclusions therefrom, are sections⁹ 60, 61, 62 and 64. Rules 462.060, 462.100, 462.160, 462.180, and 462.260 interpret these statutes.

Section 60 defines a "change in ownership" as ". . . a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equivalent to the value of the fee interest." Section 61, subdivision (g) provides that a change in ownership occurs upon "[a]ny vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63." Section 62, subdivision (d) excludes from change in ownership:

⁴ Unspecified references to "Articles" are to the California Constitution.

⁵ Assem. Com. on Rev. & Tax., Property Tax Assessment (Oct. 29, 1979), at p. 5.

⁶ The definition of "full cash value" is codified at Revenue and Taxation Code section 110.1, which is located in Division 1, Part 1 of the Revenue and Taxation Code, not Part 0.5.

⁷ Certain exceptions not relevant to this memorandum are enumerated in Revenue and Taxation Code section 110.1.

⁸ We note that the petition fails to consider that, between July 1, 1978 and July 10, 1979, a different statutory and regulatory scheme implemented Proposition 13. The petition also fails to consider that Part 0.5 consists of multiple sections of the Revenue and Taxation Code, which were added at different times and, therefore, have different potential effective dates.

⁹ All further section references are to the Revenue and Taxation Code unless otherwise specified.

Any transfer by the trustor, or by the trustor's spouse or registered domestic partner, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust, or (2) the trust is revocable; or any transfer by a trustee of such a trust described in either clause (1) or (2) back to the trustor; or, any creation or termination of a trust in which the trustor retains the reversion and in which the interest of others does not exceed 12 years duration.

Section 63 excludes interspousal transfers from change in ownership. Section 61, subdivision (h) states that a change in ownership occurs when "[a]ny interests in real property" vest in persons other than a trustor or trustor's spouse and the trust becomes irrevocable. Rule 462.160 interprets these provisions as they apply to real property held in revocable and irrevocable trusts.

Section 62, subdivision (e) excludes from change in ownership "[a]ny transfer by an instrument whose terms reserve to the transferor an estate for years or an estate for life," but provides that the termination of such a life estate or estate for years is a change in ownership except as provided in section 62, subdivision (d) and section 63. Rule 462.060 interprets this statute.

Section 61, subdivision (c) provides that a change in ownership includes the creation of a leasehold interest in taxable real property for a term of 35 years or more, the termination of a leasehold interest that had an original term of 35 years or more, or the transfer of a lessor's interest subject to a lease with a remaining term of less than 35 years. Section 62, subdivision (g) excludes from change in ownership any transfer of a lessor's interest in taxable real property subject to a lease with a remaining term of 35 years or more. Rule 462.100 interprets these provisions.

Section 61, subdivision (j) provides that any transfer of real property between a corporation, partnership, or other legal entity and a shareholder, partner or any other person is a change in ownership. However, section 62, subdivision (a)(2) excludes from change in ownership proportional ownership interest transfers. If such a transfer occurs on or after March 1, 1975, the owners of the legal entity immediately after the transfer become "original co-owners" with respect to their interests in the transferee legal entity. (Section 64, subd. (d).) Rule 462.180 interprets these provisions.

Rule 462.260 provides dates to be used "for purposes of reappraising real property as of the date of change in ownership" for transfers involving sales, leases, inheritance by will or intestate succession, and trusts.

II. Discussion of Petition

The petition seeks rule amendments to "prohibit assessors from violating the due process rights of real property taxpayers who acquired their interest in real property prior to the enactment of Part 0.5 of the Property Tax Division of the Revenue & Taxation Code."¹⁰

¹⁰ Petition, at p. 1.

However, the petition provides no explanation of how the due process rights of such owners were infringed upon, nor does it provide any specific authority to support its position.

The only explanation given is the following:

Respectfully, petitioner contends that BOE legal staff erroneously interprets *Steinhart*. [¶] . . . [¶] BOE must accept the findings in *Steinhart* as correct. BOE should realize that it can no longer contend that a remainderman's taking of actual possession constitutes a reassessable change in ownership. Why? *Two reassessments of the remainderman's interest on two different dates* violates the remainderman' [sic] constitutional right to due process as codified by our legislature's ban on "double taxation" in R&T §102.¹¹ (Emphasis added.)

Based on the petition and legal staff's numerous emails and conversations¹² with petitioner, staff believes that petitioner seeks the same result as he sought in his December 31, 2010 petition to amend Rule 462.160, and that petitioner is arguing from a premise that is fundamentally contrary to California property tax law. For these reasons the petition should be denied.

In his first petition, petitioner essentially argued that as a result of *Steinhart*,¹³ a "vesting" of a remainder interest caused a change in ownership of that interest, and thus could not be reassessed again when that vested interest became possessory.¹⁴ However, as explained fully in the Chief Counsel Memorandum dated January 14, 2011 (which is attached and incorporated by reference), petitioner's interpretation of *Steinhart* was clearly in error because it directly contradicted the interpretation of *Steinhart* set forth in *Phelps v. Orange County Assessment Appeals Bd. No. 1 (Phelps)*.¹⁵ In *Phelps*, a trustor died in 1947, at which time the trustor's three children and widow each received a lifetime income interest in the trust property, with a remainder to the grandchildren. One of those children (Wilson) died in 2002. Pursuant to the terms of the trust, Wilson's life estate terminated and his children received the right to a one-third lifetime income interest in the property. The Court of Appeal upheld the reassessment of the one-third interest stating that:

¹¹ Petition, at p. 3.

¹² The Board's legal staff met with petitioner after the January 27, 2011 meeting and explained the basis for the January 14, 2011 Chief Counsel Memorandum. At that time, staff also received for informal consideration petitioner's request for depublication of certain annotations. Petitioner sent staff twenty additional emails between February 2 and March 17, 2011, each with additional arguments or annotations to be considered. Staff discussed these emails extensively by telephone with petitioner on March 22, 2011, and, as of April 4, 2011, staff has received several additional emails containing additional arguments, citations, and demands for Board action. As previously mentioned, petitioner's request for the depublication of certain annotations is being handled separately by the Legal Department pursuant to Rule 5700.

¹³ *Steinhart v. County of Los Angeles* (2010) 47 Cal.4th 1298.

¹⁴ See petitioner's December 31, 2010 Petition, Section IV, Proposed Amendments to Rule 462.160, at pp. 7-12.

¹⁵ (2010) 187 Cal.App.4th 653. We also note that, as he did in his first petition, petitioner fails to address *Phelps* at all in this petition.

Although a change in ownership occurred in 1947 [when the trust became irrevocable and when the grandchildren's remainder interest vested], another ownership change occurred in 2002, when Wilson's entire equitable [present beneficial] interest in the real property passed to Wilson's children. Plaintiff's focus on identifying a single "transfer" or transferor finds no support in *Steinhart*.¹⁶

In this petition, petitioner argues that "two reassessments of the remainderman's interest on different dates" is illegal. This is the same argument, at least in substantive effect, petitioner made in his first petition since petitioner, again, seeks to restrict property passed via irrevocable trust to only one change in ownership regardless of how many times the present beneficial interest in the property is transferred. However, as explained in the response to his first petition, *Phelps* clearly holds to the contrary. Thus, petitioner essentially asks this Board again to contravene *Phelps* by amendments to Rules 462.060, 462.160, and 462.260.¹⁷ For this reason alone, the petition should be denied. Notwithstanding this fact, we briefly address what we understand to be petitioner's fundamental misunderstanding of the law.

Petitioner's fundamental misunderstanding is his assumption that, under any facts similar to *Phelps*, a change in ownership is being determined "retrospectively" against those whom he refers to as "Pre-Enactment Owners." Such is never the case, however, because section 60 and Rule 462.260 require a change in ownership to be determined as of the date of the transfer of a present beneficial interest. A change in ownership occurring on the date of a transfer of a present beneficial interest is never an assessment on a past or future interest.

This can best be illustrated using the facts in *Phelps*. Petitioner's assumption is that, in *Phelps*, Part 0.5 is applied in 2002 to an event (i.e., the vesting of the remainder interest) that occurred in 1947, thus making it a "retrospective" application of Part 0.5 against the remainder beneficiaries. Petitioner fails to understand, however, that it is not the remainder interest received in 1947 upon which a change in ownership determination is being made. Rather, as *Phelps* held, and as required by sections 60 and 61, and Rules 462.060, 462.160, and 462.260, a change in ownership determination is made upon the receipt by the remainderman of the present beneficial interest (what *Steinhart* and *Phelps* refer to as the "equitable interest") in 2002. It is the transfer of the present beneficial interest, originally held by Wilson, to the remainder beneficiaries in 2002 that causes the change in ownership.

¹⁶ *Phelps, supra*, 187 Cal.App.4th 653, at p. 666.

¹⁷ *Phelps* came before the California Court of Appeal a second time after its first decision was vacated by the California Supreme Court and remanded for further consideration in light of *Steinhart*. (*Phelps v. Orange County Assessment Appeals Board No. 1* (2009) 175 Cal.App.4th 448, judg. vacated and cause remanded for further consideration in light of *Steinhart* (2010) 47 Cal.4th 1298.) Upon reconsideration, the Court of Appeal reached the same conclusions and also explained how its decision was not inconsistent with *Steinhart*. *Phelps* again petitioned the California Supreme Court and his petition for review was denied. (*Phelps, supra*, 187 Cal.App.4th 653, cert. den. 2010 Cal.LEXIS 12265.) On March 1, 2011, *Phelps* filed a petition for certiorari to the United States Supreme Court; on March 30, 2011, Orange County waived its right to make a response. The petition is scheduled for consideration on April 22, 2011.

There is no 2002 assessment of the vesting of a 1947 remainder interest based on law that became effective in 1979 as petitioner believes.¹⁸

Also, for this reason, there is no “double taxation” within the meaning of section 102. The California Supreme Court has held that “double taxation occurs only when ‘two taxes of the same character are imposed on the same property, for the same purpose, by the same taxing authority within the same jurisdiction during the same taxing period.’”¹⁹ Clearly, there is no double taxation when a separate real property interest is being assessed at a different time (e.g., the remainderman’s 2002 present beneficial interest versus the 1947 event where the trust becomes irrevocable and the remainderman’s interest vests).²⁰

Petitioner also requests amendment to Rule 462.100 to provide that the termination, transfer or assignment of a long-term lease should not be reassessed as a change in ownership if the term of the lease commenced prior to the effective date of Part 0.5. Again, no explanation for this request is given. However, it appears that petitioner objects to Board legal staff opinion letters in which the portion of the lease term effective prior to the effective date of Part 0.5 is counted in determining whether or not a lease is a long-term lease (i.e., 35 years or longer) under section 61, subdivision (c) and section 62, subdivision (g).²¹ However, those opinion letters are consistent with the plain language of the statutes that require the counting of the “original term” or the “remaining term” of the lease. Nothing in those statutes suggests that a lease is exempt from Part 0.5 if it was entered into prior to the effective date of Part 0.5. Furthermore, if taken to its logical conclusion, petitioner’s position could result in such property being reassessed any time there is a termination, transfer, or assignment of such a lease whether or not the lease is 35 years or longer, since the protection afforded to leases for terms of less than 35 years would then not apply.

Petitioner also requests amendment of Rule 462.180 to provide that “original co-owner”²² status should not attach if real property is transferred to a legal entity prior to the effective date of Part 0.5. In this case, there is no need for an amendment. Both section 64, subdivision (d) and Rule 462.180, subdivision (d)(2) provide, by their own terms, that original co-owner status is only obtained for transfers of real property that occur on or after March 1, 1975.²³

¹⁸ By email dated March 24, 2011, petitioner requested that an article by Robert R. Gunning entitled *Back from the Dead: The Resurgence of Due Process Challenges to Retroactive Tax Legislation* (2009) 47 *Duquesne Law Review* 291 be included in consideration of his petition. Because the Rules that petitioner requests to be amended are not applied to periods prior to the effective date of Part 0.5 (i.e., the Rules in question have not been and are not applied retrospectively), the analysis proffered by this article does not support petitioner’s arguments.

¹⁹ *Assoc. Home Builders etc., Inc. v. City of Walnut Creek* (1971) 4 Cal.3d 633, 613 [citations omitted].

²⁰ Petitioner also fails to realize that a remainder interest can never be reassessed since, as a future interest, it does not meet the section 60 definition of change in ownership. Furthermore, the 1947 remainder interest could not be reassessed even in 1947 since Proposition 13 did not exist at that time.

²¹ These opinion letters are the basis for several annotations requested to be depublished by petitioner.

²² On page 16 of the Petition, petitioner mistakenly uses the term “original transferor,” which is a status that only applies in the context of a joint tenancy. We assume he meant “original co-owner.”

²³ As explained in Part I, although the effective date of Part 0.5 is July 10, 1979, Article XIII A, section 2 and section 110.1 make clear that the full cash value of property is first determined as of the 1975-1976 tax year for which March 1, 1975 was the lien date.

III. Staff's Recommendation

By these requested amendments to Property Tax Rules, petitioner effectively asks the Board to disregard the 2010 judicial decisions in *Steinhart* and *Phelps*. Despite the extensive judicial attention received by Proposition 13 since its adoption in 1978, we have not found any due process challenges along the lines of petitioner's contentions as presented in this petition, and we do not believe such challenges would be successful.

Staff recommends that the Board deny the petition because the current versions of Property Tax Rules 462.060, 462.100, 462.160, 462.180, and 462.260 conform to the applicable statutes as applied in *Steinhart* and *Phelps*. The petition should also be denied because it is, in substance, duplicative of the petition that the Board denied on January 27, 2011.

If you need more information or have any questions, please contact Christine Bisauta, Acting Assistant Chief Counsel, at (916) 323-2549 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

Approved:


Kristine Cazadd
Interim Executive Director

Attachment: Chief Counsel Memorandum dated January 14, 2011

RMF:bk:yg

J:/Chief Counsel/Finals/Board Memo – Item J – Petition to Amend CIO – 462.060 462.100 462.160 462.180 460.260 – 04-12-2011.doc
J:/Prop/Finals/Monthly CC Agenda Items/2011/11-053.Memo.doc

cc: Ms. Kristine Cazadd MIC: 73
Ms. Christine Bisauta MIC: 82
Mr. Richard Moon MIC: 82
Ms. Carole Ruwart MIC: 82

STATE BOARD OF EQUALIZATION



BOARD APPROVED STAFF RECOMMENDATION TO DENY

At the April 26, 2011 Board Meeting


Diane G. Olson, Chief
Board Proceedings Division

Memorandum

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

Date: January 14, 2011

From: Randy Ferris 
Acting Chief Counsel

Subject: **Petition for Amendment of Property Tax Rule 462.160**
Change in Ownership - Trusts
January 27, 2011 Board Meeting - Chief Counsel Matters - Item J - Rulemaking

On January 3, 2011, the Legal Department received Mr. Stephen Bennett's petition, pursuant to Government Code section 11340.6, to amend Property Tax Rule¹ 462.160, *Change in Ownership - Trusts*. In his petition, Mr. Bennett seeks to amend Rule 462.160 to "clarify" the change in ownership consequences when certain property interests terminate. He states that a recent California Supreme Court decision, *Steinhart v. County of Los Angeles (Steinhart)*,² raised two questions that should be clarified by Rule 462.160.

This matter is scheduled for the Board's consideration at the January 27, 2011, meeting³ on the Chief Counsel Matters Agenda. At the meeting, the Board may: (1) deny the petition; (2) grant the petition in part or in whole and commence the official rulemaking process by ordering publication of the notice pursuant to Government Code section 11346.5; (3) direct staff to commence an interested parties process to consider the requested amendment in part or in whole; or (4) take any other action the Board deems appropriate. Staff recommends that the Board deny the petition because, as explained in detail below, the questions raised in the petition have been answered by *Steinhart* and a recent California Court of Appeal decision, *Phelps v. Orange County Assessment Appeals Board No. 1 (Phelps)*.⁴ Furthermore, Mr. Bennett's proposed amendments to Rule 462.160 are contrary to *Phelps*.

This memorandum sets forth: (1) a general background of change in ownership law as it pertains to real property held in trusts; (2) a discussion of the petition and the requested amendments; and (3) staff's recommendation.

¹ All "Property Tax Rule" or "Rule" references are to title 18 of the California Code of Regulations.

² (2010) 47 Cal.4th 1298.

³ Under Government Code section 11340.7, the Board has 30 days from receipt to take action on the petition. Petitioner states in his petition that he does not waive this deadline.

⁴ (2010) 187 Cal.App.4th 653.

I. General Background – Change in Ownership and Trusts

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a “change in ownership.” This section has been implemented by statutes enacted by the Legislature and Property Tax Rules promulgated by the Board of Equalization. As relevant here, such authorities regarding trusts include Revenue and Taxation Code section⁵ 60, section 61, subdivisions (g) and (h), section 62, subdivision (d), and Rule 462.160.

Section 60 defines a “change in ownership” as “. . . a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equivalent to the value of the fee interest.” This is often referred to as a three-part test. To meet the test, there must be: (1) a transfer of a present interest; (2) that includes beneficial use; (3) the value of which is substantially equivalent to the value of the fee. Section 61, subdivision (g), provides that a change in ownership occurs upon “[a]ny vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63.” Section 62, subdivision (d) excludes from change in ownership:

Any transfer by the trustor, or by the trustor’s spouse or registered domestic partner, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust, or (2) the trust is revocable; or any transfer by a trustee of such a trust described in either clause (1) or (2) back to the trustor; or, any creation or termination of a trust in which the trustor retains the reversion and in which the interest of others does not exceed 12 years duration.

Section 63 excludes interspousal transfers from change in ownership. Section 61, subdivision (h) states that a change in ownership occurs when “[a]ny interests in property” vest in persons other than a trustor or trustor’s spouse and the trust becomes irrevocable.

Rule 462.160 interprets change in ownership statutes as they apply to transfers involving trusts. It explains in subdivisions (a) and (c) that, generally, both the creation and termination of trusts will result in a change in ownership of trust real property. Rule 462.160, subdivisions (b) and (d) provide a number of exceptions to these general rules.

II. Discussion of Petition

The petition states that its genesis was the Supreme Court’s decision in *Steinhart*. In *Steinhart*, a trustor (Helfrick) created a revocable trust with herself as the sole beneficiary, and transferred a residence to the trust. Upon Helfrick’s death in 2001, the trust became irrevocable and under its terms, Helfrick’s sister, plaintiff Lorraine Steinhart (Steinhart), received a life estate in the residence with the remainder to Helfrick’s heirs. The Los Angeles County Assessor reassessed the residence since the transfer of the life estate to Steinhart caused a change in ownership.

Steinhart argued that the residence should not have been reassessed because no change in ownership occurred upon her receipt of the life estate in the residence based on the contention

⁵ Section references are to the Revenue and Taxation Code unless otherwise indicated.

that her life estate was not "substantially equivalent to the fee" as required by section 60.⁶ The Supreme Court disagreed, stating that Steinhart's error was in focusing on the interest that she had received rather than on what interest was transferred by Helfrick. Because Helfrick, upon her death, had transferred the life estate and the remainder, she was left with no interest and thus had transferred the entire fee itself, not just an interest that was "substantially equivalent to the fee."⁷ The Court did not find it necessary to determine whether the transfer of a life estate alone would result in a change in ownership, nor did it address whether there would be a subsequent change in ownership when Helfrick's heirs obtained the remainder interest in the residence.⁸

The petition requests that the Board amend Rule 462.160 to provide three examples and several definitions (proposed by new subdivision (f)) that would purportedly answer the following two questions raised by the *Steinhart* decision.

1. Did the receipt by Lorraine Steinhart of her life estate in Helfrick's residence on Helfrick's death trigger a reassessable change in ownership?
2. Will Steinhart's future death then trigger a reassessable change in ownership of the same residence?

We first note that *Steinhart* directly answers Question 1, and *Phelps*, which petitioner does not discuss, answers Question 2.

A. Question 1

Petitioner requests amendment of Rule 462.160 to clarify the application of section 61, subdivision (g) to his Question 1. However, no amendment to Rule 462.160 is necessary to answer petitioner's Question 1 because section 61, subdivision (g) is unnecessary to answer it, and as explained in *Steinhart*, Rule 462.160 provides an answer. *Steinhart* held that sections 60, 61, subdivision (h), and 62, subdivision (d), and Rule 462.160 lead to the conclusion that a change in ownership of trust property occurs when a trust becomes irrevocable and the trustor transfers the entire equitable estate in the property. In fact, the Court goes through a detailed analysis of its conclusion beginning with section 2, subdivision (a), of Article XIII A of the Constitution, explaining how the relevant statutes are consistent with this constitutional provision, and finally explaining how the Board's Rule 462.160 properly interprets those statutes. In this regard, the Court explained as follows:

The State Board of Equalization, through an implementing regulation, has also expressly addressed section 2, subdivision (a)'s [of Article XIII A of the California Constitution] application to transactions involving trusts. That regulation begins by stating a "[g]eneral [r]ule" that, for purposes of section 2, subdivision (a), "[t]he transfer by the trustor . . . of real property into a trust is a change in ownership . . . at the time of the transfer." (Cal. Code Regs., tit. 18, § 462.160, subd. (a).) The regulation then specifies a list of "[e]xceptions" to the general rule—i.e., "transfers" involving trusts that "do not constitute changes in

⁶ *Steinhart*, *supra*, 47 Cal.4th at pp. 1323-1325.

⁷ *Ibid.*

⁸ *Ibid.*

ownership”—including, as here relevant: (1) “[t]he transfer of real property by the trustor to a trust in which the trustor-transferor is the sole present beneficiary of the trust” (*id.*, § 462.160, subd. (b)(1)(A)); and (2) “[t]he transfer of real property . . . by the trustor to a trust which is revocable by the trustor” (*id.*, § 462.160, subd. (b)(2)). [Fn. Omitted.] Regarding revocable trusts, the regulation further provides that “a change in ownership does occur at the time the revocable trust becomes irrevocable unless the trustor-transferor remains or becomes the sole present beneficiary or unless otherwise excluded from change in ownership.” (*Id.*, § 462.160, subd. (b)(2).)

We generally accord “great weight” to the statutes the Legislature has passed and the regulations the State Board of Equalization has promulgated to implement article XIII A. (*Amador, supra*, 22 Cal.3d at p. 246.) Under both the express language of, and the underlying justification for, section 61, subdivision (h), section 62, subdivision (d), and the administrative regulation discussed above, it is clear that upon Helfrick’s death, a “change in ownership” under section 2, subdivision (a), occurred in this case. Notably, Steinhart does not even argue otherwise, conceding in her brief that under “a literal application of” section 61, subdivision (h)’s language, “a change in ownership occurred” when Helfrick died, “the revocable trust became irrevocable,” and her (Steinhart’s) “life estate vested.”⁹ (Emphasis added.)

As noted by petitioner, in reaching this conclusion, the Court did not discuss section 61, subdivision (g). Such a discussion was unnecessary. The case was decided based on section 60, section 61, subdivision (h), section 62, subdivision (d), and Rule 462.160 because the event at issue was the transfer of a life estate to Steinhart as a result of Helfrick’s death and the trust becoming irrevocable. The Court’s omission of section 61, subdivision (g), in its analysis is consistent with the position that section 61, subdivision (g), becomes relevant only upon Steinhart’s death, when the remainder interests of Helfrick’s heirs become possessory. Rule 462.160 addresses petitioner’s Question 1 in subdivision (b)(1), which explains that a change in ownership of trust property occurs when a revocable trust becomes irrevocable, unless the trustor-transferor remains or becomes the sole present beneficiary or an applicable exclusion applies, which was not the case under the facts of *Steinhart*. Therefore, petitioner is incorrect in his implication that Rule 462.160 needs amendment to clarify the meaning of section 61, subdivision (g), to address his Question 1.

⁹ *Steinhart, supra*, 47 Cal.4th at pp. 1322-1323.

B. Question 2

To provide an answer to his Question 2, petitioner requests amendment of Rule 462.160 to add three examples and several definitions.¹⁰ In each of the examples, A creates a trust which becomes irrevocable upon A's death, at which time B receives a lifetime interest in income (a life estate) in real property. Upon B's death, C and D receive the remainder interest.¹¹ In such a situation, as explained above, *Steinhart* makes clear that a change in ownership occurs upon A's death. Petitioner asserts that Rule 462.160 needs to be amended to clarify whether a change in ownership occurs upon B's death. However, section 61, subdivision (g), Rule 462.160, and *Phelps* already make clear that a second change in ownership does in fact occur upon B's death. Petitioner's Examples 7 and 8 are contrary to these authorities.¹² In those examples, petitioner puts forth the analysis that since C's and D's remainder interests vested at the time of A's death, upon B's death, there is not a change in ownership. This is the same argument made by the plaintiff and rejected by the court in *Phelps*.

Relevant to this petition, in *Phelps*,¹³ a trustor died in 1947 at which time the trustor's three children and widow each received a lifetime income interest in the trust property. One of those children (Wilson) died in 2002, and pursuant to the terms of the trust, Wilson's life estate terminated and his children received the right to a one-third lifetime income interest in the property. The plaintiff argued that because all vested interests in the property were transferred in 1947, nothing was transferred when Wilson died in 2002, and that, therefore, no change in ownership of the property could occur in 2002.¹⁴ The Court disagreed stating that Proposition 13 tracks "real ownership of real property, which *Steinhart* determined followed the equitable estate."¹⁵ Thus, a change in ownership occurred in 2002 when Wilson no longer continued to own the property.¹⁶

Implicit in the court's reasoning is its analysis that Wilson possessed all three elements required to meet the three-part section 60 definition of change in ownership.¹⁷ In other words Wilson held a life estate which gave him (1) a present interest, (2) from which he derived beneficial use,

¹⁰ Because petitioner's definitions are intended to buttress his examples and the examples conflict with existing law, we do not specifically address the proposed definitions other than to state that their inclusion would also conflict with existing law.

¹¹ In his examples, petitioner includes additional facts, including that B has a general or special power of appointment that is either exercised or not exercised, as well as certain provisions of the trust regarding allocation of income and principal. None of the additional facts change the conclusion that a change in ownership occurs upon A's death and again upon B's death.

¹² While petitioner's proposed Example 5 is consistent in result with Board staff interpretations, this example would not improve the clarity of Rule 462.160 because its analysis is flawed.

¹³ *Phelps* came before the California Court of Appeal a second time after its first decision was vacated by the California Supreme Court and remanded for further consideration in light of *Steinhart*. (*Phelps v. Orange County Assessment Appeals Board No. 1* (2009) 175 Cal.App.4th 448, judg. vacated and cause remanded for further consideration in light of *Steinhart* (2010) 47 Cal.4th 1298.) Upon reconsideration, the Court of Appeal reached the same conclusions and also explained how its decision was not inconsistent with *Steinhart*. *Phelps* again petitioned the California Supreme Court and his petition for review was denied. (*Phelps, supra*, 187 Cal.App.4th 653, cert. den. 2010 Cal.LEXIS 12265.)

¹⁴ *Phelps, supra*, 187 Cal.App.4th 653 at p. 666.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Phelps, supra*, 187 Cal.App.4th 653 at pp. 658-666.

and (3) the value of that use was substantially equivalent to the value of the fee. When Wilson died, his life estate terminated, a life estate interest passed to his children, and his children received all three elements previously held by Wilson, necessitating a change in ownership of their interest in the property.

The petition to amend Rule 462.160 fails to recognize that, upon the termination of a life estate in these examples, all three requirements necessary for a change in ownership are met. Petitioner's Examples 7 and 8 seem to concede that the second and third parts of the three-part test are met but ignore the present interest requirement of the first part of the test. The Examples state that no change in ownership occurs upon B's death because C's and D's remainder interests already vested upon A's death. Petitioner's analysis, however, fails to consider that a remainderman does not have present enjoyment of the property until the precedent estate has terminated. Until the remaindermen obtain the present enjoyment of the property, their interests are "future" interests that are to be protected from reassessment by section 60's present interest requirement.¹⁸ This is true even if the remainder interest becomes "vested" at an earlier time (i.e., upon grantor's death). Furthermore, this conclusion is supported by Rule 462.160, subdivision (d)(1), which states:

Prior Change in Ownership. Termination results in the distribution of trust property according to the terms of the trust to a person or entity who received a present interest (either use of or income from the property) when the trust was created, when it became irrevocable, or at some other time. However, a change in ownership also occurs when the remainder or reversionary interest *becomes possessory* if the holder of that interest is a person or entity other than the present beneficiary unless otherwise excluded from change in ownership. (Emphasis added.)

In petitioner's Examples 7 and 8, at B's death, a present interest in the property is transferred because B's interest terminates and C's and D's interests then become possessory. And, because C and D also have the beneficial use of the property, and their interest in the property is substantially equivalent to the value of the fee, all three parts of the section 60 definition of change in ownership are met at B's death. Therefore, contrary to petitioner's proposal, pursuant to *Phelps* and Rule 462.160, subdivision (d)(1), the property must be reassessed at that time.

The plaintiff in *Phelps* also argued, and petitioner also appears to be arguing, that *Steinhart* limited section 61, subdivision (g), to retained life estates and nonsuccessive remainder interests. *Phelps* rejected this argument and concluded that section 61, subdivision (g), supported its conclusion that a change in ownership occurred upon Wilson's death:

Plaintiff [*Phelps*, the trustee of the trust] notes that under section 61, subdivision (g), a change of ownership includes, "Any vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63." He observes "the section appears to state that every time a life estate ends and the remainder

¹⁸ Assem. Com. on Rev. & Tax., Report of the Task Force on Property Tax Administration (Jan. 22, 1979) at p. 39.

interest vests in another, this is an assessable change in ownership.” He contends *Steinhart* limits section 61, subdivision (g), to retained life estates and nonsuccessive remainder interests. *Steinhart* did not involve successive transfers or vesting of remainder interests under a trust, and the court did not discuss section 61, subdivision (g), in this context. [Citation omitted.] Cases are not authority for propositions not considered. (*Silverbrand v. County of Los Angeles* (2009) 46 Cal.4th 106, 127 [92 Cal. Rptr. 3d 595, 205 P.3d 1047].) Section 61, subdivision (g), however, supports our conclusion the vesting of property rights in Wilson’s children upon termination of Wilson’s life interest effected a change of ownership.¹⁹ (Emphasis added.)

Therefore, the petition should be denied because the proposed amendments directly contradict section 61, subdivision (g), and *Phelps*. Additionally, the appellate court’s analysis in *Phelps* is consistent with Rule 462.160, subdivision (d)(1) and inconsistent with the Rule amendments proposed by petitioner.

III. Staff’s Recommendation

Staff recommends that the Board deny the petition because the current version of Rule 462.160 conforms to the applicable statutes as applied in *Steinhart* and *Phelps*. In staff’s opinion, the requested regulatory change is contrary to these authorities.

If you need more information or have any questions, please contact Christine Bisauta, Acting Assistant Chief Counsel, at (916) 323-2549 or Richard Moon, Tax Counsel IV, at (949) 440-3486.

Approved: _____

Kristine E. Cazadd
Interim Executive Director

RF:bk
Prop/Rules/Rule 462.160
Chief Counsel/Final

cc:	Ms. Kristine Cazadd	MIC: 73
	Mr. David Gau	MIC: 63
	Ms. Christine Bisauta	MIC: 82
	Mr. Dean Kinnee	MIC: 64
	Mr. Todd Gilman	MIC: 70

¹⁹ *Phelps, supra*, 187 Cal.App.4th at p. 667.

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N Street, Room 121

Sacramento, California

REPORTER'S TRANSCRIPT

APRIL 26, 2011

ITEM J1

CHIEF COUNSEL MATTERS

RULEMAKING

Reported by: Beverly D. Toms

No. CSR 1662

P R E S E N T

For the Board
of Equalization:

Jerome E. Horton
Chairman

Michelle Steel
Vice-Chairwoman

Betty T. Yee
Member

George Runner
Member

Marcy Jo Mandel
Appearing for John Chiang
State Controller
(per Government Code
Section 7.9)

Diane Olson, Chief
Board Proceedings Division

Board of Equalization
Staff:

Carole Ruwart
Legal Department

Bradley Heller
Legal Department

--oOo---

1 Sacramento, California

2 April 26, 2011

3 ----oOO----

4 MS. OLSON: Our next item is J1, Petition to
5 amend Property Tax Rule 462.060, Change in Ownership -
6 Life Estates and Estates for Years; Property Tax Rule
7 462.100, Change in Life Ownership - Leases; Property Tax
8 Rule 462.160, Change in Ownership - Trusts; Property Tax
9 Rule 462.180, Change in Ownership - Legal Entities and
10 Property Tax Rule 462.260, Date of Change in
11 Ownership.

12 We have two speakers for this matter.

13 MR. HORTON: Thank you.

14 Members, before us is Mr. -- Mr. Douglas
15 Wacker. He is the President of the California Assessors
16 Association. Also the Assessor and Recorder in Lake,
17 California. As well as Barbara Edginton, the Assessment
18 Manager of the California Assessors Association, as
19 well.

20 Please commence with your --

21 MR. WACKER: Okay.

22 MR. HORTON: -- presentation.

23 MR. WACKER: Good afternoon, Board Chairman
24 Horton and fellow Board Members.

25 Barbara Edginton, Assessment Manager, and I are
26 here on behalf of the California Assessors Association
27 to oppose Mr. Bennett's Petition on Rule 462.260 and
28 support staff's recommendation that you will deny Mr.

1 Bennett's petition to amend Rule 462.260.

2 I would like to emphasize two points. First,
3 Proposition was passed more than 30 years ago and there
4 have been many cases heard in the Superior Courts,
5 Appeal Court, the State Supreme Court as well as a case
6 heard in the United States Supreme Court.

7 This includes the Phelps case which
8 specifically addresses the question of a trust created
9 in 1947, well before part .5 was created and
10 reassessment of remainder interests following the death
11 of a life estate holder.

12 And, two, many Courts do however emphasize that
13 one cannot state as fact something that is not existent
14 in law. Had the Legislator intended to limit the
15 application of the change in ownership laws it would
16 have included that language in the statutes and
17 regulation.

18 In 1979 there was no thought that the new laws
19 would not apply to something created prior to July 1979,
20 or certainly it would have so stated.

21 Since that time this would have severely
22 limited the number of reassessments.

23 In closing, adding Mr. Bennett's proposed
24 language under Rule 462.260 is unnecessary, it would
25 cause confusion and misunderstanding and interpretation
26 by assessment staff attorneys and property owners. And
27 it would potentially open the door to future changes we
28 believe were not the intended -- were not intended by

1 the original drafters of the regulation.

2 Therefore, we firmly oppose -- are opposed to
3 Mr. Bennett's petition.

4 MR. HORTON: Thank you very much. Does that
5 conclude your presentation? Thank you so --

6 MR. WACKER: Yeah.

7 MR. HORTON: -- very much.

8 I would ask that the Department make their
9 presentation, as well, and introduce the matter, at the
10 same time take in consideration the presentation today.
11 If you could address that in any way in your
12 presentation it might be helpful. Thank you.

13 MS. RUWART: Good afternoon, Board Members.
14 My name is Carole Ruwart. I'm an attorney with the
15 Legal Department. And here with me is Bradley Heller,
16 also with the Legal Department.

17 Mr. Bennett did petition to amend a number of
18 Property Tax Rules as stated by Ms. Olson and -- and
19 April 21st he withdrew all of his petitions to amend the
20 rules except for his amendment to Rule 462.260.

21 His revised petition, both original and as
22 amended, is seeking essentially the same result as his
23 petition that he put before the Board on the Jan -- at
24 the January 27th meeting which the Board denied.

25 We firmly agree with Mr. Wacker's comments.
26 And for reasons and all the reasons set forth in the
27 Chief Counsel memorandum we believe that the requested
28 amendments and Petitioner's arguments in general are

1 directly contrary to relevant legal authority, our State
2 Supreme Court and the Court of Appeals in the Phelps
3 decision. And we recommend that the petition be denied.

4 MR. HORTON: Thank you very much.

5 Discussion, Members?

6 Hearing none, is there a motion?

7 MS. YEE: Move to adopt the staff
8 recommendation.

9 MR. HORTON: It's been moved by Ms. Yee to
10 adopt the staff recommendations.

11 Is there a second?

12 MS. MANDEL: Second.

13 MR. HORTON: Second by Ms. Mandel.

14 Discussion, Members?

15 Without objection, such will be the order.

16 ---oOo---



STATE BOARD OF EQUALIZATION

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MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Interim Executive Director

May 3, 2011

Mr. Stephen Bennett
Letwak & Bennett
26400 La Alameda #200
Mission Viejo, CA 92691

Re: *Property Tax Annotation Depublication Requests*
Assignment No: 11-050 and Email Dated April 25, 2011

Dear Mr. Bennett:

This is to acknowledge receipt of your April 28, 2011 email request to withdraw all of your requests to depublish Property Tax Annotations (Annotations). As such, your requests for depublication as described in our April 15, 2011 acknowledgement letter to you (see attached) as well as your April 25, 2011 email request to depublish Annotations 220.0345 and 220.0326.005 have been withdrawn.

Sincerely,

Carole Ruwart
Tax Counsel III (Specialist)

CR:yg

J:\Prop\NonPrec\Ruwart\11-050 withdrawal.doc

Attached: April 15, 2011 Letter

cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70



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State Controller

KRISTINE CAZADD
Interim Executive Director

April 15, 2011

Mr. Stephen Bennett
Letwak & Bennett
26400 La Alameda #200
Mission Viejo, CA 92691

**Re: Property Tax Annotation Depublication Requests
Assignment No.: 11-050**

Dear Mr. Bennett:

This is to acknowledge receipt of your March 22, 2011 email request to depublish the following Property Tax Annotations (Annotations) under Rule¹ 5700, subdivision (e): 220.0325, 220.0326, 220.0338, 220.0332.005, 220.0780, and 220.0786. On March 23, 2011, you requested that we also depublish Annotations 493.0131 and 220.0785. Finally, in your petition to amend various Property Tax Rules, which was received by the Board on March 21, 2011, you also petitioned "BOE to compel its legal staff to depublish all annotations that apply Part 0.5 retrospectively," and specifically list again Annotations 220.0325, 220.0326, 220.0338, 220.0332.005, 220.0780 and 220.0786.

Your requests have been assigned to me for a response, and pursuant to Rule 5700, subdivision (e), I will notify you as to whether Acting Chief Counsel Randy Ferris approves or denies your requests within 60 days of the receipt of your March 21, 2011 request. Your requests have been given the assignment number 11-050. Please refer to this number if you contact this office for any questions you may have concerning this matter as that helps us locate your file.

Sincerely,

Carole Ruwart
Tax Counsel III (Specialist)

CR:yg

J:/Prop/Nonprec/Ruwart/11-050 AL.doc

cc: Mr. David Gau MIC:63
Mr. Dean Kinnee MIC:64
Mr. Todd Gilman MIC:70

¹ References to "Rules" are section references to title 18 of the California Code of Regulations.



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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JOHN CHIANG
State Controller

KRISTINE CAZADD
Interim Executive Director

May 20, 2011

Stephen H. Bennett
Letwak and Bennett
Certified Public Accountants
26400 La Alameda, Suite 200
Mission Viejo, CA 92691

Re: Petition to Amend Property Tax Rule 462.260

Dear Mr. Bennett:

On March 21, 2011, the California State Board of Equalization (Board) received your petition requesting that the Board amend California Code of Regulations, title 18, sections (Property Tax Rules) 462.060, *Change in Ownership – Life Estates and Estates for Years*, 462.100, *Change in Ownership – Leases*, 462.160, *Change in Ownership – Trusts*, 462.180, *Change in Ownership – Legal Entities*, and 462.260, *Date of Change in Ownership*, which you subsequently revised. The revised petition was limited to your request that the Board amend Property Tax Rule 462.260 to "prohibit assessors from violating the due process rights of real property taxpayers who acquired their interests in real property prior to the enactment of Part 0.5 of the Property Tax Division of the Revenue and Taxation Code" (pt. 0.5 of div. 1 of the Rev. & Tax. Code).

Government Code section 15606, subdivision (c) authorizes the Board to adopt regulations governing county assessors when assessing property for property tax purposes and local boards of equalization when equalizing the assessed value of property, and all of the Property Tax Rules referred to in your original petition were adopted pursuant to that authority.

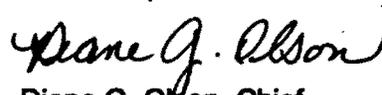
The Board's Legal Department reviewed your petition before it was limited to the requested amendments to Property Tax Rule 462.260 and prepared a Chief Counsel Memorandum dated April 13, 2011, which recommended that the Board deny the petition because all of the requested amendments were: (1) based on an incorrect understanding of basic tenets of California property tax law; (2) contrary to judicial precedent and longstanding legal interpretations of Board staff; (3) effectively repetitive of the amendments you requested be made to Property Tax Rule 462.160 in your petition dated December 31, 2010, which was unanimously denied by the Board on January 27, 2011 (see Cal. Reg. Notice Register 2011, No. 6-Z, p. 170); and (4) nothing in your current petition supported a different result. Then the Board scheduled your petition for consideration at its regularly-scheduled April meeting, and made your petition, including your subsequent addendums and the Chief Counsel Memorandum, available to the public by posting them on the Board's Website.

The Board received a written comment from Andrea Sheridan Ordin, County Counsel for Los Angeles County, dated April 18, 2011, recommending that the Board deny your petition for the same reasons as set forth in the Chief Counsel Memorandum. During its April meeting, the Board heard comments from Douglass Wacker, Lake County Assessor-Recorder and President

of the California Assessors' Association, Barbara Edginton, Assessment Manager for the San Luis Obispo County Assessor's Office, and Board staff recommending that the Board deny your revised petition for the same reasons as set forth in the Chief Counsel Memorandum and the Board unanimously voted to deny your revised petition. That decision was based on the Board's conclusion that Property Tax Rule 462.260 is consistent with the provisions of part 0.5 of division 1 (commencing with section 50) of the Revenue and Taxation Code, as interpreted in *Steinhart v. County of Los Angeles* (2010) 147 Cal.4th 1298 and *Phelps v. Orange County Assessment Appeals Board No. 1* (2010) 187 Cal.App.4th 653, and does not violate taxpayers' rights to due process.

If you have any questions, please contact me at (916) 322-3563.

Sincerely,



Diane G. Olson, Chief
Board Proceedings Division

DGO:bh:reb

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

NOTICE PUBLICATION/REGULATIONS SUBMISSION

(See instructions on reverse)

For use by Secretary of State only

STD. 400 (REV. 01-09)

OAL FILE NUMBERS	NOTICE FILE NUMBER Z-2011-0510-02	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
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For use by Office of Administrative Law (OAL) only

RECEIVED FOR FILING PUBLICATION DATE

MAY 10 '11 MAY 20 '11

Office of Administrative Law

NOTICE

REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY
State Board of Equalization

AGENCY FILE NUMBER (if any)

A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)

1. SUBJECT OF NOTICE Change in Ownership - Trusts		TITLE(S) 18	FIRST SECTION AFFECTED 462.060	2. REQUESTED PUBLICATION DATE May 20, 2011	
3. NOTICE TYPE <input type="checkbox"/> Notice re Proposed Regulatory Action <input checked="" type="checkbox"/> Other		4. AGENCY CONTACT PERSON Rick Bennion		TELEPHONE NUMBER (916) 445-2130	FAX NUMBER (Optional) (916) 324-3984
OAL USE ONLY	ACTION ON PROPOSED NOTICE <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn			NOTICE REGISTER NUMBER	PUBLICATION DATE

B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)

1a. SUBJECT OF REGULATION(S)	1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)
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2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)

SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)	ADOPT
	AMEND
	REPEAL
TITLE(S)	

3. TYPE OF FILING

<input type="checkbox"/> Regular Rulemaking (Gov. Code §11346)	<input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute.	<input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h))	<input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100)
<input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4)	<input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)	<input type="checkbox"/> File & Print	<input type="checkbox"/> Print Only
<input type="checkbox"/> Emergency (Gov. Code, §11346.1(b))		<input type="checkbox"/> Other (Specify) _____	

4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)

5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)

<input type="checkbox"/> Effective 30th day after filing with Secretary of State	<input type="checkbox"/> Effective on filing with Secretary of State	<input type="checkbox"/> §100 Changes Without Regulatory Effect	<input type="checkbox"/> Effective other (Specify) _____
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6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY

<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660)	<input type="checkbox"/> Fair Political Practices Commission	<input type="checkbox"/> State Fire Marshal
<input type="checkbox"/> Other (Specify) _____		

7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)
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8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

For use by Office of Administrative Law (OAL) only

SIGNATURE OF AGENCY HEAD OR DESIGNEE	DATE
--------------------------------------	------

TYPED NAME AND TITLE OF SIGNATORY

TITLE 18. STATE BOARD OF EQUALIZATION

NOTICE OF DECISION AS REQUIRED BY GOVERNMENT CODE SECTION 11340.7

On March 21, 2011, the California State Board of Equalization (Board) received a petition from Mr. Stephen H. Bennett requesting that the Board amend California Code of Regulations, title 18, sections (Property Tax Rules) 462.060, *Change in Ownership – Life Estates and Estates for Years*, 462.100, *Change in Ownership – Leases*, 462.160, *Change in Ownership – Trusts*, 462.180, *Change in Ownership – Legal Entities*, and 462.260, *Date of Change in Ownership*. However, Mr. Bennett subsequently revised his petition so that it was limited to his request that the Board amend Property Tax Rule 462.260.

The revised petition requested that the Board amend Property Tax Rule 462.260 to "prohibit assessors from violating the due process rights of real property taxpayers who acquired their interest in real property prior to the enactment of Part 0.5 of the Property Tax Division [titled *Implementation of Article XIII A of the California Constitution . . .*]" (pt. 0.5 of div. 1 of the Rev. & Tax Code).

Government Code section 15606, subdivision (c) authorizes the Board to adopt regulations governing county assessors when assessing property for property tax purposes and local boards of equalization when equalizing the assessed value of property, and all of the Property Tax Rules referred to in the petition were adopted pursuant to that authority.

The Board's Legal Department reviewed the petition before it was limited to the requested amendments to Property Tax Rule 462.260 and prepared a Chief Counsel Memorandum dated April 13, 2011, which recommended that the Board deny the petition because all of the requested amendments were: (1) based on an incorrect understanding of basic tenets of California property tax law; (2) contrary to judicial precedent and longstanding legal interpretations of Board staff; (3) effectively repetitive of the amendments the petitioner requested be made to Property Tax Rule 462.160 in his petition dated December 31, 2010, which was unanimously denied by the Board on January 27, 2011 (see Cal. Reg. Notice Register 2011, No. 6-Z, p. 170); and (4) nothing in the current petition supported a different result. Then the Board scheduled the petition for consideration at its regularly-scheduled April meeting, and made the petition, including subsequent addendums submitted by Mr. Bennett, and the Chief Counsel Memorandum available to the public by posting them on the Board's Website.

The Board received a written comment from Andrea Sheridan Ordin, County Counsel for Los Angeles County, dated April 18, 2011, recommending that the Board deny Mr. Bennett's petition for the same reasons as set forth in the Chief Counsel Memorandum. During its April meeting, the Board heard comments from Douglass Wacker, Lake County Assessor-Recorder and President of the California Assessors' Association, Barbara Edginton, Assessment Manager for the San Luis Obispo County Assessor's Office, and Board staff recommending that the Board deny the revised petition for the same reasons as set forth in the Chief Counsel Memorandum and the Board unanimously voted to deny the revised petition. That decision was based on the Board's conclusion that Property Tax Rule 462.260 is consistent with the provisions of part 0.5 of division 1 (commencing with section 50) of the Revenue and Taxation Code, *Steinhart v. County of Los Angeles* (2010) 147 Cal.4th 1298, and *Phelps v. Orange County Assessment*

Appeals Board No. 1 (2010) 187 Cal.App.4th 653 and does not violate taxpayers' rights to due process.

Interested persons have a right to obtain a copy of the petition and may do so by contacting Mr. Rick Bennion at P.O. Box 942879, 450 N Street, MIC: 80, Sacramento, CA 94279-0080; Telephone (916) 445-2130; Fax (916) 324-3984; or E-mail Richard.Bennion@boe.ca.gov.

Questions regarding this matter should be directed to Tax Counsel IV Richard Moon at (949) 440-3486 or Richard.Moon@boe.ca.gov.

Street Address: 1001 I Street
Sacramento, California 95814

OEHHA will organize and index the comments received and forward the information to the DARTIC members prior to the July 12 and 13 meetings at which the chemicals will be considered.

**RULEMAKING PETITION
DECISION**

**TITLE 18. STATE BOARD OF
EQUALIZATION**

**NOTICE OF DECISION AS REQUIRED BY
GOVERNMENT CODE SECTION 11340.7**

On March 21, 2011, the California State Board of Equalization (Board) received a petition from Mr. Stephen H. Bennett requesting that the Board amend California Code of Regulations, title 18, sections (Property Tax Rules) 462.060, *Change in Ownership — Life Estates and Estates for Years*, 462.100, *Change in Ownership — Leases*, 462.160, *Change in Ownership — Trusts*, 462.180, *Change in Ownership — Legal Entities*, and 462.260, *Date of Change in Ownership*. However, Mr. Bennett subsequently revised his petition so that it was limited to his request that the Board amend Property Tax Rule 462.260.

The revised petition requested that the Board amend Property Tax Rule 462.260 to “prohibit assessors from violating the due process rights of real property taxpayers who acquired their interest in real property prior to the enactment of Part 0.5 of the Property Tax Division [titled *Implementation of Article XIII A of the California Constitution . . .*]” (pt. 0.5 of div. 1 of the Rev. & Tax Code).

Government Code section 15606, subdivision (c) authorizes the Board to adopt regulations governing county assessors when assessing property for property tax purposes and local boards of equalization when equalizing the assessed value of property, and all of the Property Tax Rules referred to in the petition were adopted pursuant to that authority.

The Board’s Legal Department reviewed the petition before it was limited to the requested amendments to Property Tax Rule 462.260 and prepared a Chief Counsel Memorandum dated April 13, 2011, which recommended that the Board deny the petition because all of the requested amendments were: (1) based on an incorrect understanding of basic tenets of California property tax law; (2) contrary to judicial precedent and long-standing legal interpretations of Board staff; (3) effec-

tively repetitive of the amendments the petitioner requested be made to Property Tax Rule 462.160 in his petition dated December 31, 2010, which was unanimously denied by the Board on January 27, 2011 (see Cal. Reg. Notice Register 2011, No. 6–Z, p. 170); and (4) nothing in the current petition supported a different result. Then the Board scheduled the petition for consideration at its regularly scheduled April meeting, and made the petition, including subsequent addendums submitted by Mr. Bennett, and the Chief Counsel Memorandum available to the public by posting them on the Board’s Website.

The Board received a written comment from Andrea Sheridan Ordin, County Counsel for Los Angeles County, dated April 18, 2011, recommending that the Board deny Mr. Bennett’s petition for the same reasons as set forth in the Chief Counsel Memorandum. During its April meeting, the Board heard comments from Douglass Wacker, Lake County Assessor–Recorder and President of the California Assessors’ Association, Barbara Edginton, Assessment Manager for the San Luis Obispo County Assessor’s Office, and Board staff recommending that the Board deny the revised petition for the same reasons as set forth in the Chief Counsel Memorandum and the Board unanimously voted to deny the revised petition. That decision was based on the Board’s conclusion that Property Tax Rule 462.260 is consistent with the provisions of part 0.5 of division 1 (commencing with section 50) of the Revenue and Taxation Code, *Steinhart v. County of Los Angeles* (2010) 147 Cal.4th 1298, and *Phelps v. Orange County Assessment Appeals Board No. 1* (2010) 187 Cal.App.4th 653 and does not violate taxpayers’ rights to due process.

Interested persons have a right to obtain a copy of the petition and may do so by contacting Mr. Rick Bennion at P.O. Box 942879, 450 N Street, MIC: 80, Sacramento, CA 94279–0080; Telephone (916) 445–2130; Fax (916) 324–3984; or E-mail Richard.Bennion@boe.ca.gov.

Questions regarding this matter should be directed to Tax Counsel IV Richard Moon at (949) 440–3486 or Richard.Moon@boe.ca.gov.

**SUMMARY OF REGULATORY
ACTIONS**

**REGULATIONS FILED WITH
SECRETARY OF STATE**

This Summary of Regulatory Actions lists regulations filed with the Secretary of State on the dates indicated. Copies of the regulations may be obtained by contacting the agency or from the Secretary of State,



26400 La Alameda, Suite 200 • Mission Viejo, CA 92691
Phone (949) 582-2100 Fax (949) 582-8301

May 24, 2011

Rick Bennion
Chief, Board Proceedings Division
State Board of Equalization
450 N Street
Sacramento, CA 95814

CERTIFIED – RETURN RECEIPT
REQUESTED

Re: BOE Must Now Fulfill its Mandatory Duty to Ensure Part 0.5 of the Revenue & Taxation Code is Applied only Prospectively, not Retrospectively

Dear Mr. Bennion:

I. Bennett's 3/21/11 Petition was Granted By Operation of Law

Pursuant to Government Code §11340.7(a), on 3/21/11 I petitioned BOE to amend various BOE Rules to make it clear to both assessors and property taxpayers that Part 0.5 of the Revenue & Taxation Code can only be lawfully applied prospectively, not retrospectively.

By failing to meet the 30 day deadline in §11340.7(a). BOE lost legal jurisdiction over my petition on 4/21/11. Accordingly, my petition was then granted by operation of law.

II. BOE Must Now Fulfill its Mandatory Duties

BOE must now take several actions to ensure 1) that from its 1979 enactment Part 0.5 has been applied only prospectively, not retrospectively, and 2) that Part 0.5 is now applied, and will be applied in the future, only prospectively. These BOE actions include:

- BOE must depublish each annotation that gives retrospective effect to Part 0.5.
- BOE must instruct each assessor 1) to reverse escape assessments he or she has made in the past by giving retrospective effect (i.e., pre-1979 effect) to Part 0.5, and 2) to make past, present, and future escape assessments by giving only prospective effect (i.e., post 1979 effect) to Part 0.5.

Very truly yours,

Stephen H. Bennett

RECEIVED

MAY 27 2011

Board Proceedings

RECEIVED

MAY 27 2011

Board Proceedings

PROOF OF SERVICE

I am employed in the County of Orange, State of California. I am over the age of eighteen (18). My business address is 26400 La Alameda #200, Mission Viejo, California 92691. I declare under penalty of perjury that I served the petition on the interested parties whose names and addresses appear below, by placing a true copy thereof enclosed in a sealed envelope and mailing on May 24, 2011.



Stephen H. Bennett

Kristine Cazadd, Esq.
Chief Counsel
State Board of Equalization
450 N Street
Sacramento, CA 95814

Carole Ruwart
Legal Staff
State Board of Equalization
450 N Street
Sacramento, CA 95814

Richard Moon
Legal Staff
State Board of Equalization
16715 Von Karman Ave Ste 200
Irvine, CA 92606

Christine Bisauta
Legal Staff
State Board of Equalization
450 N Street
Sacramento, CA 95814



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
916-323-3091 • FAX 916-323-3387
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Interim Executive Director

May 25, 2011

Mr. Stephen H. Bennett
Letwak and Bennett, Certified Public Accountants
26400 La Alameda, Suite 200
Mission Viejo, CA 92691

**Re: *Inquiry Regarding Your March 21, 2011, Petition to Amend Property Tax Rules
462.060, 462.100, 462.160, 462.180, and 462.260.***

Dear Mr. Bennett:

The Board's Legal Department received your May 24, 2011, letter to Mr. Rick Bennion in the Board Proceedings Division in which you stated your opinion that your March 21, 2011, petition to amend Property Tax Rules 462.060, 462.100, 462.160, 462.180, and 462.260 was "granted by operation of law" and that the Board "must now take several actions" as a result.

This letter is to inform you that the Board Members unanimously voted to deny your petition at the Board's regularly-scheduled meeting on April 26, 2011, in accordance with Government Code section 11340.7.¹ The Board's written decision denying your petition was published in the California Notice Register on May 20, 2011, in compliance with Government Code section 11340.7, subdivision (d).² Additionally, Diane Olson, Chief of the Board Proceedings Division, mailed you a separate letter on May 20, 2011, notifying you that your petition was denied and that the written decision denying your petition was published in the California Notice Register.

This letter is also to clarify that Government Code section 11340.7 does not require the Board to take the actions specified in your letter and no further action will be taken with regard to your March 21, 2011, petition.

If you have any further questions about the Board's action on your March 21, 2011, petition, please feel free to contact Tax Counsel III (Specialist) Carole Ruwart at 916-323-3102.

Sincerely,

Bradley M. Heller
Tax Counsel IV

¹ The webcast of the meeting is available on the Board's website at <http://www.boe.ca.gov/meetings/pubmeet11.htm>.

² Register 2011, No. 20-Z, dated May 20, 2011, is available on the Office of Administrative Law's website at <http://www.oal.ca.gov/res/docs/pdf/notice/20z-2011.pdf>.



26400 La Alameda, Suite 200 • Mission Viejo, CA 92691
Phone (949) 582-2100 Fax (949) 582-8301

May 24, 2011

Bradley M. Heller
State Board of Equalization
450 N Street
Sacramento, CA 95814

CERTIFIED – RETURN RECEIPT
REQUESTED

Re: Exhaustion of Administrative Remedies

Dear Mr. Heller:

I received your 5/25/11 letter in which you claim 1) on 4/26/11 the BOE board members voted unanimously to deny my petition to amend various Rules to prohibit assessors from giving retrospective effect to Part 0.5 of the Revenue & Taxation Code, and 2) that Government Code Section 11340.7 “does not require the Board to take the actions” specified in my 5/24/11 letter.¹

The essence of my disagreement with BOE is over the interpretation of Part 0.5. I contend Part 0.5 is prospective only, not retrospective.

Each time an assessor gives retrospective effect to Part 0.5, I contend the assessor acts unlawfully. And when BOE is aware the assessor is so acting, I further contend Government Code Section 15606(h) imposes the mandatory duty on BOE to bring a court action against such assessor.

This letter now places BOE on notice that I have exhausted my administrative remedies.

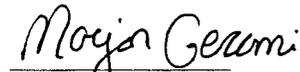
Very truly yours,

Stephen H. Bennett

¹ In my 5/24/11 letter I asked BOE to 1) depublish all annotations that give retrospective effect to Part 0.5, and 2) instruct each assessor to only give prospective effect (i.e., post-1979 effect) to Part 0.5

PROOF OF SERVICE

I am employed in the County of Orange, State of California. I am over the age of eighteen (18). My business address is 26400 La Alameda #200, Mission Viejo, California 92691. I declare under penalty of perjury that I served the petition on the interested parties whose names and addresses appear below, by placing a true copy thereof enclosed in a sealed envelope and mailing on 5 - 31 - 11.


Marjan Gerami

Kristine Cazadd, Esq.
Chief Counsel
State Board of Equalization
450 N Street
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