California State
Board *of* Equalization

LEGISLATIVE BULLETIN

PROPERTY TAX LEGISLATION 2022

Legislative, Research & Statistics Division

FOREWORD

The California State Board of Equalization's (BOE) Legislative, Research & Statistics Division (LRSD) is responsible for all aspects of the BOE's legislation, research, and statistics for the tax programs that the BOE administers. The LRSD reviews all introduced and amended bills, and the review is used to identify legislation that could impact or be of interest to the BOE.

The Property Tax Legislative Bulletin is an annual publication that describes the enacted legislation in the past year that impacts property tax programs administered by the BOE. This publication is a compilation of the legislative bill analyses issued by the BOE for bills that were enacted during 2022. The legislative bill analyses for 2022 are posted on the BOE's website at *www.boe.ca.gov/app/proptax-leg-analyses.aspx?year=2021-2022*.

2022 PROPERTY TAX LEGISLATION

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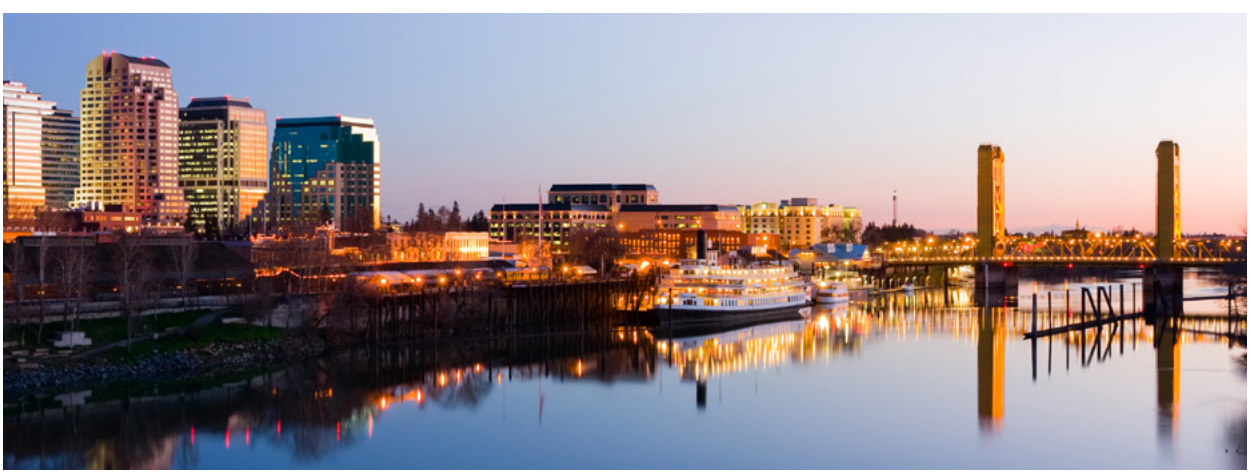

Assembly Bill 1206 (Bennett), Chapter 636

Welfare Exemption: Affordable Housing

Effective September 28, 2022.

Amends section 214 and section 259.15 of the Revenue and Taxation Code.

Summary: For property that meets the requirements for the welfare exemption and is used exclusively for rental housing and related facilities, this bill will require that a unit continue to be treated as occupied by a lower income household when the income of those occupants increases up to 140 percent of area median income (AMI) if the owner is a community land trust whose land is leased to low-income households, subject to a contract that complies with specified requirements, for fiscal years 2022-23 through 2027-28.

Existing Law: Under the California Constitution, all property is taxable, unless otherwise provided for by the State Constitution or the laws of the United States.[1] The Legislature may exempt from property taxation in whole or in part, property used exclusively for religious, hospital, scientific, or charitable purposes and owned or held in trust by nonprofit corporations or other entities, if certain criteria are met.[2]

This exemption is known as the "welfare exemption" and is implemented pursuant to Revenue and Taxation Code (R&TC)[3] section 214.

Section 214 generally exempts from taxation, subject to certain conditions and qualifications, property that is (1) owned by nonprofit organizations organized and operated for charitable purposes, and (2) used exclusively for those purposes.

Section 214(g)(1) provides generally that property used exclusively for rental housing used for low-income rentals owned and operated by nonprofit organizations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation, shall be deemed to be within the exemption authorized by section 214.

The California State Board of Equalization (BOE) and 58 County Assessors are jointly responsible for administering the welfare exemption. The BOE is responsible for determining whether an organization is qualified for either an Organizational Clearance Certificate (OCC) or a Supplemental Clearance Certificate (SCC), while the Assessor is responsible for determining whether the use of a qualifying organization's property is eligible for the welfare exemption. The Assessor shall not grant the welfare exemption on an organization's property unless the organization holds either a valid OCC or SCC issued by the BOE. However, the Assessor may deny a welfare exemption claim based on non-qualifying use of the property, notwithstanding that the BOE has issued the organization an OCC or SCC. The BOE tracks eligible nonprofit organizations and Limited Liability Companies who hold valid OCCs and SCCs and monitors those organizations for continued eligibility.

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1 California Constitution, Article XIII, section 1.

2 California Constitution, Article XIII, section 4(b).

3 All statutory references are to the Revenue and Taxation Code, unless otherwise provided.

Once an OCC or an SCC is issued by the BOE to a qualified organization, the organization will then file a claim for the welfare exemption with the County Assessor where the property is located. The County Assessor is responsible for evaluating the application, determining whether the use of the property meets the statutory requirements for receiving the welfare exemption, and for ultimately granting or denying the exemption to claimants.

Under existing property tax law, property that meets these requirements and is used exclusively for rental housing and related facilities is entitled to a partial exemption, equal to that percentage of the value of the property that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units, in any year that certain criteria apply, including that the property be subject to a legal restriction that provides that units designated for use by lower income households are continuously available to or occupied by lower income households, at rents not exceeding specified limits.[4]

For fiscal years 2018-19 through 2027-28, in the case of an owner of property receiving a low-income housing tax credit under specified federal law, existing property tax law requires that a unit continue to be treated as occupied by a lower income household for these purposes if the occupants were lower income households on the lien date in the fiscal year in which their occupancy of the unit commenced and the unit continues to be rent restricted, notwithstanding an increase in the income of the occupants of the unit up to 140 percent of AMI, adjusted for family size.[5]

Further under existing law, section 259.15(a) provides that for the 2018-19 fiscal year to the 2027-28 fiscal year, the claim for welfare exemption on a property that is eligible for and has received low-income housing tax credits pursuant to Internal Revenue Code section 42(g)(2)(D), as it relates to the treatment of units occupied by individuals whose incomes rise above the limit, an affidavit containing specified criteria must be included with the claim for exemption.[6]

In 2019, the Legislature added section 214.18 into law which stated that property owned by a community land trust (CLT) that qualifies for a welfare exemption under section 214 is also within the exemption provided by sections 4 and 5 of Article XIII of the California Constitution as long as several conditions were met.[7] In 2020, the Legislature clarified the requirements for CLTs to claim the welfare exemption and made property owned by a CLT eligible for the welfare exemption prior to beginning construction.[8]

Additionally, this section prevented County Assessors from denying the welfare exemption to CLTs who were in the process of constructing affordable housing, but did not have any units complete. However, this section made CLTs liable for property tax for the years the CLT received the exemption if construction was not completed by a certain timeframe.

On December 1, 2021, the BOE issued a Letter to Assessors (LTA) providing information and guidance on the treatment of CLT housing, considering these legislative changes.[9]

Amended Law: Allows CLTs to Continue to Utilize the Welfare Exemption if Lower Income Household Occupants Increase their Income Up to 140 percent of AMI. This bill added subdivision (g)(2)(A)(iv)(I) to section 214, which allows, in cases where the property is owned by a CLT and leased to a lower income household, subject to certain contract restrictions under section 402.1, a unit to continue to be treated as occupied by a lower income household if the occupants were lower income households on the lien date in the fiscal

4 Section 214, subd. (g)(1).

5 Section 214, subd. (g)(2)(iii)(I).

6 Section 259.15(a), subd. (a)(1)-(2).

7 SB 196, chapter 669, Stats. 2019.

8 SB 1473, chapter 371, Stats. 2020.

9 Letter to Assessors No. 2021/052, California State Board of Equalization, December 1, 2021.

year in which their occupancy of the unit commenced and the unit continues to be rent restricted, notwithstanding an increase in the income of the occupants of the unit to 140 percent of AMI, adjusted for family size. However, the unit shall cease to be treated as a lower income unit if the income of the occupants of the unit increases above 140 percent of AMI, adjusted for family size.

Requires Affidavits from CLTs. The bill clarifies that section 259.15 requires CLTs, when applying for the welfare exemption for units where occupants earn up to 140 percent of the AMI, to submit an affidavit that complies with section 259.15 for fiscal years beginning 2022-23 through the 2027-28 fiscal year, as well as provide any other information prescribed by the Board.

Legislative Findings. The bill contains legislative findings specifying the protection of sensitive personal and personal financial information contained in an affidavit accompanying a claim for welfare exemption is consistent with and furthers proper access to documents and information in the possession of local government agencies. Additionally, the amendments specify that it is in the state's best interest to limit public access to information contained in an affidavit for a welfare exemption in order to protect the privacy of an individual's personal and financial information.

Sunset Date. This bill provides for a five-year sunset date to the newly added section 214(g)(2)(A)(iv)(I), which expires at the end of the 2027-28 fiscal year.

Defines Community Land Trust. The bill provides that the term "community land trust" has the same meaning as defined in section 402.1.

Understanding Goals and Objectives. To comply with section 41, the January 3, 2022, amendments added specific goals, purposes, and objectives of expanding the welfare exemption to CLTs who rent to lower income households when the occupants' income increases up to 140 percent of AMI. The August 16, 2022, amendments remove the requirement for the Legislative Analyst's Office (LAO), beginning January 1, 2023, until January 1, 2043, to collaborate with the BOE to review the effectiveness of the tax exemption allowed by section 214(g), as amended by this bill. Instead, the LAO would be required to submit a report to the Legislature on or before January 1, 2025.

Information Sharing. The LAO may request information from the BOE to analyze the effectiveness of the exemption, but may only post the information in an anonymized and aggregated manner. Additionally, the BOE may request information from each County Assessor.

In General: Under section 4(b) of Article XIII of the California Constitution, the Legislature is authorized to exempt from taxation, in whole or in part:

- Property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by corporations or other entities (1) that are organized and operated for those purposes, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual.

In exercising the above constitutional authorization, the Legislature enacted section 214, which reiterates the constitutional authorization and outlines numerous conditions and qualifications for receiving the exemption and adds scientific as the fourth qualifying purpose. Section 214 provides that property used exclusively for charitable purposes owned and operated by corporations organized and operated for charitable purposes is exempt from taxation if the owner is not organized and operated for profit and the property is used for the actual operation of the exempt activity.

Charitable Purposes. An organization's primary purpose must be either religious, hospital, scientific, or charitable. Whether its operations are for one of these purposes is determined by its activities. The courts have broadly construed *charitable* to include some educational purposes and activities.[10] These court decisions have been codified in section 214(j), which provides that charitable purposes include certain educational purposes and activities, subject to the following requirements:

- The educational purposes and activities must benefit the community as a whole or an unascertainable and indefinite portion thereof.
- The educational activities include the study of relevant information, the dissemination of that information to interested members of the general public, and the participation of interested members of the general public.

Section 214(j) expressly precludes exemption to educational purposes and activities primarily for the benefit of the organization's shareholders.

Exclusive Use. The Revenue and Taxation Code does not specifically define the term *used* exclusively; however, the courts have done so in a series of decisions. The California Supreme Court has stated that the phrase "exclusively used" may not be given a literal interpretation so as to mean that the property exempted must be used solely for the purposes stated to the total exclusion of any other use. The Supreme Court held that *used exclusively* for exempt purposes includes any property which is used exclusively for any facility which is incidental to and reasonably necessary for the accomplishment of the exempt purpose.[11] Courts have applied this precedent to mean that a qualified organization's primary use of its property must be for exempt purposes and any other uses of property must be related to and reasonably necessary to the accomplishment of the exempt purpose.[12]

Housing Welfare Exemption. Property tax administrators have historically taken a narrow view of the exemption and have viewed much housing to be non-exempt on the grounds that the property is being used primarily for private residential purposes rather than exempt purposes and is not being used exclusively for exempt purposes as required by section 214.[13]

However, the courts have taken a broader view, consistent with the Supreme Court's directive that statutory and constitutional provisions granting exemptions are to be construed strictly, but reasonably.[14]

In 1999, the BOE adopted Property Tax Rule 137, *Application of the Welfare Exemption to Property Used for Housing*, effective December 31, 1999. The purpose of Rule 137 is to clarify that the welfare exemption from property taxation applies to housing and related facilities owned and operated by qualified nonprofit organizations and to establish a single uniform statewide standard for determining qualification for the welfare exemption as it applies to such properties.[15]

In addition, Property Tax Rule 140 further specifies requirements for the welfare exemption for low-income housing properties.

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10 See *Lundberg v. County of Alameda* (1956) 46 Cal.2d 644, 653; *Stockton Civic Theatre v. Board of Supervisors* (1967) 66 Cal.2d. 13; *Greek Theatre Association v. County of Los Angeles* (1978) 76 Cal.App.3d 768, 778-779.

11 *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736.

12 *Honeywell Information Systems, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23; *YMCA v. County of Los Angeles* (1950) 35 Cal.2d 760; *St. Germain Foundation v. County of Siskiyou* (1963) 212 Cal.App.2d 911; *Greek Theatre Association v. County of Los Angeles* (1978) 76 Cal. App.3d 768.

13 Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, p. 62.

14 Ibid.

15 Id. at p. 65.

Background: Community Land Trusts. Federal law, the Cranston-Gonzalez National Affordable Housing Act (Act), allows CLTs to obtain organizational support, technical assistance, education, training, and community support from the government in fulfilling their housing mission.[16] The Act defines "CLT" to mean a community housing development organization not sponsored by a for-profit organization, with a specified board membership, that is established to carry out the following activities:

- Acquire parcels of land, held in perpetuity, primarily for conveyance under long-term ground leases;
- Transfer ownership of any structural improvements located on the leased parcels to the lessees; and
- Retain a preemptive option to purchase any structural improvement at a price determined by a formula designed to ensure that the improvement remains affordable to low- and moderate-income families in perpetuity.

CLTs are nonprofit organizations governed by a board of CLT residents, community residents and public representatives that provide lasting community assets and shared equity homeownership opportunities for families and communities. CLTs develop rural and urban agriculture projects, commercial spaces to serve local communities, affordable rental and cooperative housing projects, and conserve land or urban green spaces. However, the heart of their work is the creation of homes that remain permanently affordable, providing successful homeownership opportunities for generations of lower income families.[17]

CLTs provide an affordable housing model to help low- and moderate-income households that may not otherwise be able to purchase homes. The CLT acquires and develops properties for sale to income-qualified households, but then retains ownership of the underlying land and leases the land to the homeowner for a nominal fee through a long-term ground lease (usually a 99-year term). The home is, therefore, more affordable because the homeowner is only buying the building and leasing the land underneath. If the homeowner decides to sell the property, the home must be resold to another income-qualified household, and the original owner will only be eligible for a smaller share of its appreciated value. Since the CLT is the owner of the land, it will be a party to all future sales and enforce resale restrictions.

For California property tax purposes, a "community land trust" is defined in section 402.1(a)(11)(C)(ii) as a nonprofit corporation organized pursuant to section 501(c)(3) of the Internal Revenue Code that satisfies all the following:

- Has as its primary purposes the creation and maintenance of permanently affordable single-family or multifamily residences.
- All dwellings and units located on the land owned by the nonprofit corporation are sold to a qualified owner to be occupied as the qualified owner's primary residence or rented to persons and families of low or moderate income.
- The land owned by the nonprofit corporation, on which a dwelling or unit sold to a qualified owner is situated, is leased by the nonprofit corporation to the qualified owner for the convenient occupation and use of that dwelling or unit for a renewable term of ninety-nine years.

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16 42 U.S.C. 12773.

17 *https://groundedsolutions.org/strengthening-neighborhoods/community-land-trusts.*

Commentary:

1. **Exemption for Five Years.** The bill extends the welfare exemption to CLT property leased to qualifying income households is effective for a five-year period beginning with the 2022-23 fiscal year. Property owned by CLTs will become assessable beginning with the 2027-28 fiscal year unless this period is extended by the Legislature.

2. **Data Collection.** This bill requires the BOE to collaborate with the LAO to review the effectiveness of this exemption for CLT property and to request data from County Assessors, if necessary.

Costs: The BOE would incur absorbable costs to update claim forms; Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*; and Publication 149, *Property Tax Welfare Exemption*.

Revenue Impact: Estimating the revenue impact of this bill is difficult. Staff cannot estimate the number of CLTs that would qualify under this bill. Staff also does not know the location and value of those properties. Revenue impact depends on: (1) the number of properties that would qualify under this bill, (2) the taxable value of the property, and (3) the location of these properties. At this time, based on these unknown factors, the revenue loss is indeterminable.

Assembly Bill 1715 (Muratsuchi), Chapter 379

Space Force

Effective January 1, 2023.

Amends section 205.5 of the Revenue and Taxation Code.

Summary: This bill adds Space Force to the list of military branches that are eligible for veterans to receive the disabled veterans' property tax exemption and makes other technical and non-substantive changes.[18]

Existing Law: The California Constitution[19] authorizes the Legislature to exempt partially or fully from property tax, the principal residence of a veteran and/or a veteran's spouse, including an unmarried surviving spouse, that has incurred certain injuries during military service, including blindness in both eyes, loss of use of two or more limbs, or totally disabled. The exemption also applies if a person has, because of a service-connected injury or disease, died while on active duty in military service. This exemption is commonly referred to as the "disabled veterans' exemption." Under current law, there is a basic disabled veteran's exemption and a low-income disabled veteran's exemption.

Revenue and Taxation Code (R&TC) section 277[20] requires that anyone claiming the disabled veterans' exemption must file a claim with the County Assessor.

Currently, a disabled veteran must have a United States Department of Veterans Affairs (USDVA) disability rating of 100 percent to be eligible for the exemption.

Amended Law: Adds a New Military Branch to the Disabled Veterans' Exemption. This bill adds Space Force to the list of military branches that are eligible for veterans to receive the disabled veterans' property tax exemption.

In General: California law provides a qualified disabled veteran and/or their spouse, or their unmarried surviving spouse with a property tax exemption that applies to their principal residence's assessed value. Exemption eligibility provisions require that the claimant obtain a USDVA disability rating that either (1) rates the veteran's disability at 100 percent or (2) rates the veteran's disability compensation at 100 percent because the veteran is unable to secure and maintain gainful employment.

The law also allows unmarried surviving spouses to receive the exemption if the veteran's death was service connected. To be eligible for the exemption, unmarried surviving spouses must receive a USDVA determination that the veteran's death was service connected. A USDVA determination is necessary for (1) active-duty personnel deaths and (2) veterans without a 100 percent rating when alive, but whose cause of death is deemed service connected. Surviving spouses of veterans with a 100 percent disability rating during their lifetime continue to receive the exemption after the veteran's death, so long as they are not currently remarried.

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18 While the bill's amendments affect other code sections, this analysis will only consider R&TC section 205.5.

19 Article XIII, section 4(a) of the California Constitution and R&TC section 205.5.

20 R&TC section 277.

The exemption amount depends upon the claimant's income. For the 2023 lien date, the basic exemption amount adjusted for inflation, is $161,083. However, if the claimant's household income is less than $72,335, the low-income exemption amount is $241,627.[21] For the 2021 assessment year, a total of 63,968 disabled veterans, their spouses, or their unmarried surviving spouses were granted the exemption.[22]

Commentary:

1. **Exemption Amounts.** Under current statute, disabled veterans may receive a basic exemption or a low-income exemption if they meet income requirements. The original $100,000 basic exemption and $150,000 low-income exemption amounts have been annually updated for inflation. For the 2023 lien dates, the disabled veterans' basic exemption amount is $161,083 and the low-income exemption amount is $241,627 for disabled veterans with an annual household income of less than $72,335. Veterans who are totally disabled because of an injury or disease incurred in military service or who are blind or lost the use of two or more limbs and have a 100 percent disability rating would have their property exempt from taxation. These veterans would benefit under the increased exemption.

2. **Related Legislation.** SB 1073 (Grove) would allow a partial disabled veterans' exemption based upon a veteran's disability rating percentage from the USDVA or the military service from which the veteran was discharged. The bill was held on the Senate Appropriations Committee suspense file. AB 2898 (Vince Fong) would increase the base exemption amounts that would then be adjusted for inflation. The bill was held on the Assembly Appropriations Committee suspense file. SB 1357 (Archuleta) adds section 205.5.1 to the R&TC, which would increase the disabled veterans' exemption amount for property tax lien dates occurring on or after January 1, 2023. The bill is currently pending in the Assembly.

Costs: The California State Board of Equalization (BOE) would incur costs of approximately $1,734 and 21 personnel hours to update claim forms; amend the annual Letter to Assessors, which provides annual exemption amounts, adjusted for inflation, and the annual household income limit, adjusted for inflation; update the *Disabled Veterans'* page on the BOE's website; and update Assessors' Handbook Section 260, *General Exemptions*.

Revenue Impact: Existing property tax law provides a disabled veterans' exemption to military personnel and/or their spouses, or their unmarried surviving spouse, in the event of a service-connected injury, disease, or death, as specified. The law provides a basic exemption amount of $100,000 and a low-income exemption amount of $150,000 if the claimant's annual household income does not exceed $40,000, with all amounts adjusted for inflation. For the 2022 lien date, the basic exemption amount is $149,993. The low-income exemption amount is $224,991 for claimants with an annual household income below $67,355. Under the existing law, the total qualifying basic exemption value reported by BOE for fiscal year 2020-21[23] was $8.1 billion, and low-income exemption value was $1 billion, adding to total $9.1 billion. At the one percent basic rate, this amounts to an estimated $91 million in revenue loss (1% × $9.1 billion). The additional revenue loss from the inclusion of the Space Force branch of the military is indeterminable, as the number of Space Force veterans living in California would be eligible for the disabled veterans' exemption is unknown.

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[21] Letter to Assessors No. 2022/018, California State Board of Equalization, April 28, 2022.

[22] Open Data Portal, Table 8, California State Board of Equalization.

[23] The most current data for the Disabled Veterans' Property Tax Exemption is for the fiscal year 2021-22.

Assembly Bill 1933 (Friedman), Chapter 643

Property Taxation: Welfare Exemption

Effective September 28, 2022.

Adds 214.15.1 to the Revenue and Taxation Code.

Summary: This bill adds Revenue and Taxation Code (R&TC) section 214.15.1 to provide the welfare exemption from property tax for property that is owned and operated by a nonprofit corporation, that is otherwise qualified for the exemption, and is organized and operated for the specific and primary purpose of building and rehabilitating single or multifamily residential units that meet certain requirements. The new section would remain in effect only until January 1, 2034, and repealed as of that date.

Existing Law: Under the California Constitution, all property is taxable, unless otherwise provided for by the State Constitution or the laws of the United States.[24] The Legislature may exempt from property taxation in whole or in part, property used exclusively for religious, hospital, scientific, or charitable purposes and owned or held in trust by nonprofit corporations or other entities, if certain criteria are met.[25]

This exemption is known as the "welfare exemption" and is implemented pursuant to R&TC[26] section 214.

Section 214 generally exempts from taxation, subject to certain conditions and qualifications, property that is (1) owned by nonprofit organizations organized and operated for charitable purposes, and (2) used exclusively for those purposes.

Section 214(g)(1) provides generally that property used exclusively for low-income rental housing owned and operated by nonprofit organizations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation, shall be deemed to be within the exemption authorized by section 214.

The BOE and 58 County Assessors are jointly responsible for administering the welfare exemption. The BOE is responsible for determining whether an organization is organized and operated for exempt purposes, which qualifies the organization for either an Organizational Clearance Certificate (OCC) or a Supplemental Clearance Certificate (SCC). The County Assessor is responsible for determining whether the use of a qualifying organization's property is eligible for the welfare exemption. The County Assessor shall not grant the welfare exemption for an organization's property unless the organization holds either a valid OCC or SCC issued by the BOE. However, the County Assessor may deny a welfare exemption claim based on non-qualifying use of the property, notwithstanding that the BOE has issued the organization an OCC or SCC. The BOE tracks eligible nonprofit organizations and Limited Liability Companies that hold valid OCCs and SCCs and monitors those organizations for continued eligibility.

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24 California Constitution, Article XIII, section 1.

25 California Constitution, Article XIII, section 4(b).

26 All statutory references are to the Revenue and Taxation Code, unless otherwise provided.

Once an OCC or an SCC is issued by the BOE to a qualified organization, the organization must then file a claim for the welfare exemption with the County Assessor where the property is located. The County Assessor is responsible for evaluating the application, determining whether the use of the property meets the statutory requirements for receiving the welfare exemption, and for ultimately granting or denying the exemption to claimants.

Under existing property tax law, properties that meet these requirements and are used exclusively for rental housing, including related facilities, are entitled to a partial exemption, equal to that percentage of the value of the property that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units, in any year that certain criteria apply. These criteria include that the property be subject to a legal restriction that provides that units designated for use by lower income households are continuously available to or occupied by lower income households, at rents not exceeding specified limits.[27]

In 1999, section 214.15 was added into statute which clarified that the welfare exemption included nonprofit corporations that build residences for low-income persons that would otherwise qualify for the welfare exemption under section 214.[28] The section requires the nonprofit corporation must be organized and operated for the specific and primary purpose of building and rehabilitating single or multifamily residences for sale at cost to low-income families, with financing in the form of a zero interest rate loan and without regard to religion, race, national origin, or the sex of the head of household.[29]

In the case of property not previously designated as open space, the exemption provided under 214.15 may not be denied to a property on the basis that the property currently does not include a single or multifamily residence, or a single or multifamily residence that is in the course of construction.[30]

Additionally, this section made a qualitative difference between nonprofits that own and operate a housing project on an ongoing basis as opposed to nonprofits in this section that make housing, and the land necessary for that housing, available for sale to low-income residents.

Given this distinction, the Legislature deemed the holding of real property by a nonprofit corporation that builds housing for sale to low-income households as central to that corporation's exempt purposes and activities, thus constituting the exclusive use of that property for a charitable purpose within the meaning of subdivision (b) of section 4 of Article XIII of the California Constitution.

Section 532.2 authorizes County Assessors to issue escape assessments for any property for which a welfare exemption was granted while that property was "in the course of construction," as defined in section 214.2, if the construction was abandoned or, if upon completion of construction, the property does not meet the requirements of exclusive use for religious, hospital, scientific, or charitable purposes.

Background: Section 214.15 was added into statute in 1999 by AB 1559 (Wiggins), which clarified that nonprofit corporations that are organized and operated for the specific and primary purpose of building and rehabilitating housing units qualify for the welfare exemption, and additionally qualify when the property is acquired rather than when construction on the property commenced.[31]

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[27] Section 214, subd. (g)(1).

[28] AB 1559 (Wiggins), ch. 927, Statutes of 1999.

[29] Section 214.15, subd. (a).

[30] Section 214.15, subd. (b).

[31] AB 1559 (Wiggins), ch. 927, Statutes of 1999.

Sales made to low-income residents must include a 0% interest rate loan to homebuyers. According to the author, the sponsor of AB 1933, Heritage Housing Partners, utilizes public sector subsidies to fill the gap between what the homebuyer can afford and what the full cost of development is. These subsidies are then recast as a 0% interest junior loan with a 30 to 45-year repayment to the low-income homebuyer and paired with a conventional first mortgage from a traditional lender.

The 0% interest junior loan is non-performing, meaning the homebuyer only needs to make principal and interest payments on the conventional first mortgage, which is set based on the size of the down payment and a pricing formula specific to the subsidy source.

AB 1933's sponsors claim to have been denied the property tax exemption by County Assessors because the homebuyer is paying interest on a conventional mortgage instead of all financing going through a 0% interest loan. As a result, the bill's sponsors must pay property taxes from the time they purchase the land, develop through construction, and until the close of escrow with the homebuyer. The bill's sponsors say this additional property tax burden results in "many thousands of dollars per home that could instead be placed back into development and construction."[32]

According to the author, AB 1933 updates "California law to reflect the unique ways non-profit organizations are using and leveraging public subsidies to construct affordable homeownership units."[33]

New Law: Explicitly Includes Properties to be Sold to First-Time Homebuyers in Welfare Exemption. The bill explicitly applies the welfare exemption to property owned and operated by nonprofit corporations that would otherwise qualify for the welfare exemption under R&TC section 214, that are organized and operated for the specific purpose of rehabilitating and building single or multifamily residential units, if the property is subject to a 45-year recorded agreement with the appropriate local agency and if the agreement includes the following:

1. Requires some or all of the property's units to be owner-occupied and sold only to and purchased only by first-time homebuyers that are low-income.

2. Requires the initial down payment on the units to be five percent or less of the market value of the unit at the time of purchase.

3. Requires the units to be made available at an affordable housing cost to buyers.

Exemption Application. The bill specifies only the portion of the property proposed to be built or rehabilitated with units that meet the requirements shall receive the exemption. Following the completion of construction, only the portion of the property with units that meet the requirements shall receive the exemption.

Escape Assessments. The bill requires the County Assessor, on each lien date, to adjust the exemption by a proration factor that reflects the portion of the property proposed to be built or rehabilitated with units that meet the requirements for exemption as a percentage of the total development. Following completion of the construction, the adjustment shall reflect the portion of the property with units that meet the exemption requirements as a percentage of the total development. County Assessors shall issue escape assessments, pursuant to section 532, for any property for which the welfare exemption was granted if either of the following occurs: construction was abandoned or upon completion of construction, the portion of property that was proposed to be, but was not, built or rehabilitated with units that were eligible for the exemption.

[32] AB 1933 Factsheet.

[33] Ibid.

Requires Audit to Be Eligible for Exemption. The bill specifies that a nonprofit shall make their annual independent audits available upon request in order to be eligible for the exemption.

Holds Nonprofits Liable for Property Taxes. The bill specifies that the nonprofit corporation shall be liable for property tax for the years for which the property was exempt from taxation if the property was not developed or rehabilitated, or if the development or rehabilitation was not in the course of construction, in accordance with the following schedule:

- In the case of property acquired by the nonprofit corporation before January 1, 2023, by January 1, 2028;
- In the case of property acquired by the nonprofit corporation on and after January 1, 2023, and before January 1, 2028, within five years of the lien date following the acquisition of the property by the nonprofit corporation.

The bill additionally requires the nonprofit corporation to notify the appropriate County Assessor if the property that was granted an exemption is not in the course of construction by the dates specified above.

Allows Mixed Development. The bill allows the exemption to apply to larger, mixed-income development projects where a portion of the units may be available to persons or families that are not low-income families. However, the exemption would only be available to the portion of the units that meet the requirements listed above.

Prevents Denial of the Exemption if Land Does Not Have Housing. This bill specifies that if the property was not previously designated as open space, then the welfare exemption may not be denied on the basis that the property does not currently include a single or multifamily residential unit, or a single or multifamily residential unit that is in the course of construction.

Holding of Real Property. The bill provides that the holding of real property by a nonprofit corporation for purposes of future construction for housing that complies with this bill's provisions is central to that corporation's exempt purposes and activities.

Future Construction. This bill provides that the holding of property by a nonprofit corporation for future construction on that property of a single or multifamily residence as described in subdivision (a), constitutes the exclusive use of that property for a charitable purpose within the meaning of subdivision (b) of section 4 of Article XIII of the California Constitution.

Definitions. The bill has the following definitions:

1. "Abandoned" has the same meaning as that term is used in section 214.2.
2. "Affordable housing cost" means a cost, with respect to low-income families, that does not exceed 30 percent of gross income.
3. "First-time homebuyer" means a person who does not currently have any ownership interest in any principal residence and has not had any ownership interest in any principal residence in the three-year period prior to the date that the mortgage is executed for a unit purchased by the person described in paragraph (1) of subdivision (a) of this section. For purposes of this paragraph, "principal residence" means any property used as the person's principal place of residence.

4. "Low-income families" means very low income households, as defined in section 50105, extremely low income households, as defined in section 50106, lower income households, as defined in section 50079.5, and persons and families of low income, as defined in section 50093, and includes persons and families of extremely low income and persons and families of very low income, as those terms are used in section 50093 of the Health and Safety Code, as those sections read on January 1, 2022.

Affidavits. The bill specifies that a nonprofit corporation making a claim for the exemption shall not be eligible for the exemption unless the nonprofit corporation signs under penalty of perjury an affidavit affirming to the County Assessor that the property owned is for future construction of single or multifamily residential units with requirements on that property as required under the bill.

Effective and Sunset Dates. The bill specifies section 214.15.1 shall be operative for lien dates occurring on or after January 1, 2023, and before January 1, 2028. The May 19, 2022, amendments extended the sunset date for the bill to remain in effect until January 1, 2034, and as of that date is repealed.

Findings and Declarations. The bill requires to comply with section 41 requirements, including requiring the BOE to submit an annual report to the Legislature by June 1, 2025, and every June 1 thereafter until June 1, 2028, on data received from County Assessors. The BOE would be required to collect from County Assessors the amount of assessed value exempted, and the number of owner-occupied dwelling units created by nonprofits that were granted the exemption under section 214.15.1.

Audits. Nonprofit corporations that utilize the exemption under this newly added section shall be subject to an annual independent audit to ensure that buyers of the units meet the requirements of this section. The nonprofit corporations shall then make the audit available on request to certain local and state agencies.

Mandates and Reimbursements. The bill specifies no reimbursement of certain costs that may be incurred by a local agency or school district unless the Commission on State Mandates determines the act contains other costs mandated by the state.

No Reimbursement Revenues. Any local agencies that lose local property tax revenues because of the expanded welfare exemption proposed by this bill will not be reimbursed by the state.

Effective Immediately. The exemption will go into effect immediately.

In General: Under section 4(b) of Article XIII of the California Constitution, the Legislature is authorized to exempt from taxation, in whole or in part:

Property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by corporations or other entities (1) that are organized and operated for those purposes, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual.

In exercising the above constitutional authorization, the Legislature enacted section 214, which reiterates the constitutional authorization and outlines numerous conditions and qualifications for receiving the exemption, and adds scientific as the fourth qualifying purpose. Section 214 provides that property used exclusively for charitable purposes owned and operated by entities organized and operated for charitable purposes is exempt from taxation if the owner is not organized and operated for profit and the property is used for the actual operation of the exempt activity.

Charitable Purposes. An organization's primary purpose must be either religious, hospital, scientific, or charitable. Whether its operations are for one of these purposes is determined by its activities.

Exclusive Use. The Revenue and Taxation Code does not specifically define the term *used exclusively*; however, the courts have done so in a series of decisions. The California Supreme Court has stated that the phrase "exclusively used" may not be given a literal interpretation so as to mean that the property exempted must be used solely for the purposes stated to the total exclusion of any other use. The Supreme Court held that *used exclusively* for exempt purposes includes any property which is used exclusively for any activity which is incidental to and reasonably necessary for the accomplishment of the exempt purpose.[34] Courts have applied this precedent to mean that a qualified organization's primary use of its property must be for exempt purposes and any other uses of property must be related to and reasonably necessary for the accomplishment of the exempt purpose.[35]

Housing Welfare Exemption. Property tax administrators have historically taken a narrow view of the exemption and have viewed much housing to be non-exempt on the grounds that the property is being used primarily for private residential purposes rather than exempt purposes and is not being used exclusively for exempt purposes as required by section 214.[36]

However, the courts have taken a broader view, consistent with the Supreme Court's directive that statutory and constitutional provisions granting exemptions are to be construed strictly, but reasonably,[37] and that "charitable purposes" be defined broadly.[38]

In 1999, the BOE adopted Property Tax Rule 137, *Application of the Welfare Exemption to Property Used for Housing*, effective December 31, 1999. The purpose of Rule 137 is to clarify that the welfare exemption from property taxation applies to housing and related facilities owned and operated by qualified nonprofit organizations and to establish a single uniform statewide standard for determining qualification for the welfare exemption as it applies to such properties.

In addition, Property Tax Rule 140 further specifies requirements for the welfare exemption for low-income rental housing properties.

Commentary:

1. **Escape Assessments.** The bill requires a County Assessor on each lien date during the course of construction to apply an exemption proration factor that reflects the portion of the property that is eligible for the exemption as a percentage of the total development. Following the completion of the construction, the County Assessor shall issue escape assessments pursuant to section 532, for any property that received a welfare exemption during the course of construction if the construction was abandoned or if the portion of the property that was proposed to be, but was not, built or rehabilitated with units that would qualify for the exemption. Property, which includes the underlying land, that is ineligible for the exemption will not receive any exemption benefits.

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34 *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736.

35 *Honeywell Information Systems, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23; *YMCA v. County of Los Angeles* (1950) 35 Cal.2d 760; *St. Germain Foundation v. County of Siskiyou* (1963) 212 Cal.App.2d 911; *Greek Theatre Association v. County of Los Angeles* (1978) 76 Cal. App.3d 768.

36 Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, Part 1, p. 62.

37 Ibid.

38 *Lundberg v. County of Alameda* (1956) 46 Cal.2d 644, 650.

2. **BOE Annual Reporting Requirement.** The bill, to comply with section 41 requirements, would require the BOE to annually collect information from county assessors and submit a report to the Legislature in compliance with Government Code section 9795 reporting the amount of assessed value exempted and the number of owner-occupied dwelling units created by nonprofits granted the exemption, commencing June 1, 2025, and occurring on or before each June 1 thereafter until December 1, 2028.

   However, section 41 only applies to taxes imposed under Parts 1, 10 and 11 of Division 2 of the R&TC.[39] These code references refer to sales and use taxes, personal income tax, and corporation tax. Section 41 does not apply to property tax or the welfare exemption. If the reporting requirement is based on section 41, then what is the basis for imposing a reporting requirement since this section does not apply to property tax? Additionally, these reporting requirements are in the findings and declarations section of the bill and are not in statute. It is not clear whether these reporting requirements are enforceable with regard to the BOE and/or County Assessors.

3. **County Assessor Workload.** The bill requires nonprofits to report to County Assessors information regarding the additional dwelling units created under the expanded exemption. Many County Assessors' offices may not have the staffing, budget, or technology systems to track this type of data separately beyond aggregated data for the welfare exemption regarding low-income housing. This reporting requirement would be an administrative and workload burden on County Assessors' offices. As a result, the BOE may only be able to submit information of those counties that are able to comply with this provision.

4. **Lien Dates.** Section 214.15.1 is operative for lien dates occurring on or after January 1, 2023, and before January 1, 2028. The bill then repeals the section January 1, 2034. This section would be operative for the January 1, 2023, lien date through the January 1, 2027, lien date. However, the section is effective until January 1, 2034. Under this interpretation, County Assessors would deny any January 1, 2028, lien date claims since the bill's provisions are only operative "*before January 1, 2028*." The January 1, 2027, lien date would apply for the fiscal year July 1, 2027, to June 30, 2028. This means the statute would be effective until December 31, 2028, but not include the timeframe of July 1, 2028, to December 31, 2028.

5. **Administrative Issue.** The bill adds section 214.15.1 which would authorize the welfare exemption if the properties are subject to a 45-year agreement with the appropriate local agency and requires several items, including that some units be sold to first-time homebuyers who are low-income. However, section 214.15 currently requires a 0% interest loan that must be available to only low-income families and does not provide additional requirements on persons being a first-time homebuyer. Both section 214.15 and section 214.15.1 would be operative at the same time, as section 214.15 is not made inoperative by the bill. Having two different standards for the welfare exemption for low-income families operative at the same time may increase the administrative and compliance burden and workload on County Assessors to ensure the exemption is fairly and properly administered.

6. **Addresses Technical Issue.** The current welfare exemption provided to nonprofit corporations that rehabilitate housing and sell to low-income families under section 214.15 requires the financing to be done with a zero-interest rate loan. Some nonprofits recast the zero-interest rate junior loan with a 30-to-45-year repayment, and pair it with a conventional first mortgage from a traditional lender. The junior loan is non-performing, meaning all principal and interest payments service the traditional loan. Because of this financing structure, County Assessors have denied the welfare exemption to entities that otherwise qualify for the exemption since the homebuyer is paying interest on a conventional loan instead of all financing being serviced through the 0% interest loan.

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[39] Section 41, subd. (a).

7. **Nonprofits Liable for Property Taxes.** The bill holds nonprofit corporations liable for property taxes for the years the property received the welfare exemption but was not actually eligible for exemption because the property was not developed or rehabilitated or in the course of construction during specified time periods. The current wording of the statute may cause confusion to taxpayers, by stating that organizations "shall be liable for property tax for the years for which the property was exempt from taxation . . ." This phrase could cause confusion as to why organizations are liable for taxes when the property is exempt from taxation, the author may wish to clarify that nonprofit corporations shall be liable for property tax for the years for which the property received the welfare exemption but were not actually eligible for exemption because the property was not developed or rehabilitated, or in the course of construction during specified time periods.

8. **Property Not Developed or in the Course of Construction.** The bill adds section 214.15.1 which would hold nonprofit corporations liable for property taxes for the years the property received the welfare exemption, but was not actually eligible for exemption, because the property was not developed or rehabilitated, or in the course of construction, during specified time periods. However, section 214.15 currently provides that nonprofit corporations that are organized and operated for the specific and primary purpose of building and rehabilitating housing units qualify for the welfare exemption when the property is acquired and held for future construction, rather than when construction on the property commenced. Both section 214.15 and section 214.15.1 would be operative at the same time, as section 214.15 is not made inoperative by the bill. Having two different standards for the welfare exemption for low-income housing operative at the same time may increase the administrative and compliance burden and workload on County Assessors to ensure the exemption is fairly and properly administered.

9. **Audit Requirement.** The bill states that eligible nonprofit corporations are "subject to" an annual independent audit. It is unclear whether this requires the nonprofit corporation affirmatively seek out an independent audit annually or whether it is merely subject to an independent audit should an agency, such as the Department of Housing and Community Development choose to do an audit. The bill specifies the nonprofit corporations must make the audit available upon request in order to continue to qualify for the exemption.

Costs: The BOE would incur costs of approximately $1,734 and 21 personnel hours to update claim forms; Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*; and Publication 149, *Property Tax Welfare Exemption*. The BOE is currently analyzing the agency costs on requesting data from County Assessors and submitting a report to the Legislature.

Revenue Impact: Estimating the future revenue impact of this bill is difficult as it is unknown how many properties would be subject to the bill, the number of units sold, the sale price of those units, the purchase price of the development property, construction time and the amount of tax that would be paid during the construction phase.

Staff cannot estimate the number of units that would be built in compliance with the bill. However, the bill's sponsors did provide the BOE with data for 11 housing development projects (all located in Los Angeles County) that they have built dating back to 2005 including the development locations, sum of property taxes paid by the sponsor during the course of construction, and the property taxes paid by the new homeowners. Staff believes it may be helpful to provide context to how the bill's provisions would have operated had they been in effect for these projects.

Staff analyzed three developments that seemed to be strictly low-income and found they were in the course of construction for 5, 6, and 5 years, respectively. During that time, the bill's sponsors reported they paid $130,575 in local property taxes for these low-income developments. Under this bill, 100 percent of this would qualify for the welfare exemption. If the exemption applied to these developments with an average construction time of 5 years, Los Angeles County would have lost an average of $26,115 in local property tax revenue. Upon completion of construction, the sponsor sold all units to low-income homebuyers and the property's net assessed value increased due to the new construction.

The units in the analysis above were sold from: July 2011 to August 2011, and August 2020 to October 2020.

Since these units were sold, the bill's sponsors estimate based on the property's net assessed value that homeowners have paid $233,785 in local property taxes over the time period from when the units were sold. When adding the homeowner property tax payments to the amount of tax that would be exempted, staff estimated a local property tax revenue gain of approximately $103,210.

-$130,575 (exemption) + $233,785 (homeowner payments) = $103,210 (net property tax gain)

Qualifying Remark: The data analysis and revenue figures above are only estimates and do not consider future behavior. Additionally, this analysis does not consider potential revenue loss if a county was to instead allow market-rate housing or other property uses rather than low-income housing. Given the way property is taxed in California based upon one percent of a property's assessed value, adjusted annually up to two percent for inflation, it is likely that counties who authorize development or rehabilitation of land to low-income housing will see an increase in local property tax revenues over time versus the amount of local property tax revenue lost in the short-term by authorizing the welfare exemption.

Assembly Bill 2651 (Petrie-Norris), Chapter 656

Property Taxation: Welfare Exemption

Effective September 28, 2022.

Amends section 214.18 of the Revenue and Taxation Code.

Summary: This bill extends the sunset date for the property tax welfare exemption for community land trusts (CLTs) that qualify under the exemption granted under Revenue and Taxation Code (R&TC) section 214.18 for an additional two years from January 1, 2025, to January 1, 2027.

Existing Law: Under the California Constitution, all property is taxable, unless otherwise provided for by the State Constitution or the laws of the United States.[40] The Legislature may exempt from property taxation in whole or in part, property used exclusively for religious, hospital, scientific, or charitable purposes and owned or held in trust by nonprofit corporations or other entities, if certain criteria are met.[41]

This exemption is known as the "welfare exemption" and is implemented pursuant to R&TC section 214.[42]

Section 214 generally exempts from taxation, subject to certain conditions and qualifications, property that is (1) owned by nonprofit organizations organized and operated for charitable purposes, and (2) used exclusively for those purposes.

Section 214(g)(1) provides generally that property used exclusively for rental housing used for low-income rentals owned and operated by nonprofit organizations, including limited partnerships in which the managing general partner is an eligible nonprofit corporation, shall be deemed to be within the exemption authorized by section 214.

The California State Board of Equalization (BOE) and 58 County Assessors are jointly responsible for administering the welfare exemption. The BOE is responsible for determining whether an organization is qualified for either an Organizational Clearance Certificate (OCC) or a Supplemental Clearance Certificate (SCC), while the Assessor is responsible for determining whether the use of a qualifying organization's property is eligible for the welfare exemption. The Assessor shall not grant the welfare exemption on an organization's property unless the organization holds either a valid OCC or SCC issued by the BOE. However, the Assessor may deny a welfare exemption claim based on non-qualifying use of the property, notwithstanding that the BOE has issued the organization an OCC or SCC. The BOE tracks eligible nonprofit organizations and Limited Liability Companies who hold valid OCCs and SCCs and monitors those organizations for continued eligibility.

Once an OCC or an SCC is issued by the BOE to a qualified organization, the organization will then file a claim for the welfare exemption with the County Assessor where the property is located. The County Assessor is responsible for evaluating the application, determining whether the use of the property meets the statutory requirements for receiving the welfare exemption, and for ultimately granting or denying the exemption to claimants.

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[40] California Constitution, Article XIII, section 1.

[41] California Constitution, Article XIII, section 4(b).

[42] All statutory references are to the Revenue and Taxation Code, unless otherwise provided.

Under existing property tax law, property that meets these requirements and is used exclusively for rental housing and related facilities is entitled to a partial exemption, equal to that percentage of the value of the property that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units, in any year that certain criteria apply, including that the property be subject to a legal restriction that provides that units designated for use by lower income households are continuously available to or occupied by lower income households, at rents not exceeding specified limits.[43]

In 2019, the Legislature added section 214.18 into law which stated that property owned by a community land trust (CLT) that qualifies for a welfare exemption under section 214 is also within the exemption provided by sections 4 and 5 of Article XIII of the California Constitution as long as several conditions were met and repeals the section on January 1, 2025.[44]

SB 196 also required the BOE to annually collect data from County Assessors relating to CLTs and the number of units created by CLTs under the welfare exemption authorized under section 214.18.[45] In 2020, the Legislature clarified the requirements for CLTs to claim the welfare exemption and made property owned by a CLT eligible for the welfare exemption prior to beginning construction.[46]

Additionally, this section prevented County Assessors from denying the welfare exemption to CLTs who were in the process of constructing affordable housing, but did not have any units complete. However, this section made CLTs liable for property tax for the years the CLT received the exemption if construction was not completed by a certain timeframe.

On December 1, 2021, the BOE issued a Letter to Assessors (LTA) providing information and guidance on the treatment of CLT housing considering these legislative changes.[47]

Amended Law: The bill extends the sunset date for the property tax welfare exemption for community land trusts (CLTs) that qualify under the exemption granted under Revenue and Taxation Code (R&TC) section 214.18 for an additional two years from January 1, 2025, to January 1, 2027.

In General: Under section 4(b) of Article XIII of the California Constitution, the Legislature is authorized to exempt from taxation, in whole or in part:

Property used exclusively for religious, hospital, or charitable purposes and owned or held in trust by corporations or other entities (1) that are organized and operated for those purposes, (2) that are nonprofit, and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual.

In exercising the above constitutional authorization, the Legislature enacted section 214, which reiterates the constitutional authorization and outlines numerous conditions and qualifications for receiving the exemption, and adds scientific as the fourth qualifying purpose. Section 214 provides that property used exclusively for charitable purposes owned and operated by corporations organized and operated for charitable purposes is exempt from taxation if the owner is not organized and operated for profit and the property is used for the actual operation of the exempt activity.

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[43] Section 214, subd. (g)(1).

[44] SB 196, chapter 669, Stats. 2019.

[45] Ibid.

[46] SB 1473, chapter 371, Stats. 2020.

[47] Letter to Assessors No. 2021/052, California State Board of Equalization, December 1, 2021.

Charitable Purposes. An organization's primary purpose must be either religious, hospital, scientific, or *charitable*. Whether its operations are for one of these purposes is determined by its activities. The courts have broadly construed charitable to include some educational purposes and activities.[48] These court decisions have been codified in section 214(j), which provides that charitable purposes include certain educational purposes and activities, subject to the following requirements:

- The educational purposes and activities must benefit the community as a whole or an unascertainable and indefinite portion thereof.
- The educational activities include the study of relevant information, the dissemination of that information to interested members of the general public, and the participation of interested members of the general public.

Section 214(j) expressly precludes exemption to educational purposes and activities primarily for the benefit of the organization's shareholders.

Exclusive Use. The Revenue and Taxation Code does not specifically define the term used *exclusively*; however, the courts have done so in a series of decisions. The California Supreme Court has stated that the phrase "exclusively used" may not be given a literal interpretation so as to mean that the property exempted must be used solely for the purposes stated to the total exclusion of any other use. The Supreme Court held that *used exclusively* for exempt purposes includes any property which is used exclusively for any facility which is incidental to and reasonably necessary for the accomplishment of the exempt purpose.[49] Courts have applied this precedent to mean that a qualified organization's primary use of its property must be for exempt purposes and any other uses of property must be related to and reasonably necessary to the accomplishment of the exempt purpose.[50]

Housing Welfare Exemption. Property tax administrators have historically taken a narrow view of the exemption and have viewed much housing to be non-exempt on the grounds that the property is being used primarily for private residential purposes rather than exempt purposes and is not being used exclusively for exempt purposes as required by section 214.[51]

However, the courts have taken a broader view, consistent with the Supreme Court's directive that statutory and constitutional provisions granting exemptions are to be construed strictly, but reasonably.[52]

In 1999, the BOE adopted Property Tax Rule 137, *Application of the Welfare Exemption to Property Used for Housing*, effective December 31, 1999. The purpose of Rule 137 is to clarify that the welfare exemption from property taxation applies to housing and related facilities owned and operated by qualified nonprofit organizations and to establish a single uniform statewide standard for determining qualification for the welfare exemption as it applies to such properties.[53]

In addition, Property Tax Rule 140 further specifies requirements for the welfare exemption for low-income housing properties.

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[48] See *Lundberg v. County of Alameda* (1956) 46 Cal.2d 644, 653; *Stockton Civic Theatre v. Board of Supervisors* (1967) 66 Cal.2d. 13; *Greek Theatre Association v. County of Los Angeles* (1978) 76 Cal.App.3d 768, 778-779.

[49] *Cedars of Lebanon v. County of Los Angeles* (1950) 35 Cal.2d 729, 736.

[50] *Honeywell Information Systems, Inc. v. County of Sonoma* (1974) 44 Cal.App.3d 23; *YMCA v. County of Los Angeles* (1950) 35 Cal.2d 760; *St. Germain Foundation v. County of Siskiyou* (1963) 212 Cal.App.2d 911; *Greek Theatre Association v. County of Los Angeles* (1978) 76 Cal.App.3d 768.

[51] Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, p. 62.

[52] Ibid.

[53] Id. at p. 65.

Background: Community Land Trusts. Federal law, the Cranston-Gonzalez National Affordable Housing Act (Act), allows CLTs to obtain organizational support, technical assistance, education, training, and community support from the government in fulfilling their housing mission.[54] The Act defines "CLT" to mean a community housing development organization not sponsored by a for-profit organization, with a specified board membership, that is established to carry out the following activities:

- Acquire parcels of land, held in perpetuity, primarily for conveyance under long-term ground leases;
- Transfer ownership of any structural improvements located on the leased parcels to the lessees; and
- Retain a preemptive option to purchase any structural improvement at a price determined by a formula designed to ensure that the improvement remains affordable to low- and moderate-income families in perpetuity.

CLTs are nonprofit organizations governed by a board of CLT residents, community residents and public representatives that provide lasting community assets and shared equity homeownership opportunities for families and communities. CLTs develop rural and urban agriculture projects, commercial spaces to serve local communities, affordable rental and cooperative housing projects, and conserve land or urban green spaces. However, the heart of their work is the creation of homes that remain permanently affordable, providing successful homeownership opportunities for generations of lower income families.[55]

CLTs provide an affordable housing model to help low-and moderate-income households that may not otherwise be able to purchase homes. The CLT acquires and develops properties for sale to income-qualified households, but then retains ownership of the underlying land and leases the land to the homeowner for a nominal fee through a long-term ground lease (usually a 99-year term). The home is, therefore, more affordable because the homeowner is only buying the building and leasing the land underneath. If the homeowner decides to sell the property, the home must be resold to another income-qualified household, and the original owner will only be eligible for a smaller share of its appreciated value. Since the CLT is the owner of the land, it will be a party to all future sales and enforce resale restrictions.

For California property tax purposes, a "community land trust" is defined in section 402.1(a)(11)(C)(ii) as a nonprofit corporation organized pursuant to section 501(c)(3) of the Internal Revenue Code that satisfies all the following:

- Has as its primary purposes the creation and maintenance of permanently affordable single-family or multifamily residences.
- All dwellings and units located on the land owned by the nonprofit corporation are sold to a qualified owner to be occupied as the qualified owner's primary residence or rented to persons and families of low or moderate income.
- The land owned by the nonprofit corporation, on which a dwelling or unit sold to a qualified owner is situated, is leased by the nonprofit corporation to the qualified owner for the convenient occupation and use of that dwelling or unit for a renewable term of 99 years.

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[54] 42 U.S.C. 12773.

[55] *https://groundedsolutions.org/strengthening-neighborhoods/community-land-trusts*.

Commentary:

1. **Makes Time Period Consistent.** The bill reduces the time for the CLT to develop or rehabilitate the property or start construction of the property from seven years to five years from the date of acquisition of the property. This bill is consistent with current statute under section 214.18, which allows a time-period of five years rather than the seven years that was proposed in a prior version of the bill.

2. **Data Collection.** Currently, the BOE collects specified data from County Assessors relating to the welfare exemption authorized under section 214.18 so the Legislature may examine the efficacy of the exemption. However, R&TC section 41 only applies to taxes imposed under Parts 1, 10, and 11 of Division 2 of the R&TC.[56] R&TC section 41 does not apply to property tax or the welfare exemption, as the referenced Parts of Division 2 refer to sales and use taxes, personal income tax, and corporation tax. As such, these reporting requirements are only within the findings and declarations section of the bill and are not statutorily mandated. Accordingly, if the reporting requirement is based solely on R&TC section 41 and an uncodified note from the Legislature, the data reporting requirements may have low response rates.

   CLTs are required to report data with County Assessors, but no requirement is made to County Assessors to house the data. In 2022, the BOE requested 2021 lien date data from the 58 County Assessors' offices. The BOE received only 28 responses. Of the 28 responses, only 7 counties specified the number of parcels owned by CLTs. Only 7 counties reported parcels owned by CLTs eligible under section 214.18. and the assessed value of those properties. Of the counties reporting, no new units were reported as of the January 1, 2021, lien date. The author may wish to consider an amendment specifying the County Assessors shall track the data separately to ensure the Legislature has the best data for future policy discussions around the exemption authorized under section 214.18.

Costs: The BOE would incur costs of approximately $4,021 and 45 personnel hours to update claim forms; Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*; Publication 149, *Property Tax Welfare Exemption*; and collect data from County Assessors.

Revenue Impact: Estimating the revenue impact of this bill is difficult. Staff cannot estimate the number of CLTs that would qualify under this bill. Staff also does not know the location and value of those properties. Revenue impact depends on: (1) the number of properties that would qualify under this bill, (2) the taxable value of the property, and (3) the location of these properties. At this time, based on these unknown factors, the revenue loss is indeterminable.

Qualifying Remark: As stated earlier, the BOE collects specified data from County Assessors relating to the welfare exemption authorized under section 214.18 so the Legislature may examine the efficacy of the exemption. At the time of preparing this estimate, BOE reached out to the 58 County Assessors for data regarding the 2021 lien date. The BOE received only 28 responses of which only counties specified the number of parcels owned by CLTs. Of the counties that reported CLT owned parcels, all 7 counties reported parcels owned by CLTs eligible under section 214.18. and the assessed value of those properties. As of January 1, 2021, lien date, the estimated assessed value for the seven counties was $10.8 million.

[56] R&TC section 41, subd. (a).

Senate Bill 989 (Hertzberg), Chapter 712

Property Taxation: Taxable Value Transfers

Effective September 28, 2022.

Adds section 2610.8 and section 2636.1 of the Revenue and Taxation Code.

Summary: This bill adds sections 2610.8 and 2636.1 to the Revenue and Taxation Code[57] (R&TC) to add a disclosure on certain property tax bills regarding Proposition 19 benefits and property tax deferment procedures and allows taxpayers to defer payment of local property taxes if their property meets certain qualifications. The bill's provisions only apply to counties with a population greater than 4 million as determined by the 2020 federal census. Other counties may comply if the county's Board of Supervisors, after consultation with the County Assessor, County Auditor, County Treasurer, and County Tax Collector, adopts a resolution implementing the requirements of the bill.

Existing Law: For property tax purposes, the law requires assessors to reassess real property from its Proposition 13 protected value (called the "base year value") to its current market value whenever a change in ownership occurs.[58] Exceptions to this reassessment requirement have been enacted, including base year value transfers for property owners whose property has been damaged or destroyed in a disaster for which the Governor proclaimed a state of emergency. In addition, subject to many conditions, the law[59] allows homeowners at least age 55 years, or who are severely and permanently disabled, or victims of a wildfire or natural disaster, to sell their existing home (called the "original property"), buy or build a new one, and transfer their base year value to the new home (replacement home).

Proposition 19 Over 55/Disabled/Victims of Wildfire or Natural Disaster Base Year Value Transfer. Operative April 1, 2021, Proposition 19 added section 2.1(b) to Article XIII A of the California Constitution to allow homeowners who are over age 55, severely disabled, or victims of wildfire or natural disasters to transfer a base year value to a replacement home anywhere in California, regardless of the location or value. SB 539, the Proposition 19 implementation bill made clarifying changes to the provisions and added section 69.6.[60] Specifically:

- **Principal Place of Residence.** To qualify for this benefit, both the original property and the replacement home must be eligible for either the homeowners' or the disabled veterans' exemption, based on the claimant's ownership and occupation of the home as a principal place of residence.[61]
- **Original Property.** The original property must be sold. SB 539 clarified that the base year value of the original property cannot be transferred until the original property is sold.
- **Replacement Property.** The replacement property must be purchased or newly constructed within two years of the sale of the original property.

[57] All code sections shall reference the Revenue and Taxation Code unless otherwise specified.

[58] Article XIII A, section 2 of the California Constitution.

[59] Article XIII A, section 2(a) of the California Constitution and R&TC section 69.5.

[60] SB 539 (Hertzberg), ch. 427, Stats. 2021.

[61] R&TC section 69.6(b)(2).

- **Location.** The replacement property can be located anywhere in California.
- **Value.** The base year value may be transferred to a home of equal or lesser value. However, if the value of the replacement home is *greater* than the value of the original property, the difference in market values must be added to the transferred base year value. Victim of a wildfire or natural disaster who chooses not to rebuild on their substantially damaged property to use the value of their property prior to it being in a damaged condition for a base year value transfer.
- **Limitation on the Number of Base Year Value Transfers.** Homeowners over age 55 or severely disabled may use this base year value transfer up to three times. There is no limit on transfers for those who are victims of wildfires or natural disasters.

New Law: Adds Disclosure to Property Tax Bills. The bill requires a disclosure to be printed on each tax bill for properties that have been purchased, newly constructed, or changed in ownership in the year preceding the tax bill that includes a brief summary of the Proposition 19 base year value transfer provisions and the property tax deferment procedures authorized by the bill.

Allows Deferment of Local Property Taxes. The bill allows a taxpayer to defer local property taxes, without penalty or interest, if both of the following conditions apply:

- The property owner has claimed the property tax relief pursuant to section 69.6 for the property, but the County Assessor has not completed its determination of the property's eligibility for property tax relief under section 69.6;
- The property owner requests deferment with the County Assessor within one calendar year, but before January 1, 2024, of receiving the first tax bill for the property.

Deferred Payment. The bill specifies local property taxes that have been deferred by a taxpayer shall be deferred until either the County Assessor has reassessed the property and a corrected tax bill prepared pursuant to section 69.6 has been sent to the property owner[62] or the County Assessor has determined the property is not eligible for exclusion pursuant to section 69.6 and the County Assessor has notified the property owner.[63]

Payment of Deferred Local Property Taxes. The bill specifies the following timeframe for payment of deferred local property taxes:

Eligible Taxpayers:

- For taxpayers that deferred payment, and County Assessors have reassessed the property and reissued a corrected tax bill, local property taxes shall become due and payable December 10 or 30 days after the date the corrected bill is mailed or electronically transmitted to the property owner, whichever is later. Second installments of local property taxes that have been deferred are due and payable April 10 or 30 days after the date the corrected bill is mailed or electronically transmitted to the property owner, whichever is later. Deferred taxes that are unpaid shall become delinquent at 5 p.m., or the close of business, whichever is later, of the due date and shall be subject to delinquency penalties as provided by law.

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[62] Section 2636.1, subd. (b)(1).

[63] Section 2636.1, subd. (b)(2).

Ineligible Taxpayers:

- For taxpayers that deferred payment, and County Assessors have determined are not eligible for deferment shall have taxes be due and payable December 10 or 30 days after the postmark date or date of mailing printed on the County Assessor's notice to the property owner, whichever is later. Second installments of property taxes that have been deferred pursuant to this section but that have since been corrected shall be due and payable April 10 or 30 days after the postmark date or date of mailing printed on the County Assessor's notice to the property owner, whichever is later. Deferred taxes that are unpaid shall become delinquent at 5 p.m., or the close of business, whichever is later, of the due date and shall be subject to delinquency penalties as provided by law.

Does Not Apply to Impound Accounts. The bill specifies that deferment of local property taxes does not apply to property taxes paid through impound accounts.

Applies to Counties with Certain Population. The bill specifies its provisions apply only to counties with a population over 4 million as determined by the 2020 federal census and do not apply to counties with populations of 4 million or less unless the county's Board of Supervisors, after consultation with the County Assessor, County Auditor, County Treasurer, and County Tax Collector, adopts a resolution implementing the requirements of the bill.

Effective Date. The bill will go into immediate effect if passed by the Legislature and signed by the Governor.

Sunset Date. The bill specifies the local property tax deferment section shall remain in effect only until January 1, 2026, and as of that date is repealed.

In General: Property Tax System. In 1978, voters approved Proposition 13, which added Article XIII A to the California Constitution. Under this system, property is valued at its full cash value shown on the 1975 tax bill, with annual increases thereafter limited to the amount of inflation or two percent, whichever is less, until the property changes ownership or new construction occurs. Once a reassessable event occurs (for example, a change in ownership or new construction), the value of the property for tax purposes is redetermined based on its current market value. The value initially established, or redetermined where appropriate, is referred to as the "base year value." Because real estate values generally appreciate at a rate greater than two percent per year, when an event occurs triggering a reassessment of property to its current market value, the reassessed value (for example, its new base year value) will likely be substantially higher.

California property tax law provides for various situations where the base year value of a property is either: (1) retained, notwithstanding that new construction has taken place or that the property has changed ownership, or (2) transferred to another property, notwithstanding that the property has changed ownership. These special situations are provided pursuant to various constitutional amendments modifying the original Proposition 13 framework and serve to avoid the otherwise required reassessment of a property to its current market value.

Over 55/Disabled Base Year Value Transfers. Prior to November 3, 2020, voters approved three constitutional amendments permitting persons over age 55 or disabled to transfer their Proposition 13 base year value from one home to another that is of equal or lesser value.[64] The base year value transfer avoids reassessment of the newly purchased home to its fair market value.

[64] Article XIII A, section 2(a).

- **Intracounty.** In 1986, Proposition 60[65] amended the constitution to allow persons who are over the age of 55 to sell a principal residence and transfer its base year value to a replacement principal residence within the same county.
- **Intercounty.** In 1988, Proposition 90[66] amended the constitution to extend these provisions to a replacement residence located in another county on a county-optional basis. Relevant to this bill, the law gives each county board of supervisors the option to accept intercounty base year value transfers from homeowners moving from a different county. The boards of supervisors are required to consult with local affected agencies, cities, special districts, school districts, and community college districts, before making the decision to enact a necessary local ordinance.
- **Disabled Persons.** In 1990, Proposition 110[67] amended the constitution to extend these provisions to any severely disabled person regardless of age.

R&TC section 69.5 implements these three propositions.

The BOE's Assessors' Handbook Section 401, *Change in Ownership*,[68] (September 2010) chapter 14, provides more details, and the BOE's website includes FAQ's for Propositions 60/90 and Proposition 110.

Payment of Property Taxes. The County Tax Collector is responsible for preparing property tax bills. Bills for the regular secured assessment roll (generally real property) are mailed by November 1 and are due in two equal installments. The first installment is due November 1 and becomes delinquent December 10. The second installment is due on February 1 and becomes delinquent April 10.

If taxes are not paid by the delinquent date, there is a ten percent penalty.[69] After the second installment of taxes is delinquent, the County Tax Collector shall collect a cost of $10 for preparing delinquent tax records and giving notice of delinquency.[70]

If a taxpayer receives a notice of impending default, and the taxes remain unpaid on the date the notice says they are due, the property is declared tax-defaulted. Monthly redemption penalties of one and a half percent are added to the unpaid taxes. The property owner has the right to redeem the property by paying the taxes, penalties, and costs within five years of the date the property becomes tax-defaulted. If the property is not redeemed within five years, the property may be sold at public auction or acquired by a public agency.[71]

Background: Proposition 19, approved by the voters on November 3, 2020, as relevant here, added section 2.1 to Article XIII A of the California Constitution to provide the following two types of property tax relief:

- Operative February 16, 2021, sections 2.1(c) and (d) replaced the former parent-child and grandparent-grandchild exclusions with a new intergenerational transfer exclusion, if the property continues as the family home or family farm of the transferee, and requires the family home or family farm to meet a specified value test.

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[65] Proposition 60, approved November 4, 1986.

[66] Proposition 90, approved November 8, 1988.

[67] Proposition 110, approved June 5, 1990.

[68] This document is in the process of being converted to be ADA compliant and is available upon request.

[69] Sections 2617 and 2618.

[70] Section 2621.

[71] Publication 29, *California Property Tax: An Overview*, California State Board of Equalization.

- Operative April 1, 2021, section 2.1(b) allows a base year value transfer for homeowners who are over age 55, severely disabled, or victims of a wildfire or natural disaster to a replacement home in California, regardless of location or value.

To receive a Proposition 19 base year value transfer, a taxpayer must file a claim form with the County Assessor where the taxpayer's new and current residence is located after both transactions (current and prior residence) have been completed and the taxpayer is living in the current residence. The taxpayer may receive the Proposition 19 claim form from the website of the County Assessor where the new residence is located.

County Assessors then process Proposition 19 claim forms and verify that the purchases meet the qualifications of a base year value transfer and issue an updated taxpayer base year value and adjusted property tax bill.

Commentary:

1. **Summary of Bill.** The bill's provisions shall not apply to counties with a population of 4 million or less as determined by the 2020 federal census unless the county's Board of Supervisors, after consultation with the County Assessor, County Auditor, County Treasurer, and County Tax Collector, adopts a resolution implementing the requirements of the bill. Additionally, the amendments added an urgency clause.

2. **Los Angeles County.** The bill specifies its provisions apply only to counties with a population greater than 4 million as determined by the 2020 federal census, unless other county Board of Supervisors pass a resolution to participate in the bill's provisions. According to the 2020 Census Data, the bill's provisions would only apply to Los Angeles County.[72]

3. **Potentially Lengthy Delay.** The bill authorizes taxpayers to defer payment of local property taxes until County Assessors determine whether the property is eligible for a base year value transfer and issue a corrected tax bill or until County Assessors deny a claim. Currently, the bill allows payment of deferred local property taxes to be either of the following, the new date of December 10 and April 10 or the date following the correction or determination of ineligibility, whichever is later.

   County Assessors cannot determine if a taxpayer qualifies for a base year value transfer under Proposition 19 until they have valued both properties and determined the market value of each, which may require coordination between two counties should the properties be in different counties. Currently, some counties are behind in processing transfers, as well as processing claims for base year value transfers, so there is no timetable for when claims are resolved. This could potentially lead to lengthy delays of when deferred property taxes must be paid since the deferment is open ended since the deadline is left open ended by specifying *whichever is later*. The delay in local property tax revenues can have significant downstream effects on local governments that rely on property tax revenues coming in on time.

4. **Deferment Claims.** The bill allows taxpayers to claim local property tax revenue deferment before January 1, 2024. Taxpayers who have Proposition 19 claims in this timeframe may benefit from this deferment, but what occurs if the claims process backlog still exists beyond January 1, 2024? Taxpayers who have claims outside this window will then be required to pay their property taxes even if the backlog persists.

[72] California: 2020 Census, *www.census.gov*.

5. **Technical Clarification.** The bill added subdivision (c), paragraph (2) relating deferred property tax payments for ineligible claimants. In relation to the first installment, the language references tax bills that "have been deemed correct," but in the second installment language, the paragraph references "since have been corrected." Since the denial of the claim means the tax bill was issued correctly, the author may wish to consider the technical amendment below to reference "been deemed correct."

   (2) First installments of property taxes that have been deferred pursuant to this section but that have been deemed correct pursuant to paragraph (2) of subdivision (b) shall be due and payable December 10 or 30 days after the postmark date or date of mailing printed on the County Assessor's notice to the property owner, whichever is later. Second installments of property taxes that have been deferred pursuant to this section, but that have been deemed correct, shall be due and payable April 10 or 30 days after the postmark date or date of mailing printed on the County Assessor's notice to the property owner, whichever is later.

Costs: The BOE would incur costs of approximately $1,734 and 21 personnel hours to issue a Letters to Assessors notifying County Assessors of the change in law.

Revenue Impact: The revenue impact of SB 989 is difficult to estimate. This bill authorizes taxpayers to defer payment of local property taxes if a property owner has claimed a Proposition 19 base year value transfer and County Assessors have not processed the claim and if the taxpayer requests deferment within one calendar year, but before January 1, 2024, of receiving their first tax bill for the property.

Under Proposition 19, a replacement home can be purchased or constructed anywhere in California and of any value. It is difficult to attribute how many taxpayers would request deferment of local property taxes under this bill and are ultimately eligible for the deferment. However, using statewide average values and limited Proposition 19 transfer data, staff can attempt to compute an average revenue impact if taxpayers were to request and be eligible for deferment.

According to the California Association of Realtors, the January 2021 median home price in California was $699,920. For roll year 2021-22, the estimated average assessed value of a property receiving the homeowners' exemption is $466,000. Therefore, where a claim for transfer is granted, the estimated amount of assessed value difference per home on average is $234,000 ($700,000 – $466,000). Average revenue loss at the basic one percent property tax rate is estimated at $2,340 per replacement home ($234,000 x 1%). From April 1, 2021, to March 31, 2022, 25 counties reported 2,027 total Proposition 19 transfer claims. If every taxpayer who transferred their base year value had applied for local property tax deferment under this bill, local counties would have experienced approximately $4.7 million in delayed local property tax revenue.

Senate Bill 1340 (Hertzberg), Chapter 425

Property Taxation: Active Solar Energy Systems

Effective September 18, 2022.

Amends section 73 of the Revenue and Taxation Code.

Summary: This bill changes the current new construction exclusion repeal date to January 1, 2027, and specifies any active solar energy system (ASES) that qualifies for the exclusion under section 73 prior to January 1, 2027, shall continue to be excluded until there is a subsequent change in ownership.

Existing Law: Under the California Constitution, all property is taxable unless specifically exempted.[73] The Constitution limits the assessed value of property upon which the property tax is imposed. For property tax purposes, real property is reassessed to its current market value when real property undergoes a change in ownership or is newly constructed.[74] Generally, the law establishes a property's assessed value at its market value[75] on the date purchased (base year value) and requires additional assessments to reflect certain construction activities that qualify as "new construction."

Change in Ownership. Different change in ownership laws apply to a person or legal entity who purchases or leases California real property than to a person or legal entity who obtains ownership interests in a legal entity (e.g., voting stock in a corporation, capital and profits in a limited liability company or partnership) that holds an interest in California real property.[76] As a general rule, transfers of ownership interests in legal entities do *not* constitute a change in ownership (and, therefore, no reassessment) of the legal entity's real property.[77] However, there are two exceptions wherein the transfer of ownership interests in a legal entity would trigger a change in ownership of the real property owned by the legal entity.

- **Change in Legal Entity Control.** Section 64(c)(1) requires reassessment when any person or entity obtains control through direct or indirect ownership or control of more than 50 percent of corporation voting stock, or obtains a majority interest (more than a 50 percent ownership interest) in any other type of legal entity. The reassessment applies to all real property owned by the acquired legal entity (and any entity under its control).

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73 Article XIII, section 1 of the California Constitution.

74 California Constitution, Article XIII A, section 2; R&TC section 110.1.

75 The assessed value is based on 1975 market value for property that has not changed ownership since that date.

76 California Constitution, Article XIII A, section 2; R&TC sections 60 – 69.5.

77 R&TC section 64(a).

- **Cumulative Transfers by "Original Co-owners."** Section 64(d) requires reassessment when voting stock or other ownership interests representing cumulatively more than 50 percent of the total interests in a legal entity are transferred by any of the "original co-owners" in one or more transactions.[78] The reassessment applies to only the real property previously excluded from change in ownership under section 62(a)(2).

New Construction. When substantial additions or alterations occur, the law requires the County Assessor to increase the assessment to reflect the value of "newly constructed" property.[79] The County Assessor assigns the assessable new construction with its own distinct base year value. The remainder of the property's assessment is unaffected and retains its base year value.[80] The Constitution allows the Legislature to provide that the term "newly constructed" does not include certain construction activities. These are commonly called "new construction exclusions." Any value added by these additions or alterations is not subject to be assessed, until the real property undergoes a change in ownership.

ASES New Construction Exclusion. The California Constitution[81] grants the Legislature the authority to exclude the construction or addition of any ASES from the definition of assessable new construction. Section 73 implements the new construction exclusion, which is available through the 2023-24 fiscal year. Section 73 is scheduled to sunset on January 1, 2025. Any ASES that was excluded prior to this date will continue to be excluded until a change in ownership occurs.

In 2011, the Legislature added findings and declarations,[82] which provide that in cases where a newly constructed ASES is sold or transferred in sale-leaseback arrangements, partnership flip structures, or other transactions to take advantage of federal tax benefits, the ASES new construction exclusion applies, as long as (1) the system is newly constructed or added, and (2) no other taxpayer has received the exclusion for that same system. The new construction exclusion remains in effect only until there is a subsequent change in ownership.

Amended Law: Extends Section 73 Repeal Date. The bill extends the section 73 repeal date from December 31, 2025, to January 1, 2027, and additionally specifies any ASES that qualifies for the exclusion under section 73 prior to January 1, 2027, shall continue to be excluded until there is a subsequent change in ownership.

Findings and Declarations. The Legislature finds and declares that section 73 was enacted to encourage and to provide incentives for the development of ASES by providing an exclusion from classifications as newly constructed the construction or addition of ASES.

No Reimbursement. Any local property tax dollars lost pursuant to the bill's provisions will not be reimbursed by the state.

Effective Date. The bill's provisions will become effective immediately.

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[78] **Proportional Ownership Interests Exclusion Creates "Original Co-owner" Designation.** Under section 62(a)(2), a transfer of real property to a legal entity does not result in a reassessment if the transfer is merely a change in the method of holding title and the proportional ownership interests of the transferors and transferees in the real property transferred are *exactly* the same before and after the transfer. However, after a transfer of real property qualifies for this exclusion from reassessment, the person(s) or entity(ies) holding ownership interests in the legal entity immediately after the transfer are considered "**original co-owners**" for purposes of tracking subsequent transfers by original co-owners of those interests. When such transfers cumulatively exceed 50 percent, the real property previously excluded from reassessment under R&TC section 62(a)(2), is subject to reassessment under R&TC section 64(d), absent an applicable exclusion.

[79] Article XIII A, section 2 of the California Constitution (Proposition 13) and R&TC section 70. Additionally, "supplement assessment" laws make the new construction taxable as of the completion date.

[80] Unless the new construction replaces certain types of existing improvements, in which case the value attributable to those preexisting improvements is deducted from the property's existing base year value.

[81] Article XIII A, section 2(c)(1).

[82] ABx1 15, ch. 3, Stats. 2011.

In General: Property Tax System. Article XIII, section 1 of the California Constitution provides that all property is taxable at the same percentage of "fair market value," unless specifically exempted, or authorized for exemption. Article XIII A, section 2 of the California Constitution defines "fair market value" as the County Assessor's opinion of value for the 1975-76 tax bill, or, thereafter, the appraised value of property when purchased, newly constructed, or a change in ownership has occurred. This value is generally referred to as the "base year value." Annual adjustments to the base year value are limited to two percent or the rate of inflation, whichever is less. Article XIII A, section 2 also provides for certain exclusions from consideration as a "change in ownership" and "newly constructed" as approved by voters via constitutional amendments.

New Construction. The California Constitution does not define the terms "new construction" or "newly constructed." Section 70 defines these terms, in part, to mean:

- Any addition to real property, whether land or improvements (including fixtures) since the last lien date.
- Any alteration of land or any improvements (including fixtures) since the last lien date that constitutes a "major rehabilitation" or that converts the property to a different use.

A major rehabilitation is any rehabilitation, renovation, or modernization that converts an improvement or fixture to the substantial equivalent of a new improvement or fixture.

With respect to any new construction, the law requires the County Assessor to determine the added value upon completion. The value is established as the base year value for those specific improvements qualifying as "new construction" and is added to the property's existing base year value. When new construction replaces certain types of existing improvements, the value attributable to those pre existing improvements is deducted from the property's existing base year value.[83]

New Construction Exclusions. Certain types of construction activity are excluded from assessment as "new construction" via constitutional amendment. Consequently, while these improvements may increase the value of the property, the additional value is not assessable. Relevant to this bill, Proposition 7, approved by California voters in November 1980, created an exclusion for ASES.

Overview of Solar Energy New Construction Exclusion. An "active solar energy system" is defined in section 73 as a system that uses solar devices, which are thermally isolated from living space or any other area where the energy is used, to provide for the collection, storage, or distribution of solar energy. An ASES may be used for any of the following:

- Domestic, recreational, therapeutic, or service water heating
- Space conditioning
- Production of electricity
- Heat processing
- Solar mechanical energy

An ASES includes storage devices, power conditioning equipment, transfer equipment, and parts related to the functioning of those items. "Parts" includes spare parts that are owned by the owner of, or maintenance contractor for, an ASES for which the parts were specifically purchased, designed, or fabricated for installation in that system. Such a system includes only equipment used up to, but not including the stage of conveyance or use of the electricity.

[83] Section 71.

An ASES also includes pipes and ducts that are used exclusively to carry energy derived from solar energy. Pipes and ducts that are used to carry both energy derived from the sun and energy derived from other sources may be considered ASES property only to the extent of 75 percent of their full cash value.

This exclusion is scheduled to sunset on January 1, 2025. Any ASES that was completed and excluded from assessment prior to this date will continue to be excluded until a change in ownership occurs.

An ASES does not include auxiliary equipment, such as furnaces and hot water heaters, that use a source of power other than solar energy to provide usable energy. Dual use equipment, such as ducts and hot water tanks, that is used by both auxiliary equipment and solar energy equipment is considered ASES property only to the extent of 75 percent of its full cash value.

Section 73 explicitly provides that the exclusion does not apply to solar swimming pool heaters or hot tub heaters. By definition, the exclusion does not apply to "passive" solar systems. Lastly, the exclusion does not apply to wind energy systems.

Exclusion Extended to Initial Purchaser. Section 73 was amended in 2008[84] to extend the new construction exclusion after a change in ownership if a new building is initially constructed with an ASES incorporated and subsequently sold by the developer through the 2015-16 fiscal year. Specifically, in the case where an ASES is incorporated by an owner-builder in the initial construction of a new building that the owner-builder does not intend to occupy or use (for example, a building offered for sale, such as a new home in a subdivision or a new warehouse), the exclusion for the system applies to the building's first buyer if (1) the owner-builder did not receive the exclusion for the same system, (2) if the initial buyer purchased the new building prior to that building becoming subject to reassessment to the owner builder,[85] and (3) a claim[86] is filed with the County Assessor.

Section 73 was amended in 2014 to extend the exclusion through the current 2023-24 fiscal year.[87]

If the exclusion is eligible to be extended to the initial purchaser, then in determining the base year value to be established as a result of the change in ownership, the base year value is reduced by the portion of the purchase price that is attributable to the ASES. Thereafter, any subsequent change in ownership of the property ends the exclusion of the value of the ASES from property tax.

Common Transactions that may be Eligible for Federal Tax Benefits. Under the 2011 legislative intent language, newly constructed ASES continue to receive the property tax exclusion if they are transferred using certain transactions that require the ASES to be sold or transferred to a third party that may qualify for federal tax benefit. Transactions that may be eligible for federal tax benefits include, but are not limited to, the following:

- *Sale-leaseback transactions* involve the sale of a property in which the seller immediately begins to lease the property from the buyer. Thus, the seller no longer has ownership of the property, but operates it for the duration of the lease agreement.

- A *partnership flip transaction* is a financing arrangement between a renewable energy developer and a single or multiple tax investors whereby the parties form a partnership or limited liability company to develop and/or own an ASES. This structure involves the tax investor making an investment in the partnership or limited liability company in exchange for the majority of the tax attributes (for example, federal tax credits,

[84] AB 1451, ch. 538, Stats. 2008.

[85] Section 73(e)(1).

[86] Section 73(e)(1)(A); BOE-64-SES, *Initial Purchaser Claim for Solar Energy System New Construction Exclusion*.

[87] SB 871, ch. 41, Stats. 2014.

depreciation, and net income) until the investor achieves its pre-established yield. The investor's share of these items is then reduced. The transaction is known as the "flip."

In the case of a partnership flip transaction, if the investment made by the tax investor causes it to obtain more than 50 percent of the capital and profits interests of the partnership or limited liability company (either upon the making of the initial investment or pursuant to subsequent changes in the capital and profits percentages owned by the investor required by the partnership or operating agreement), the change in control is excluded by the new construction exclusion and no reassessment of the ASES will occur. Once the investors achieve a pre-established yield or until after a pre-established period of time, at which time the tax attributes are reduced, and the developer obtains a majority of both the capital and profit interests of the partnership or limited liability company, no change in ownership or reassessment will occur. This type of transaction is limited to one with respect to any portion of an ASES.[88]

Legal Entity Change in Control or Ownership. County Assessors discover most real property changes in ownership via grant deeds or other documents recorded with the County Recorder. However, real property owned by a legal entity may undergo a "change in control or ownership" with no grant deed or other document recorded that could alert the County Assessor to a reassessment. These types of changes in control or ownership are reported directly to the BOE Legal Entity Ownership Program (LEOP) by the person or entity involved.

Existing law[89] requires legal entities to file a change in ownership statement (LEOP COS) with the BOE within 90 days of a change in control or ownership under section 64(c) or (d). In the case of a change in control under section 64(c), the person or legal entity that *acquired* control of the legal entity is responsible for filing the LEOP COS.

In addition to the self-reporting requirement to file a LEOP COS, the BOE may send a LEOP COS to an entity to complete and file with the BOE. Annually, the BOE canvasses legal entities with a query on the California Franchise Tax Board income tax return. County Assessors and other interested parties may send referrals reporting possible changes.

Once the BOE determines that a legal entity has undergone a change in control or ownership, the BOE notifies County Assessors of those legal entities' changes in control or ownership.

Commentary:

1. **Bill's Provisions.** The bill extends the current new construction exclusion repeal date to January 1, 2027, and specifies any ASES that qualifies for the exclusion under section 73 prior to January 1, 2027, shall continue to be excluded until there is a subsequent change in ownership.

2. **Section 73 is not a real property tax "exemption" for solar energy facilities, but a new construction "exclusion."** The new construction exclusion was created in 1980 via Proposition 7 to provide that the construction or addition of an ASES to an existing property, by itself, would not lead to a revaluation of the property for property tax purposes. A new construction exclusion terminates if there is a transfer of the property resulting in a property's change in ownership (a reappraisal event). In the case of any locally assessed large scale solar project, only the ASES improvements are eligible for the new construction exclusion, while the land remains subject to property tax.[90]

[88] SB 267, ch. 424, Stats. 2021.

[89] Sections 480.1 and 480.2.

[90] If the land is government owned, the land could become subject to a possessory interest. Generally, a taxable possessory interest exists when a taxpayer possesses an interest in government real property that is durable, independent, exclusive of the rights held by others in the real property and the interest provides a private benefit to the possessor.

3. **State-assessed properties are not eligible for the new construction exclusion because it is only applicable to locally assessed property.** In *ITT World Communications, Inc. v. City and County of San Francisco* (1985) 37 Cal.3d 859, the California Supreme Court ruled that Proposition 13's (Article XIII A) assessment rollback, its two percent limit on annual assessment growth, and its limit on current market value assessment only upon a change in ownership or new construction did not apply to state-assessed property, only to locally assessed property. As a result, taxable property in California is now generally split into two major categories: locally assessed property subject to Article XIII A assessment limitations and state-assessed property not subject to those assessment limitations. Thus, ASES owned by public utilities and subject to BOE assessment do not benefit from the section 73 new construction exclusion; value of these properties would continue to be captured under the unitary approach to value.

Costs: The BOE estimates a total agency cost of $1,734 and 21 personnel hours would be attributable to issuing one Letter to Assessors to inform County Assessors of the change in law and updating Assessors' Handbook sections.

Revenue Impact: This bill's revenue impact depends on how many systems apply under the bill's provisions. The BOE does not have this data available; thus, the revenue impact is indeterminable.

SECTIONS	ACTION	BILL NUMBER	CHAPTER NUMBER	SUBJECT
Revenue and Taxation Code				
§73	Amend	SB 1340	425	New Construction: Active Solar Energy Systems
§205.5	Amend	AB 1715	379	Disabled Veterans' Property Tax Exemption
§214	Amend	AB 1206	636	Property Tax Welfare Exemption
§214.15.1	Add	AB 1933	643	Property Tax Welfare Exemption
§214.18	Amend	AB 2651	656	Property Tax Welfare Exemption
§259.15	Amend	AB 1206	636	Property Tax Welfare Exemption
§2610.8	Add	SB 989	712	Property Tax Bill Disclosures
§2636.1	Add	SB 989	712	Property Tax Bill Deferments




LEGISLATIVE BULLETIN
PROPERTY TAX LEGISLATION 2022