

Issue Paper Number 04-006



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

PETITION FOR AMENDMENT OF PROPERTY TAX RULE 305.3

I. Issue

Should the Board grant the petition filed by the California Assessors' Association to amend subsections (b)(2) and (b)(3) of Property Tax Rule 305.3, *Application for Equalization Under Revenue and Taxation Code Section 469*?

II. Staff Recommendation

Staff recommends that the Board deny the petition filed by the California Assessors' Association to amend subsections (b)(2) and (b)(3) of Property Tax Rule 305.3.

III. Other Alternative(s) Considered

1. The Board could accept the California Assessors' Association petition to amend Property Tax Rule 305.3 and initiate the rulemaking process to amend subsections (b)(2) and (b)(3) with the attached proposed language (see Attachment A).
2. The Board could adopt alternative language to amend Property Tax Rule 305.3 and initiate the rulemaking process to amend subsection (b)(2) with the attached proposed language (see Attachment B).

IV. Background

Under Government Code section 15606, subdivision (c), the Board is given the power and duty to prescribe rules and regulations to govern local boards of equalization and assessment appeals boards when equalizing and county assessors when assessing. Pursuant to that authority, following a public hearing on November 28, 2001, the Board adopted section 305.3 of Title 18 of the California Code of Regulations, Subchapter 3, Local Equalization Property Tax Rules, to interpret the provisions of Revenue and Taxation Code section 469 relating to assessment appeal rights of certain taxpayers and appeals boards' jurisdiction to determine whether property subject to escape assessments resulted from an audit.

On September 29, 2003, the Board received a petition pursuant to Government Code section 11340.6 from the Honorable Joan Thayer, President, California Assessors' Association, proposing that the Board commence the rulemaking process to amend Property Tax Rule 305.3, *Application for Equalization Under Revenue and Taxation Code Section 469*, to specify that a taxpayer is required to present evidence of property "of material value" to an appeals board as a precondition of a hearing to appeal the original assessment of all property, and to delete a reference to property identified in writing by the taxpayer from the definition of the "result of an audit." On December 4, 2003, the Board ordered staff to commence the Property Tax Committee interested parties process to discuss the issues that were raised in the petition, with direction that the issue of low-value ordinance statutes be considered in conjunction with the interested parties meeting.

Revenue and Taxation Code section 469 requires that a county assessor audit at least once each four years the assessable trade fixtures and business tangible personal property with a full value of \$400,000 or more owned, claimed, possessed, or controlled by a taxpayer engaged in a profession, trade, or business. Section 469 further provides that for all audits:

(b)(3) If the result of an audit for any year discloses property subject to an escape assessment, then the original assessment of all property of the assessee at the location of the profession, trade, or business for that year shall be subject to review, equalization and adjustment by the county board of equalization or assessment appeals board pursuant to Chapter 1 (commencing with Section 1601) of Part 3 of this division, except in those instances when the property had previously been equalized for the year in question.

Subdivision (b)(3) was added by 1978 legislation amending section 469. Prior to the amendment, the only issue a taxpayer could appeal following an audit was the escaped assessment. In a letter to Governor Edmund G. Brown, Jr., dated August 31, 1978, the sponsors of the amendment (the Taxation Section of the California State Bar) expressed the intent of the legislation as follows:

The bill would allow a business taxpayer of property tax to have his entire assessment for a particular year at a business premises to be reviewed and equalized when the assessor by reason of an audit proposes an escape assessment. The bill is needed because many taxpayers do not protest assessments when the overall assessment at a business location seems fair, even though some components are over-assessed and some under-assessed. Then, years later the assessor by reason of audit, proposes an escape assessment for the under-assessed component. Under the present law, the taxpayer has no redress for the over-assessed component at the late date of the proposed escape assessment.

Thus, subdivision (b)(3) of section 469 was intended to address situations where a taxpayer was satisfied with an overall property assessment, even while recognizing that he/she was not in agreement with the

assessor's allocation of value among the different classes of property in the appraisal unit, e.g., personal property and fixtures. Subsequently, the assessor conducted an audit that disclosed one class of property subject to escape assessment, thereby increasing the overall assessment for the property for a particular year. Following the audit, the taxpayer could only appeal the escape assessment, even though the original value allocations were incorrect and another class of property was overassessed.

Disputes over the proper application of the foregoing provision led to the adoption of Property Tax Rule 305.3 to interpret, to implement, and to make specific the equalization provisions of Revenue and Taxation Code section 469. Several interested parties participated in the rulemaking process, including the California Assessors' Association, the California Association of Clerks and Election Officials, County Counsels' Association of California, California Taxpayers' Association, and industry representatives. Issues concerning Rule 305.3 came before the Board on April 5, 2000, November 1, 2000, May 30, 2001, June 21, 2001, October 24, 2001, and the current language was adopted on November 28, 2001.

California Assessors' Association Petition Requesting Rulemaking Action

The California Assessors' Association's (CAA's) September 29, 2003 petition sought amendments to Rule 305.3 to modify the definitions of "property subject to an escape assessment" and "result of an audit." The modification to "property subject to an escape assessment" specifies that a taxpayer who seeks a determination of such property by an appeals board must present evidence of property of "material value" that is subject to escape assessment. The petition explained the need for a material value standard as follows:

This sentence [definition] could create the misimpression that the taxpayer can control the Assessor's audit findings by presenting evidence to the Assessment Appeals Board (AAB) that a minor item of minimal value had not been assessed or was under assessed, and, therefore, should have been the subject of an audit escape assessment. For example, a taxpayer owning personal property assessed at \$50 million could contend before the AAB that the Assessor failed to levy an audit escape assessment on an item of property worth only \$250, even though that amount of assessed value would not be significant relative to the entire assessment. Such an appeal under 305.3(b)(2) would waste the time of the AAB, and provide a means by which the taxpayer could file appeals on its property years after the regular filing deadline had passed.

The modification to "result of an audit" deletes from that definition any property subject to escape assessment that has been identified in writing by the taxpayer. The phrase is proposed for deletion because the CAA believes that it suggests that the taxpayer may determine the result of an audit. The CAA maintains that only the assessor has the statutory duty to determine the result of an audit.

The proposed modifications are as shown below:

(b)(2) "Property subject to an escape assessment" means any individual item of the assessee's property that was underassessed or not assessed at all when the assessor made the original assessment of the assessee's property, and which has not been previously equalized by an appeals board, regardless of whether the assessor actually makes or enrolls an escape assessment...If no such finding is made by the assessor, the taxpayer may file an application and present evidence to the board of the existence and disclosure of property of material value subject to escape assessment.

(b)(3) "Result of an audit" means the final conclusions reached by the assessor during the audit process as described in Rule 191 and shall include a description of any property subject to escape assessment as noted in the audit work papers ~~or as identified in writing by the taxpayer.~~

Board staff distributed the proposed petition amendments and invited interested parties to submit suggestions or comments. On June 25, 2004, staff met with interested parties in Sacramento to discuss the proposed language contained in the CAA petition and alternative language proposed by other interested parties. Interested parties who attended the June 25 meeting included representatives of the CAA, the County Counsels' Association, the California Association of Clerks and Election Officials, Contra Costa County Assessor's and Counsel's Offices, Santa Clara County Assessor's and Counsel's Office, and industry representatives.

The parties were unable to agree on the specific language proposed in the petition and the CAA stated that it would revise its proposed modifications. The CAA revised the modification of "property subject to escape assessment" by defining the term "material value" as a minimum value of 1 percent of the taxpayer's audited property. The revision to "result of an audit" deletes the entire phrase specifying that it includes a description of property subject to escape assessment. According to this revision, the "result of the audit" would be limited to the assessor's final audit conclusions. The reasons for the revisions are set forth in Alternative 1. The revised modifications are shown in underline and strikeout below:

(b)(2) "Property subject to an escape assessment" means any individual item of the assessee's property that was underassessed or not assessed at all when the assessor made the original assessment of the assessee's property, and which has not been previously equalized by an appeals board, regardless of whether the assessor actually makes or enrolls an escape assessment...If no such finding is made by the assessor, the taxpayer may file an application and present evidence to the board of the existence and disclosure of property of material value subject to escape assessment. For purposes of this regulation only, "material value" means value of no less than 1% of the audited value of the taxpayer's trade fixtures and tangible personal property for the year under audit.

(b)(3) "Result of an audit" means the final conclusions reached by the assessor during the audit process as described in Rule 191 ~~and shall include a description of any property subject to escape assessment as noted in the audit work papers or as identified in writing by the taxpayer.~~

Board's Authority to Establish a Material Value Standard

An underlying legal issue discussed at the June 25 interested parties meeting was the Board's legal authority to adopt the CAA proposed amendment to subsection (b)(2) to require that a taxpayer present evidence of property "of material value" as a condition of requesting an appeals board to exercise its jurisdiction to determine whether the audit disclosed property subject to escape assessment. Interested parties were invited to submit their views on the Board's authority to adopt the proposed amendment, and the Board's Legal staff agreed to provide an opinion on the issue.

In a legal memorandum dated July 30, 2004, the Board's Legal staff concluded that the Board has authority to amend subsection (b)(2) of the rule to provide that a taxpayer is required to present evidence of property "of material value" subject to escape if the Board determined that such an amendment was necessary.

In that memorandum, the Board's Legal staff opined that, pursuant to Government Code section 15606, subdivision (c), the Board has authority to amend the provision of Rule 305.3 which recognizes an appeals board's authority to determine whether evidence submitted by a taxpayer establishes that it has jurisdiction to hear an application. Unlike the other provisions of Rule 305.3, the provision in issue concerning a taxpayer's right to request an appeals board's determination of an escape assessment was not adopted pursuant to the authority of section 469. Rather, as noted in the final statement of reasons for

adoption of the rule, case law precedent establishes that appeals boards have the authority to determine their own jurisdiction regardless of whether an application has been filed, by conducting a jurisdictional determination hearing.¹ Because a jurisdictional determination hearing functions only to elicit information from the audited taxpayer, the Board could reasonably conclude that there is a need for a material value threshold in order to ensure that only evidence of probative value is presented to an appeals board. In that event, the proposed language would effectuate the purpose of section 15606, subdivision (c), by providing guidance to appeals boards as to the type of evidence necessary to consider a request by a taxpayer to determine whether an audit disclosed property subject to escape assessment.

V. Staff Recommendation

Staff recommends that the Board deny the petition filed by the CAA to amend subsections (b)(2) and (b)(3) of Property Tax Rule 305.3.

A. Description of the Staff Recommendation

Currently, the language in Rule 305.3 interprets section 469 by specifying (1) the conditions under which an assessee may appeal, and (2) the property that may be appealed if the result of an audit discloses property subject to escape assessment. The language of section 469 is specific:

If the result of an audit for any year discloses property subject to an escape assessment, then the original assessment of all property of the assessee at the location of the profession, trade, or business for that year shall be subject to review, equalization and adjustment....

If the result of an audit for any year discloses property subject to an escape assessment, then the assessee has a right to appeal the assessed value of *all* the property, except property previously equalized, at the location of the profession, trade, or business that is the subject of the audit, regardless of whether the county assessor actually enrolls an escape assessment.² *All property* as that phrase is used in section 469 means land, improvements, and personal property.

The Board promulgated Rule 305.3, in part, in response to numerous complaints from audited taxpayers who claimed that some assessors had deliberately ignored audit results and "walked away" from an audit once evidence of escaped property was discovered, simply to deny the taxpayer the right to file an application for equalization of all of the taxpayer's property as provided in section 469. Likewise, taxpayers related instances where the county assessor had concluded an audit with a "no change" finding when, in fact, there was evidence of property subject to escape assessment.

In order to ensure that an audited taxpayer has not been improperly foreclosed from appealing the original assessment of the property, the Board adopted the provision in subsection (b)(2) by which a taxpayer may request an appeals board to determine whether the result of the audit disclosed property subject to escape assessment. Such a determination is a function of an appeals board's inherent power to determine its jurisdiction over the taxpayer's application appealing the original assessment.

Subsection (b)(2)

Subsection (b)(2) specifies that if the assessor does not make a finding that the audit has disclosed "property subject to an escape assessment," a taxpayer may file an application and present evidence of property subject to escape assessment to an appeals board for its determination that the audit

¹ *Stevens v. Fox Realty Corp.* (1972) 23 Cal.App.3d 199, 204.

² *Heavenly Valley v. El Dorado County Board of Equalization* (2000) 84 Cal.App.4th 1323.

disclosed such property. The CAA petition requested that the fourth sentence in subsection (b)(2) be amended to require a taxpayer to present evidence of property "of material value" to an appeals board.

As stated above, the CAA has revised its request by adding a definition of "material value" as follows:

For purposes of this regulation only, "material value" means value of no less than 1% of the audited value of the taxpayer's trade fixtures and tangible personal property for the year under audit.

Staff believes that an appeals board exercising inherent power to determine its jurisdiction should have the opportunity to review the same information as was considered by the assessor. Therefore, in staff's view, the Board should not attempt to limit the appeals board's inherent jurisdictional authority by restricting the type of information presented to an appeals board in its determination of the results of an audit by adding a materiality requirement or by establishing a minimum property value requirement to subsection (b)(2).

Furthermore, a material value requirement would result in different standards for the assessor and the appeals board to make a finding of property subject to escape assessment. The first sentence of subsection (b)(2) defines "property subject to escape assessment" as:

... any individual item of the assessee's property that was underassessed or not assessed at all when the assessor made the original assessment of the assessee's property, and which has not been previously equalized by an appeals board, regardless of whether the assessor actually makes or enrolls an escape assessment.

The definition establishes no minimum value threshold for property that was underassessed or not assessed at all. Under the CAA proposal, an assessor would make a finding based on the result of the audit that includes all property, while an appeals board would have available for consideration evidence of only property "of material value" as defined therein. Thus, the material value requirement might preclude an appeals board from making a finding of property subject to escape assessment consistent with the plain language of the definition.

Board staff, the California Taxpayers' Association, the Western States Petroleum Association, the California Independent Petroleum Association, and other industry representatives believe that the Board should not modify the current language of Rule 305.3, subsection (b)(2), that does not limit the evidence presented by a taxpayer to an appeals board.

Subsection (b)(3)

Subsection (b)(3) defines the phrase "result of an audit" as used in Revenue and Taxation Code section 469. The CAA has modified their original petition language and requests that the Board amend Rule 305.3, subsection (b)(3), as follows:

(b)(3) "Result of an audit" means the final conclusions reached by the assessor during the audit process as described in Rule 191 ~~and shall include a description of any property subject to escape assessment as noted in the audit work papers or as identified in writing by the taxpayer.~~

In staff's view, deletion of the language in subsection (b)(3) as requested by the CAA could prevent a taxpayer from exercising his/her appeal rights under section 469 by precluding a taxpayer's written

comments from being considered part of the result of an audit. Moreover, the CAA's proposed revision is inconsistent with Property Tax Rule 191, *Property Tax Audits, General*, that describes the audit process and the "result of an audit." In staff's view, Rule 191 makes clear that audit results include the taxpayer's written comments. That rule provides, in relevant part, that:

... Upon completion of the audit, the taxpayer shall be given the auditor's findings in writing with respect to data which would alter any previously enrolled assessment. The taxpayer shall be given an opportunity to make written and/or oral response thereto, and his written comments shall become part of the audit report.

After having considered the results of the audit, including discussions with and written comments of the taxpayer, the assessor shall inform the taxpayer of his conclusions as to the value of the property and may (1) cause an escape assessment to be made, (2) make an assessment subject to penalty, or (3) inform the taxpayer of his right to a cancellation of assessment or a refund of taxes.

Rule 191 describes the following steps in the audit process:

- Upon completion of the audit, the taxpayer will be given the audit findings.
- The taxpayer will be given an opportunity to make written and/or oral responses to the auditor's findings.
- The taxpayer's written comments shall become part of the audit report.
- The assessor will consider the results of the audit that includes that audit report with the taxpayer's written comments.
- The assessor shall reach a final conclusion for the audit, which may or may not include all of the findings and/or the taxpayer's comments in the audit report.
- The assessor shall inform the taxpayer of the final conclusions of the audit.

The provisions in Rule 191 give the taxpayer the opportunity to provide the assessor with information to correct errors that the taxpayer believe exist in the audit findings, including information about property subject to escape assessments, and those comments become part of the results of the audit. This opportunity to respond is an essential element in the audit process. The current language of subsection (b)(3) interprets and implements Rule 191 as well as section 469 by providing that a taxpayer's comments are considered as part of the result of the audit.

As explained above, the "result of an audit" consists of the audit findings and any comments the taxpayer makes concerning those findings. The assessor's "final conclusion" is the final stage in the audit process summarizing the assessor's analysis of the data. Thus, the CAA's amendment would be inconsistent with Rule 191 by defining "result of an audit" as the "final conclusion" and would thereby eliminate consideration of the taxpayer's comments regarding the audit findings in those instances where the assessor fails to include those comments in the "final conclusion."

Board staff, the California Taxpayers' Association, the Western States Petroleum Association, the California Independent Petroleum Association, and other industry representatives believe that the current language of Rule 305.3, subsection (b)(3), is consistent with the intent of section 469 and should be retained.

B. Pros of the Staff Recommendation

The current language in Rule 305.3, subsection (b)(2), provides that an appeals board is not precluded from reviewing the same evidence disclosed by the audit as was considered by the assessor. The

current language also ensures that an appeals board will make a determination of property subject to escape assessment consistent with the definition set forth in subsection (b)(2) which provides in relevant part that "property subject to an escape assessment" means "any individual item of property that was underassessed or not assessed in any year of the audit." Furthermore, the definition of "material value" sets an arbitrary limit for evidence of property subject to escape assessment. For many businesses, an assessor would make an escape assessment of property with a value far less than 1 percent of the taxpayer's audited property.

The current language of subsection (b)(3) is consistent with the description of the audit process as provided in Rule 191 and ensures that the taxpayer's comments are part of the results of an audit and thereby afford the taxpayer the appeal rights set forth in section 469.

C. Cons of the Staff Recommendation

Maintaining the current language in Rule 305.3, subsections (b) and (c), may allow a large business taxpayer to appeal all of its property (land, structures, personal property) by producing evidence of escaped property of negligible value in circumstances where the assessor has concluded that no property was subject to escape assessment.

D. Statutory or Regulatory Change

Action by the Board will amend section 305.3 of Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

Rule amendments are routinely prepared and any associated costs are accommodated within the Board's existing budget. There are no other costs.

2. Revenue Impact

See attached Revenue Estimate

G. Taxpayer/Customer Impact

Amendment of Property Tax Rule 305.3 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

H. Critical Time Frames

None

VI. Alternative 1

The Board could accept the CAA petition to amend Property Tax Rule 305.3 and initiate the rulemaking process to amend subsections (b)(2) and (b)(3) with the attached proposed language (see Attachment A).

A. Description of the Alternative

During the rulemaking process for the adoption of Rule 305.3 in 2000 and 2001, the CAA expressed many concerns regarding the proposed definitions of the phrases "property subject to an escape assessment" and "result of an audit." The CAA stated that the language ultimately adopted by the Board contradicted the legislative intent of section 469 and other provisions of the Revenue and Taxation Code by giving business taxpayers a "second chance" to appeal their property values, and by establishing an equalization process that was inefficient and unworkable. The CAA filed the petition to request amendments to the rule that address those concerns.

Subsection (b)(2)

As stated above, the CAA has revised the proposed amendment of subsection (b)(2) of Rule 305.3 as follows:

"Property subject to an escape assessment" means any individual item of the assessee's property that was underassessed or not assessed at all when the assessor made the original assessment of the assessee's property, and which has not been previously equalized by an appeals board, regardless of whether the assessor actually makes or enrolls an escape assessment...If no such finding is made by the assessor, the taxpayer may file an application and present evidence to the board of the existence and disclosure of property of material value subject to escape assessment. For purposes of this regulation only, "material value" means value of no less than 1% of the audited value of the taxpayer's trade fixtures and tangible personal property for the year under audit.

In a letter dated July 13, 2004, the CAA states:

The CAA's position is that in subsection (b)(2) the original proposed language "of material value subject to escape assessment" be followed with our proposed quantitative definition of "material value" as follows: ... This is a reasonable attempt to define materiality, which we believe is not prohibited by the statutes and should be permitted as an accepted and recognized practice used by accountants and auditors.

The Santa Clara County Counsel's office states in a letter dated July 8, 2004 that the:

pending petition to revise Section 305.3 (b)(2) simply revises the existing language to state that if the Assessor's audit does not include a finding that there is property subject to escape assessment, then the taxpayer may file an application and present evidence to the board of the existence and disclosure of property of material value. The same authority under which the SBE first promulgated 305.3 (b)(2) in order to create this new hearing opportunity, is that same authority which now permits the requested revision in order to more clearly define the parameters for when such a hearing may take place.

With respect to the Board's authority to add a material value requirement, the CAA stated in a letter dated July 8, 2004 that:

Government Code section 15606(c) grants quasi-legislative authority to the State Board of Equalization to adopt rules and regulations governing the local assessment appeal boards equalization process. See *Helene Curtis, Inc. v. Assessment Appeals Bd.* (1999) 76 Cal.App.4th 124. Under this grant of authority, the SBE may promulgate rules and regulations that are consistent with the applicable statutes and which "fill in the details of the statutes enacted by the Legislature." See *Helene Curtis, Inc., supra*, at 129; *Masonite Corp. v. Superior Court* (1994) 25 Cal.App.4th 1045, 1053; *Dyna-Med, Inc. v. Fair Employment & Housing Com.* (1987) 43 Cal.3d 1379, 1389; Government Code section 11342.2. Revenue and Taxation Code ("RT Code") section 469 neither permits nor prohibits the inclusion of a materiality requirement as part of the mandatory property tax audit process. The California Assessors' Association also notes that the concept of "materiality" is a longstanding and fully accepted auditing/accounting concept utilized in the auditing of corporations and other businesses. It may therefore be reasonably assumed by the SBE that the Legislature was aware of the presence of this audit concept when it enacted RT Code 469 in the 1970s. The CAA submits that the inclusion of a materiality element into the RT Code section 469-audit process is a reasonable detail that is not mentioned in any fashion by the statute. This legal justification is also consistent with past SBE legal staff advice to the State Board of Equalization regarding prior property tax regulations adding details to the implementation of other property tax statutes by SBE rule.

Subsection (b)(3)

As stated above, the CAA has revised the proposed amendment of subsection (b)(3) of Rule 305.3 as follows:

(b)(3) "Result of an audit" means the final conclusions reached by the assessor during the audit process as described in Rule 191 ~~and shall include a description of any property subject to escape assessment as noted in the audit work papers or as identified in writing by the taxpayer.~~

The CAA states that the last portion of the sentence could be misinterpreted to allow a taxpayer to control the final conclusions of the assessor's audit by merely stating in writing what property has escaped assessment. This potential interpretation is contrary to two published California appellate opinions³ that make it clear that the assessor, and not the taxpayer, determines the results of an audit conducted pursuant to Revenue and Taxation Code section 469.

In support of the revised amendment, the CAA stated in the July 8 letter that:

The CAA believes that this definition of "result of an audit" is clear, concise, and straightforward. Furthermore, such a simple, clear and straightforward definition integrates seamlessly with the rest of the regulatory framework already in place. It directs the reader to Rule 191. Rule 191 sets forth the requirements for what must be included in the audit report and directs that the taxpayer's written comments shall become part of the audit report. In addition, Rule 305 (b)(2) provides a venue for the taxpayer's grievance to be addressed by an appeals board when the taxpayer believes that the property subject to escape assessment has been disclosed to the assessor, but the assessor fails to issue an escaped assessment.

³ *Heavenly Valley v. El Dorado County Board of Equalization* (2000) 84 Cal.App4th 1323; *Apple Computer, Inc. v. County of Santa Clara Assessment Appeals Board* 105 Cal.App.4th 1355.

B. Pros of the Alternative

Amending subsection (b)(2) would prevent a taxpayer from seeking equalization of all of its property in circumstances where the taxpayer seeks to present evidence of property of negligible value that was underassessed or not assessed at all. The amendment of subsection (b)(3) would ensure that assessors have the ability to properly exercise their duty of determining the result of the audit.

C. Cons of the Alternative

Amending the current language in subsection (b)(2), as provided in Alternative 1, would prevent an appeals board from considering all information available to the assessor during the course of the audit, unless the evidence meets the 1 percent threshold established by the proposed amendment. For some larger business taxpayers, the 1 percent value threshold would require that the escaped property exceed millions of dollars. In that event, if a taxpayer had evidence of escaped property of substantial value that did not meet the value threshold, the appeals board would be barred from exercising its inherent authority to determine whether it had jurisdiction to hear a taxpayer's appeal of the original assessment of all the property. A material value requirement would also establish a standard of review for the appeals board inconsistent with the definition of "property subject to escape assessment."

Amending the current language in subsection (b)(3), as provided in Alternative 1, would make the rule inconsistent with Rule 191 in that it would make the definition of "result of an audit," for purposes of interpreting the equalization provisions of section 469, the assessor's "final conclusion." As provided in Rule 191, the final conclusion reached by the assessor may or may not reflect any written comments provided by the taxpayer regarding the results of the audit. Thus, under the CAA definition, an assessor could prevent an appeals board from considering evidence of escaped property simply by not including such evidence either as determined by the auditor's findings or as provided by the taxpayer in the final conclusions.

D. Statutory or Regulatory Change

Action by the Board will amend section 305.3 of Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

Rule amendments are routinely prepared and any associated costs are accommodated within the Board's existing budget. There are no other costs.

2. Revenue Impact

See attached Revenue Estimate

G. Taxpayer/Customer Impact

Amendment of Property Tax Rule 305.3 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

H. Critical Time Frames

None

VII. Alternative 2

The Board could adopt alternative language to amend Property Tax Rule 305.3 and initiate the rulemaking process to amend subsection (b)(2) with the attached proposed language (see Attachment B).

A. Description of the Alternative

The CAA September 29, 2003 original petition language requested that subsection (b)(2) be amended as follows:

"Property subject to an escape assessment" means any individual item of the assessee's property that was underassessed or not assessed at all when the assessor made the original assessment of the assessee's property, and which has not been previously equalized by an appeals board, regardless of whether the assessor actually makes or enrolls an escape assessment...If no such finding is made by the assessor, the taxpayer may file an application and present evidence to the board of the existence and disclosure of property of material value subject to escape assessment.

The CAA provided the following in support of their request for the above amendment:

This sentence could create the misimpression that the taxpayer can control the Assessor's audit findings by presenting evidence to the Assessment Appeals Board (AAB) that a minor item of minimal value had not been assessed or was under assessed, and, therefore, should have been the subject of an audit escape assessment. For example, a taxpayer owning personal property assessed at \$50 million could contend before the AAB that the Assessor failed to levy an audit escape assessment on an item of property worth only \$250, even though that amount of assessed value would not be significant relative to the entire assessment. Such an appeal under 305.3(b)(2) would waste the time of the AAB, and provide a means by which the taxpayer could file appeals on its property years after the regular filing deadline had passed.

B. Pros of the Alternative

Amending subsection (b)(2), as provided in Alternative 2, would eliminate misinterpretation and misapplication of the section 469 equalization provisions. The objectives in the assessor's audit are to verify substantial compliance and to recognize any material discrepancies between the taxpayer's reporting and its books and records. The belated disclosure by the taxpayer of a minor item of minimal value relative to the overall assessment should not require the assessor to reopen the audit and issue new audit findings. Consequently, any taxpayer availing itself of the procedure outlined in subsection (b)(2) should be required to demonstrate that any property that is purportedly "subject to escape assessment" be of material value within the context of that audit. The issue of materiality would then be decided by the appeals board based on the evidence presented.

C. Cons of the Alternative

Maintaining the current language in subsection (b)(2) will ensure that an appeals board may consider evidence of any individual item of property that was underassessed or not assessed in any year of the audit consistent with the definition of "property subject to escape assessment" specified in that subsection.

D. Statutory or Regulatory Change

Action by the Board will amend section 305.3 of Title 18 of the California Code of Regulations, Subchapter 3.

E. Administrative Impact

None

F. Fiscal Impact

1. Cost Impact

Rule amendments are routinely prepared and any associated costs are accommodated within the Board's existing budget. There are no other costs.

2. Revenue Impact

See attached Revenue Estimate

G. Taxpayer/Customer Impact

Amendment of Property Tax Rule 305.3 will affect administrative procedures for the assessment appeals process at the county level and the functions of the clerks of the appeals boards, appeals board members, county assessors, county counsels, and each taxpayer seeking a reduction in assessment of his or her property's value following an audit conducted pursuant to section 469.

H. Critical Time Frames

None

Prepared by: Property and Special Taxes Department; Assessment Policy and Standards Division
Legal Department; Property Tax Division

Current as of: August 9, 2004

State of California
BOARD OF EQUALIZATION
PROPERTY TAX RULES

Chapter 1. State Board of Equalization – Property Tax
Subchapter 3. Local Equalization
Article 1. Hearing by County Board

**RULE 305.3. APPLICATION FOR EQUALIZATION UNDER REVENUE AND TAXATION CODE
SECTION 469**

Authority Cited: Section 15606(c), Government Code.

Reference: Sections 23, 408, 469, 531, 531.8, 533, 534, 1603 and 1605, Revenue and Taxation Code.

(a) GENERAL. In addition to any rights of appeal of escape or supplemental assessments as described in Rule 305(d)(2) of this subchapter, if the result of an audit discloses property subject to an escape assessment for any year covered by the audit, then, pursuant to section 1605 of the Revenue and Taxation Code, an application may be filed for review, equalization, and adjustment of the original assessment of all property of the assessee at the location of the profession, trade, or business for that year, except any property that has previously been equalized for the year in question.

(b) DEFINITIONS. For purposes of subsection (a) of this regulation:

(1) "Audit" means any audit of the books and records of a taxpayer engaged in a profession, trade, or business who owns, claims, possesses, or controls locally assessable business tangible personal property and trade fixtures within the county.

(2) "Property subject to an escape assessment" means any individual item of the assessee's property that was underassessed or not assessed at all when the assessor made the original assessment of the assessee's property, and which has not been previously equalized by an appeals board, regardless of whether the assessor actually makes or enrolls an escape assessment. Property is subject to an escape assessment even if the audit discloses an overassessment of another portion of an item of the property, and the amount of the underassessment could be offset completely by the amount of overassessment. If the audit discloses that any property was subject to an escape assessment, the assessor shall include that fact as a finding presented to the taxpayer as required by Rule 191. If no such finding is made by the assessor, the taxpayer may file an application and present evidence to the board of the existence and disclosure of property of material value subject to escape assessment. **For purposes of this regulation only, "material value" means value of no less than 1% of the audited value of the taxpayer's trade fixtures and tangible personal property for the year under audit.** If the board determines that property subject to escape assessment was disclosed as a result of an audit, the board shall permit the taxpayer's section 469 appeal.

(3) "Result of an audit" means the final conclusions reached by the assessor during the audit process as described in Rule 191 ~~and shall include a description of any property subject to escape assessment as noted in the audit work papers or as identified in writing by the taxpayer.~~

(4) "Original assessment" means the assessment and any subsequent roll corrections or roll changes prior to the date of the commencement of the audit for the roll year for which the result of the audit discloses property subject to an escape assessment.

(5) "All property of the assessee" means any property, real or personal, assessed to the assessee, or the assessee's statutory or legal predecessor in interest, at the location of the profession, trade, or business for the year of the audit.

(6) "Location of the profession, trade, or business" means a site, as determined by the board, where the property subject to the escape assessment is located. Site includes all property within the same appraisal unit as the property that is subject to escape assessment.

Site also includes other property not within the same appraisal unit as the property that is subject to escape assessment, when the other property and the property that escaped assessment function as part of the same economic unit of the profession, trade, or business. A "location of the profession, trade, or business" may include multiple parcels of real property, noncontiguous parcels, parcels with separate addresses, and parcels in separate revenue districts within the county.

(7) "Property that has been previously equalized for the year in question" means that the board has previously made a final determination of full value for that item, category, or class of property that was the subject of an assessment appeals hearing or was the subject of a stipulated agreement approved by the board. An item, category, or class of property, or portion thereof, shall be deemed to have been the subject of a hearing or of a stipulated agreement only to the extent the board's decision or the stipulated agreement specifically identify the value of such item, category, or class, or portion thereof, as having been contested and resolved at hearing or as having been agreed to by the parties in stipulation.

(c) NOTICE OF AUDIT RESULTS. Upon completion of an audit of the assessee's books and records, the assessor shall notify the assessee in writing of the results of the audit as defined in subsection (b)(3) of this rule for all property, locations, and years that were the subject of the audit. At the request of the assessee, the assessor shall permit the assessee or his or her designated representative to inspect or copy any information, documents, or records relating to the audit in accordance with the provisions of Revenue and Taxation Code section 408.

(d) NOTICE FOR FILING AN APPLICATION. An application shall be filed with the clerk no later than 60 days after the date of mailing by which the assessee is notified that the result of the audit has disclosed property subject to escape assessment. The notice shall be mailed to the assessee by regular United States mail directed to the assessee at the assessee's latest address known to the assessor, unless, prior to the mailing of the notice, the assessor is notified in writing by the assessee of a change in address. The notice for purposes of filing an application shall be one of the following, depending upon the conclusion(s) of the audit:

(1) Where an escape assessment is enrolled by the assessor, the notice shall be the tax bill based upon the results of the audit and resulting escape assessment(s) for counties of the first class or any county that has adopted a resolution pursuant to Revenue and Taxation Code section 1605, subdivision (c). If the county is not a county of the first class or has not adopted a resolution pursuant to Revenue and Taxation Code section 1605, subdivision (c), the notice of escape assessment pursuant to Revenue and Taxation Code section 534 shall serve as the notice.

(2) Where the assessor does not enroll an escape assessment resulting from the audit or when the escape assessment is enrolled but offset pursuant to Revenue and Taxation Code section 533, the assessor's written notification of the audit results for the property, locations, and each year that were the subject of the audit as described in subsection (c) of this rule shall be the notice. The notice of audit results showing property subject to escape assessment for each year shall indicate that it is the notice of the assessee's right to file an application.

(e) EXAMPLES. The following examples are illustrative of the foregoing criteria. Examples 1 and 2 concern "who may file" an application on the assessee's property. Examples 3, 4, and 5 clarify the "location" of the profession, trade, or business.

Example 1: Taxpayer DRK owns and is assessed for land, a building, and business property. DRK leases the entire business to RCJ. The county assessor conducts an audit of DRK and the result of the audit discloses property subject to an escape assessment. DRK, as the assessee, can file an application for equalization for all property, real and personal, where the property subject to the escape assessment is located. In addition, RCJ may file an application for equalization of DRK's property if RCJ qualifies as a person affected pursuant to rule 302 of this subchapter.

Example 2: Taxpayer DRK owns and is assessed for land and a building. DRK leases the land and building to RCJ. RCJ operates a business in DRK's building and is assessed for business tangible personal property and trade fixtures. The county assessor conducts an audit of RCJ, and the result of the audit discloses property subject to an escape assessment. RCJ, as the assessee, can file an application for equalization on his personal property and trade fixtures only. RCJ cannot file an application on DRK's land and building as this is not property of the assessee. In addition, since DRK is not a person affected

pursuant to rule 302 of the subchapter, he cannot file an application on either his land and building or RCJ's personal property and fixtures.

Example 3: An assessee conducts a profession, trade, or business on a campus-like setting that is composed of three separate buildings. Each building has its own address and assessor's parcel number and is owned and operated by the same assessee. If an audit discloses any property subject to an escape assessment, then all property of the assessee on the campus is eligible for equalization if the board determines that it functions and is operated as one economic unit of a profession, trade, or business.

Example 4: An assessee operates five grocery stores in a county. Although the stores are owned and operated by one assessee, carry the same type of merchandise, and share in common advertising, each store operates independently. If property subject to an escape assessment is discovered only at one store, the property at that store's location is subject to equalization following an audit. The other four stores are not considered property at the site of the profession, trade, or business where the escape assessment occurred, as they operate independently as separate economic units.

Example 5: An assessee owns and operates a department store with a parking garage on an adjacent parcel. The parcel that houses the parking garage has no personal property or fixtures located on it. If an audit discloses personal property subject to an escape assessment for the department store, the parking garage would also be eligible for equalization if the board determines that the parcels with the garage and the store are part of the same appraisal unit or economic unit of the profession, trade, or business.

(f) JURISDICTION OF THE BOARD. Nothing in this rule shall be interpreted to limit or enlarge a board's jurisdiction under specific statutory provisions or other rules of this subchapter.

History: Adopted November 28, 2001, effective May 17, 2002. The rule was added to interpret the equalization provisions of section 469 of the Revenue and Taxation Code by clarifying the conditions under which an assessee may file an application for assessment appeal based on the result of an audit. When the result of an audit discloses property subject to escape assessment, section 469 provides that the assessee may appeal the original assessment of all property at the location of the business, trade or profession.

State of California
BOARD OF EQUALIZATION
PROPERTY TAX RULES

Chapter 1. State Board of Equalization – Property Tax
Subchapter 3. Local Equalization
Article 1. Hearing by County Board

**RULE 305.3. APPLICATION FOR EQUALIZATION UNDER REVENUE AND TAXATION CODE
SECTION 469**

Authority Cited: Section 15606(c), Government Code.

Reference: Sections 23, 408, 469, 531, 531.8, 533, 534, 1603 and 1605, Revenue and Taxation Code.

(a) GENERAL. In addition to any rights of appeal of escape or supplemental assessments as described in Rule 305(d)(2) of this subchapter, if the result of an audit discloses property subject to an escape assessment for any year covered by the audit, then, pursuant to section 1605 of the Revenue and Taxation Code, an application may be filed for review, equalization, and adjustment of the original assessment of all property of the assessee at the location of the profession, trade, or business for that year, except any property that has previously been equalized for the year in question.

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(3) "Result of an audit" means the final conclusions reached by the assessor during the audit process as described in Rule 191 and shall include a description of any property subject to escape assessment as noted in the audit work papers or as identified in writing by the taxpayer.

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of the same economic unit of the profession, trade, or business. A "location of the profession, trade, or business" may include multiple parcels of real property, noncontiguous parcels, parcels with separate addresses, and parcels in separate revenue districts within the county.

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BOARD OF EQUALIZATION
REVENUE ESTIMATE
ISSUE #04-006



**PETITION FOR AMENDMENT OF
PROPERTY TAX RULE 305.3**

Staff Recommendation

Staff recommends that the Board deny the petition filed by the California Assessors' Association (CAA) to amend subsections (b)(2) and (b)(3) of Property Tax Rule 305.3.

Alternative

The Board could accept the CAA petition to amend Property Tax Rule 305.3 and initiate the rulemaking process to amend subsections (b)(2) and (b)(3).

Background, Methodology, and Assumptions

The California Assessors' Association (CAA) is seeking to amend Rule 305.3 to change the definitions of "property subject to an escape assessment" and "result of an audit" to specify that a taxpayer is required to present evidence of property of material value to an appeals board and to delete a reference to property identified in writing by the taxpayer from the definition of the result of an audit. These changes would limit the type of information that could be presented to an appeals board and could preclude appeals hearings to equalize all property of a taxpayer where the escaped property did not meet the "material value" standard or where the evidence of escaped property is not included in the final conclusions.

There would be a revenue impact under the CAA proposal to the extent that property values would have been changed in those cases where an appeal is precluded because the escaped property did not meet the "material value" standard or where the evidence of escaped property is not included in the final conclusions. It is not possible to determine the revenue impact of this proposal as the information regarding the number of properties that would be potentially affected, the value of those properties and any change in value as a result of the appeal hearing cannot be predicted.

Revenue Summary

Staff Recommendation

There is no revenue impact under the staff recommendation.

California Assessors' Association Alternative

It is likely that there would be a revenue impact under the CAA proposal since the proposed changes could preclude appeals hearings to equalize all property of a taxpayer where the escaped property did not meet the "material value" standard or where the evidence of escaped property is not included in the final conclusions. Due to the lack of predictability of the factors involved, it is not possible to determine the impact.

Preparation

This revenue estimate was prepared by Aileen Takaha Lee, Research and Statistics Section. This revenue estimate was reviewed by Mr. David E. Hayes, Manager, Research and Statistics Section and Dean Kinnee, Assessment Policy and Standards Division, Property and Special Taxes Department. For additional information, please contact Aileen Takaha Lee at (916) 445-0840.

Current as of August 10, 2004.