STATE OF CALIFORNIA

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No. 81/19

TO COUNTY ASSESSORS:

RECENT JUDICIAL DECISIONS

The State Board of Equalization's legal staff has prepared a synopsis of recent judicial decisions categorized by subject matter as follows:

Appraisal

State Board of Equalization's Previous Use of RCNLD As A Ceiling In Appraising Public Utility Property Did Not Foreclose It From Adopting Other Valuation Methods.

In years prior to fiscal year 1975-1976, the State Board of Equalization had followed a published policy of valuing public utility property at not more than its reproduction cost new less depreciation (RCNLD). In 1975-1976 and 1976-1977, the Board assessed property owned by plaintiff, a public utility, using market data on sales of similar property, replacement costs, historical costs less depreciation, and, primarily, capitalization of income. The result was an assessed valuation exceeding RCNLD. Plaintiff contended that its property could not lawfully be assessed at a value in excess of RCNLD.

The Court of Appeal held that the Board was free to alter its method of assessing plaintiff's property subject to requirements of fairness and uniformity, and that its abandonment of RCNLD as a ceiling was not arbitrary, in excess of discretion, or in violation of the standards prescribed by law. The Court held further that the Board's capitalization of income method was proper even though the valuation exceeded RCNLD. ITT World Communications, Inc. v. County of Santa Clara, (1980) 101 Cal. App. 3d 246.

Refer to California's assessors' only letter, No. 80/12, Judgment: ITT World Communications, Inc. v. County of Santa Clara et al, issued November 7, 1980.

Equalization

Former Revenue and Taxation Code Section, 4831 Can Be Used Only To Correct Clerical Errors That Are Apparent From Inspection Of The Property, Records Of Assessee, Roll, Or Assessor's Papers.

A mining company brought an action to obtain a refund of taxes paid under protest. A mineral interest owned by the company had been appraised in 1974 using the capitalization of income method in which the appraiser had not allowed a replacement capital deduction after 1977. The company contended that the replacement capital allowance utilized by the appraiser was too low. Company officials met with the appraiser to provide him with a revised appraisal which included a much higher allowance for replacement capital and allowed for annual replacement capital for each year through 2003. The appraiser adopted the company's figures and based the assessed value of the mineral interest on those figures. Early in 1975, the appraiser's predecessor noticed that the 1974-1975 value for the mineral interest was substantially lower than the valuations made in previous years. A review of the documents disclosed that replacement capital had been allowed until 2003. The appraiser, as he later testified, had misunderstood the company's calculations and assumed that the allowance ended in 1978. The assessor corrected the appraiser's error pursuant to former Revenue and Taxation Code, Section 4831(a), which provided for correcting clerical errors discovered after delivery of the assessment roll. The assessed value was then increased. The taxpayer paid the increased assessment under protest and brought an action for refund.

The California Supreme Court held that former Section 4831(a) was intended to provide a method of correcting clerical defects which could be ascertained from an inspection of the property, the records of the assessee, or from any papers in the assessor's office. The Court found that in this case, any error committed by the appraiser was not ascertainable from an inspection of the papers in the assessor's office or any of the other sources listed in the statute. Therefore, the alteration of the assessment roll and the levy of the additional taxes was unauthorized. United States Borax & Chemical Corp. v. Mitchell, (1980) 27 Cal. 3d 84.

The Assessor May Not Use Information Relating to The Business Affairs Of Another Taxpayer To Defend Against An Application For Reduction of Assessment.

Plaintiff, through its parent company, acquired the assets of a petroleum company. Prior to making a bid on the assets, plaintiff prepared a complex appraisal of the future net income stream derivable from the company's oil and gas producing properties. Pursuant to his power under Revenue and Taxation Code, Section 441(d), to require a taxpayer to provide details of property acquisition transactions, the assessor obtained plaintiff's records concerning the transaction. When a competitor of plaintiff filed an application seeking reduction of the assessment of one of its oil and gas producing properties, the assessor proposed to introduce evidence of plaintiff's purchase as a comparable sale. Plaintiff sought a preliminary injunction restraining the assessor from disclosing information pertaining to the appraisal. Plaintiff contended that the information was a corporate secret, disclosure of which would result in serious disadvantage to plaintiff in bidding on future oil and gas property acquisitions. The assessor contended that the information was market data which he was entitled to disclose in defending his assessment of the competitor's property.

The Court of Appeal held that numerous items in the appraisal report such as plaintiff's assumptions as to the amount of oil recoverable, the cost of recovery, the future price of oil, the risk factor and the acceptable rate of return, did not constitute market data. These matters constituted business matters which the assessor could not disclose except under court order pursuant to Revenue and Taxation Code, Section 408(b). Market data is limited to the location of

the property, the date of the sale, and the consideration paid for the property. Chanslor-Western Oil & Dev. Co. v. Cook, (1980) 101 Cal. App. 3d 407.

Imports

Imported Goods Unloaded For Sale And Distribution To Customers Are Not Immune From Ad Valorem Property Taxation Under Pre-1976 Law.

Plaintiff, a seller and distributor, imported automobile tires by sea van. The tires were not packaged separately or in other containers. They were unloaded directly from the vans into a designated area of the warehouse, apart from the area for domestic tires. The tires were only removed from that area for distribution to plaintiff's other warehouses and to dealers. Plaintiff paid property taxes on its domestic inventory and claimed immunity for the imported tires. In 1975, the county levied an escape assessment on the imported tires. Plaintiff paid the assessment under protest and brought an action for refund.

In 1976, the United States Supreme Court reversed prior law and held that imported goods which had come to rest in the state were not immune from ad valorem taxation. The California Legislature responded by enacting Revenue and Taxation Code, Section 226, which provides for assessment of imported goods according to the law in effect prior to the Supreme Court decision unless the circumstances or equities warrant taxation. Plaintiff contended that its goods were immune from taxation under pre-1976 law and, therefore, such prior law was applicable to it pursuant to Revenue and Taxation Code, Section 226.

The Court of Appeal held that the tires were taxable under pre-1976 law. Under the prior law, when an importer enters a van to remove cargo for further storage until it is shipped to outlets for sale, the goods remain immune from taxation. However, when the importer enters the vans for the purpose of sales and distribution, the opening of the van constitutes the breaking of bulk and results in loss of immunity from taxation. Although plaintiff's tires were kept separate, transfers were made for distribution to other distributors, jobbers and retailers. There was no separation of tires intended for transfer to plaintiff's own warehouses and those intended for shipment to customers. Therefore, the entire shipment was subject to taxation. J. N. Ceazan Co. v. County of Los Angeles, (1980) 102 Cal. App. 3d 486.

Imported Goods Previously Immune From Ad Valorem Taxation Are Not Subject to Escape Assessments When The Goods Could Not Be Taxed Under Prior Law And No Circumstances Or Equities Warrant An Escape Assessment.

Sears imported foreign goods which were originally packed in cardboard boxes and shipped in cargo containers to California. On arrival, the goods were removed from the containers and stored in warehouses pending distribution to retail stores. In tax years 1973 and 1974, Sears filed, and was allowed, a claim for immunity from ad valorem taxation on the goods under the Import-Export Clause of the United States Constitution. In 1976, following a decision of the United States Supreme Court which held that imported goods that had come to rest in the state were not immune from ad valorem taxation, the assessor levied escape assessments on the 1973 and 1974 Sears' imports.

The court found that the law in effect prior to the Supreme Court decision provided that goods removed from sea vans and then stored in the importer's warehouse retained their immunity from taxation while awaiting further shipment to the importer's wholesale or retail outlets. The amendment to Revenue and Taxation Code, Section 226, which permits retroactive application of the Supreme Court decision if the goods were assessed before January 1976 and if it would be equitable to do so, was not applicable because Sears had believed its imported goods were immune from ad valorem taxation and had priced them accordingly. Sears, Roebuck & Co. v. County of Los Angeles, (1980) 105 Cal. App. 3d 58.

Proposition 13

The Limitations Imposed By Article XIII A Do Not Apply To The 1978-1979 Unsecured Roll.

The Board of Supervisors of San Diego County filed an action to determine whether the real property tax rate and valuation limitations of Constitution, Article XIII A, are applicable to property taxed on the unsecured roll for the tax year 1978-1979.

The California Supreme Court held that Constitution, Article XIII, Section 12, clearly provides that taxes on unsecured property, both real and personal, are to be assessed at the prior year's rate for the secured roll. The Court found that nothing in Proposition 13 suggested that it was intended to apply to unsecured taxes in the first year of its operation. Therefore, property on the 1978-1979 unsecured roll is to be taxed at the 1977-1978 secured rate. Board of Supervisors v. Lonergan, (1980) 27 Cal. 3d 855.

Refer to assessors' letter, No. 80/175, Recent Developments Regarding the 1978-1979 Unsecured Roll, issued December 5, 1980.

Note: A petition for hearing in the United States Supreme Cours has been filed.

Article XIII, Section 12(b), Does Not Mandate That Article XIII A Be Applied To The 1978-1979 Unsecured Roll.

A taxpayer sought a refund of taxes paid on property assessed on the 1978-1979 unsecured roll. The taxpayer contended that the application of the one percent rate limitation of Constitution, Article XIII A to the 1978-1979 unsecured roll was mandated by Constitution, Article XIII, Section 12(b), which provides that "in any year in which the assessment ratio is changed, the Legislature shall adjust the rate described in subdivision (a) to maintain equality between property on the secured and unsecured rolls". The taxpayer contended that adoption of Article XIII A resulted in a change in the assessment ratio and the Legislature made the required adjustment by enacting Revenue and Taxation Code, Section 2237.

The California Supreme Court held that the purpose of Article XIII, Section 12(b), was to assure that in any year in which the assessment ratio is changed, taxes on the unsecured roll are fairly assessed by adjusting the current rate for the unsecured roll to accurately reflect the rate for the prior years' secured roll. When the assessment ratio is changed, Section 12(b) requires that the rate be adjusted in accordance with the new assessed valuation in order to maintain uniformity in

taxation with the prior year's secured roll. The section was to be used to further successive year equality between the rolls, not to compel roll uniformity in the same year. Roy E. Hanson, Jr., Mfg. v. County of Los Angeles, (1980) 27 Cal. 3d 870.

Note: A Petition for hearing in the United States Supreme Court has been filed for Hanson's companion case, Board of Supervisors v. Lonergan.

State Board of Equalization's Rule Which Provided That The Value Of Real Property Shall Not Reflect Actual Market Value Depreciation After The Base Year Assessment Is Void.

Following enactment of Proposition 13, the Board of Equalization adopted Rule 461(b) which provided that the taxable value of real property shall not reflect changes for depreciation after the base year value has been established. On November 7, 1978, the voters adopted Proposition 8 which provided that the acquisition value of real property would be reduced to reflect a decline in value. The Board then amended Rule 461(d) which provided that the "decline in value" amendment applied only prospectively to the 1979-1980 tax year and tax years thereafter. Thus for the 1978-1979 tax year, former Rule 461(b) was to be applicable.

The Court held that the Board's rule, providing that the value of real property is not limited by fair market value for 1978-1979, is void. The Court found the rule to be in violation of California Constitution, Article XIII, Section 1, which provides that "all property in the state shall be taxed in proportion to its value, to be ascertained as directed by law...." The Court also held that Proposition 8, which provided that the acquisition value would be reduced to reflect a decline in real property value, was to be given retroactive effect as of the effective date of Proposition 13. State Board of Equalization v. Board of Supervisors, (1980) 105 Cal. App. 3d 813.

Refer to assessors' letter, No. 80/129, Judgment: State Board of Equalization v. San Diego County Assessment Appeals Board, issued August 19, 1980.

Note: Contra Costs County is preparing to challenge this decision in the near future.

Welfare Exemption

Church Owned Recreational Facilities Used Primarily By Church Boosters Club Are Held Not To Be Exempt From Property Tax.

The Peninsula Covenant Church owned property consisting of a community center building, a swimming pool, parking lots, five tennis courts, and a children's playground. The building contained meeting rooms, an office area, and a small bookstore. Ninety percent of the books sold were religious and the remaining 10 percent were sports books. Also, some tennis equipment was sold and the building had locker rooms and a sauna. The building was used for church activities, for training classes [Redacted], and for an operation which provided free food and clothing [Redacted]. The recreational facilities were primarily used by members of a church boosters organization, who paid a substantial membership fee to use the facilities and had priority in their use for six and one-half days a week. The recreational facilities were not open to the public and the members of the boosters had little or no contact with the church minister. The

county contended that the property did not qualify for the welfare exemption because it was not used exclusively for religious or charitable purposes.

The Court of Appeal held that the community center building, excluding the locker rooms and sauna, was entitled to the welfare exemption from property tax because it was used primarily as a center for the church's religious study and recreational groups and for the administrative and religious work of its minister. The fact that the center also contained a small nonprofit religious bookstore and that the building was infrequently used by nonchurch members for nonchurch functions did not alter the exemption. The statutory requirement that the property be used exclusively for religious activities does not foreclose some additional or complementary use. The Court also held that the church owned parking lots were exempt because they were noncommerical and were necessarily and reasonably required by the church for persons attending religious services and activities. However, the Court held that the swimming pool, tennis courts, locker rooms and sauna did not qualify for an exemption. Although the church members sometimes used these facilities, the primary user of the facilities was a church boosters organization. At the very least, the term "exclusive use" means that the property must be used primarily for exempt purposes. Peninsula Covenant Church v. County of San Mateo, (1979) 94 Cal. App. 3d 382.

Miscellaneous

Applicability Of Revenue And Taxation Code, Section 219, To Escape Assessment On Business Inventories Is Governed By The Law In Effect On The Lien Date Of The Year The Property Escaped Assessment.

Plaintiff filed business property statements for fiscal years 1972-1973 and 1973-1974 reporting inventory costs. The assessor used the reported costs as the basis for the business inventory assessment. A subsequent audit by the assessor disclosed that plaintiff's 1972 and 1973 property statements were incorrect, and the property had been underassessed for each of those years. The assessor entered escape assessments on the 1975-1976 tax roll. The escape assessments were made without any allowance for the partial exemption granted to business inventories by Revenue and Taxation Code, Section 219. Section 219 provided that "30 percent of the assessed value of such property shall be exempt from taxation through the 1972-1973 fiscal year... For the 1973-1974 fiscal year, 45 percent of the assessed value of such property shall be exempt...For the 1974-1975 fiscal year and fiscal years thereafter, 50 percent of the assessed value of such property shall be exempt...." The statute further provided that these exemptions did not apply to escape assessments. In 1974, Section 219 was amended to provide that the exemptions would apply to escape assessments unless the omission or misinformation was willful or fraudulent. Plaintiff contended that this amendment should apply to escape assessments entered on the 1975-1976 tax roll irrespective of the year in which the escape occurred.

The Court of Appeal held that the right to the taxes on escape property accrues on the lien date, not on the date of entry on the tax roll. Therefore, the extent of the exemption must be determined in accordance with the law in effect on the lien date of the years in which the escape occurred and plaintiff was not entitled to the exemption. California Computer Products, Inc. v. County of Orange, (1980) 107 Cal. App. 3d 731.

The Power Granted To the County Assessor By The Constitution Not To Allow Anyone To Escape A Just And Equal Assessment, Is Enforceable Even Without The Enactment of Statutory Authorization.

In 1971 and 1972, a company reported its costs for special tooling as inventory on its business property statement. On audit several years later, the assessor determined that the tooling should be valued as a fixed asset at a higher value. Escape assessments were then levied. The company argued that a tax could be collected retroactively only in those situations specifically provided for by statute and contended that retroactive collection in this situation was not specifically provided for. The county contended that the assessor has the right and the duty to impose escape assessments against property which has eluded taxation, no matter what the reason.

The Court of Appeal held that an escape assessment can, and must, be levied despite the Legislature's failure to specifically provide for one in the circumstances of this case. The direct constitutional grant of authority to the assessor not to allow anyone to escape a just and equal assessment may not be curtailed by the Legislature through either its silence or direct enactment. General Dynamics Corp. v. County of San Diego, (1980) 108 Cal. App. 3d 132.

Sincerely,

Verne Walton, Chief
Assessment Standards Division

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