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May 29, 1996

Mr. Steven M. Woodside, County Counsel
County of Santa Clara
County Government Center, East Wing
70 West Hedding Street
San Jose, California 95110-1770

Attn: Mr. James Rees,
Deputy County Counsel

Dear Mr. Woodside,

This is in response to your written inquiry of April 29, 1996 in which you requested an interpretation of the provision set forth in section 402.5 of the Revenue and Taxation Code and Board Property Tax Rule 324(d) which prohibits an assessment appeals board from considering comparable sales of real property which occur more than ninety (90) days after the valuation date. You specifically asked for our opinion as to whether the prohibition applies to the assessment appeals board's consideration of comparable sales occurring more than ninety (90) days beyond the valuation date when those sales are used to derive a capitalization rate.

In our view, the language of section 402.5 and its legislative history compel the conclusion that the section and the rule only apply when the comparable sales method of valuation is used. Accordingly, the section and the rule are not a prohibition on considering capitalization rates derived using sales occurring more than 90 days beyond the valuation date.

The section begins by stating its intended valuation method: "When valuing property by comparison with sales of other properties..." The section then lists qualitative factors which must be considered by an appraiser in determining comparability, including the requirement that the sales occur no later than 90 days after the lien date. The statute makes clear that its focus is on providing guidelines to enhance the accuracy of comparable sales market data. Moreover, a contemporary analysis which reviewed S.B. 754, the bill enacted as section 402.5, noted that "[w]hen valuing property *by the sales method*, S.B. 754 establishes a standard to guide assessors in the selection of comparable sales." (italics added) The legislative history clearly indicates an intent that section 402.5 should apply only to the comparable sales approach.

Section 402.5 sets forth a methodology for developing reliable comparable sales data and is in accordance with Property Tax Rule 4, which states that "[w]hen reliable market data are available with respect to a given real property, the preferred method of valuation is by reference to sales price." The rule goes on to make reference to sales prices of comparable properties that are used to value a subject property.

The purpose of section 402.5 does not harmonize with the basic rationale for using the income approach. As stated above, the sole purpose of section 402.5 is to generate a method of determining reliable comparable sales data. By contrast, when using an income approach, an assessor recognizes that, in the given situation, reliable comparable sales data are lacking. Property Tax Rule 8 states that the income approach "is the preferred approach for the appraisal of land when reliable sales data for comparable properties are not available. It is the preferred approach for the appraisal of improved real properties and personal properties when reliable sales data are not available and the cost approaches are unreliable . . ." An underlying assumption of the income approach is that unreliable sales data should not be used to value the property, whereas section 402.5 and Rule 4 contemplate that reliable comparable sales data are available and set forth criteria for ascertaining sales of properties which are most similar to the property that is the subject of the appraisal.

As you note in your letter, the court of appeal in Bank of America v. County of Fresno, 127 Cal.App.3d 295, 308, 179 Cal.Rptr. 497 (1981) upheld the trial court's ruling that the assessee should have been permitted to present evidence concerning an entire year's crop production and sales revenue at the equalization hearing even though it spanned more than the 90 days after the lien date. The court of appeal held that section 402.5 is "a rule which is restricted to fair market value assessments" and "should not apply to a capitalization income situation." Though the case seems to settle the issue of the applicability of section 402.5, in our view, the court misapplies the statute and its holding could be subject to challenge.

At the outset of the case, section 402.5 should not have been invoked as grounds for objection to the introduction of the assessee's evidence. The evidence which the assessee sought to introduce at the equalization hearing was not comparable sales data; it was crop production and sales revenue information for the year 1976. Section 402.5 mentions sales of property but says nothing about consideration of other information that is indicative of value. Here, the court of appeal failed to make the distinction and, instead, merely asserted without reasoning or authority that the section is "restricted to fair market value assessments" and "should not apply to a capitalization income situation."

The court probably meant "comparable sales" when it used the general term "fair market value", because the income approach is one of the methods used to arrive at a fair market value assessment. (Board Property Tax Rules 3 and 8). It would be illogical to say that the section applies to all valuation methods and then to exclude one of those methods.

In conclusion, in our view, the court reached the correct result in view of the statutory construction and legislative intent. However, for the foregoing reasons, we do not believe that the case can be cited as authoritative support for the position that the section and rule only apply when the comparable sales method of valuation is used.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon you or the assessor of any county.

Very truly yours,

Louis Ambrose
Staff Counsel

LA:so

cc: Mr. Lawrence Stone,
Santa Clara County Assessor
Mr. James Speed, MIC:63
Mr. Richard Johnson, MIC:64
Ms. Jennifer Willis, MIC:70

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JAMES E. SPEED,
Executive Director

March 30, 2000

Re: *Use of Post Lien Date Income Information for the Purposes of Developing an Opinion of Value Based on the Income Approach*

Dear Mr. :

This is in reply to your letter of March 13, 2000 in which you request a legal opinion concerning the use of post-lien date income information to value property by the income approach. According to your letter, the assessor's office has used an income approach to determine the value of business property that changed ownership in June 1987 that incorporated actual income earned by the business in 1987 and 1988. You dispute the assessor's use of post - June 1987 income and contend that under Revenue and Taxation Code section 110 when fair market value is determined by use of the income method, the income forecast must be based on information known or reasonably knowable as of the lien date.

Generally, we agree that income forecast must be based on information known or "reasonably knowable" as of the lien date. However, the language of Revenue and Taxation Code section 402.5 and its legislative history compel the conclusion that section only applies when the comparable sales method of valuation is used. Thus, section 402.5 does not apply to the use of income information obtained more than 90 days after the valuation date, and there are several court cases that approve the use of post-lien date information when valuation methods other than the comparable sales method are used.

Law and Analysis

Income Approach

With respect to income to be capitalized using the income approach, Property Tax Rule 8, subsection (c) provides in part that,

> The amount to be capitalized is the net return which a reasonably well informed owner and reasonably well informed buyers may anticipate on the valuation date

that the taxable property existing on that date will yield under prudent management and subject to such legally enforceable restrictions as such persons may foresee as of that date.

Thus, Rule 8 contemplates that a fair market value determined by the income approach will be based on the anticipated income from the property as of the valuation date.

In *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 564-566, the Supreme Court adopted the principle of anticipated income when it stated that the first step in the process of the income approach is "to determine prospective net income . . . by estimating future gross income and deducting therefrom expected necessary expenses . . ." As a result, the court held that: "The net earnings to be capitalized, therefore, are not those of the present owner of the property, but those that would be anticipated by a prospective purchaser." In *California Portland Cement Co. v. State Bd. of Equalization* (1967) 67 Cal.2d 578, 583, the Supreme Court affirmed its holding in *De Luz Homes* by reiterating that "anticipated income is the basis for an estimate of property value under the capitalized earning ability approach".

In *Bank of America v. County of Fresno* (1974) 127 Cal.App. 3d 295, to which you refer, the court held that, in order "to present a prima facie case of overassessment when property is assessed by the capitalization of income method, the taxpayer must present evidence of projected future income and expenses." In the course of its decision, the court addressed the use of post-lien date information hereinafter discussed.

A further consideration is whether a taxpayer has provided the assessor with the necessary information to employ that method based upon taxpayer's submission. In this instance, it is not clear from your letter what has occurred in this regard.

Section 402.5

Section 402.5 of the Revenue and Taxation Code, provides in pertinent part, that "When valuing property by comparison with sales of other properties, in order to be considered comparable, the sales shall be sufficiently near in time to the valuation date, . . .". That section further states that "near in time to the valuation date" does not include "any sale more than 90 days after the lien date." Board Property Tax Rule 324(d) interprets that provision of section 402.5 to prohibit an assessment appeals board from considering comparable sales of real property which occur more than ninety (90) days after the valuation date.

As quoted above, Section 402.5 begins by stating its intended valuation method: "When valuing property by comparison with sales of other properties. . ." The section then lists qualitative factors which must be considered by an appraiser in determining comparability, including the requirement that the sales occur no later than 90 days after the lien date. The

statute makes clear that its focus is on providing guidelines to enhance the accuracy of comparable sales market data. A contemporary analysis which reviewed S.B. 754, the bill enacted as section 402.5, noted that "[w]hen valuing property *by the sales method*, S.B. 754 establishes a standard to guide assessors in the selection of comparable sales." (italics added) Thus, the plain language of the statute and the legislative history clearly indicate an intent that section 402.5 should apply only when the comparable sales method of valuation is used.

Moreover, the purpose of section 402.5 does not harmonize with the basic rationale for using the income approach. As stated above, the sole purpose of section 402.5 is to generate a method of determining reliable comparable sales data. By contrast, when using an income approach, an assessor recognizes that, in the given situation, reliable comparable sales data are lacking. Property Tax Rule 8, subsection (a) states that the income approach "is the preferred approach for the appraisal of land when reliable sales data for comparable properties are not available. It is the preferred approach for the appraisal of improved real properties and personal properties when reliable sales data are not available and the cost approaches are unreliable . . ." An underlying assumption of the income approach is that unreliable sales data should not be used to value the property, whereas section 402.5 contemplates that reliable comparable sales data are available and sets forth criteria for ascertaining sales of properties which are most similar to the property that is the subject of the appraisal.

As you note in your letter, the court of appeal in *Bank of America v. County of Fresno* (1981) 127 Cal.App.3d 295, 308 upheld the trial court's ruling that the assessee should have been permitted at the appeals hearing to present evidence of an entire year's crop production and sales revenue at the equalization hearing even though it spanned a period more than the 90 days after the lien date. In making that determination, the court of appeal referred to section 402.5 as "a rule which is restricted to fair market value assessments [which] should not apply to a capitalization income situation":

> (4) Nor can we find the trial court erred in ruling that respondent should have been able to present evidence concerning the 1976 crop year production and sales revenue to corroborate the testimony of Sarabian and Miles. The evidence was excluded on the ground of irrelevancy, i.e., that no data later than 90 days after the lien date should be considered in arriving at the value of the property on the lien date. (See Revenue and Taxation Code §402.5) However, a rule which is restricted to fair market value assessments should not apply to a capitalization income situation "Relevant evidence" means evidence upon which responsible persons are accustomed to rely in the conduct of serious affairs; i.e., any evidence having any tendency in reason to prove or disprove any disputed fact that is of consequence to the action, including evidence relevant to the credibility of a witness. (Evidence Code, §210; Revenue and Taxation Code, §1609.) In hindsight, the 1976 production returns would have some bearing on the income *potential* of the property as of March 1, 1976, and would tend to corroborate the testimony of Smith and Sarabian concerning the poor quality of the soil, water and vines.

In your letter, you address this distinction thusly:

> " . . . Although the court allowed certain post lien date information to corroborate testimony for credibility purposes, it did not approve substituting post lien date income information for projections made as of the lien date."

Following its distinction between section 402.5 and a capitalization of income projection, however, the court stated not only that in hindsight, the 1976 production returns would tend to corroborate the testimony of Smith and Sarabian concerning the poor quality of the soil, water and vines but also that they "would have some bearing on the income *potential* of the property as of March 1, 1976." Thus the court recognized that post-lien date information could constitute relevant evidence if it were evidence upon which responsible persons are accustomed to rely.

Similarly, in *Domenghini v. County of San Luis Obispo* (1974) 40 Cal.App. 3d 689, the assessor was allowed to utilize post-lien date information when assessing beef cattle and feed which the cattle consumed. When the assessor questioned the taxpayer's property statement but no additional information was forthcoming, he estimated the number of cattle and the amount of feed in the taxpayer's possession on the lien date and levied an escape assessment.

The court noted that the assessor's function under the circumstances was inquisitive rather than adversary. Thus, when plaintiff refused to furnish the information demanded, the assessor was required by section 501 of the Revenue and Taxation Code to estimate the value of all plaintiff's property, and this he could do by making an escape assessment in the form of an "estimate" based upon the information in his possession. When, while the assessment appeal was pending, the assessor obtained a copy of the taxpayer's loan application filed with a lender several weeks after the lien date, the assessment appeals board reduced the assessment on the bases of the information in the loan application, which reduced the amount of the escape assessment.

> In court, the taxpayer relied upon *De Luz Homes, Inc. v. County of San Diego* (1955) 45 Cal.2d 546, 561 [291 P.2d 544], as authority for the proposition that the term "value of property subject to taxation under California Constitution, article XIII, section 1, means market value, i.e., the price at which it can be sold-freely in the open market without exigencies on either side. From this point Taxpayer seems to argue that since there was not a substantial factual basis for the assessment appeals board's conclusions, the superior court was required to reverse the assessment appeals board and this court is therefore required to reverse the superior court.
>
> Taxpayer's conclusion is based upon the assumption that his written application to the Production Credit Association of San Luis Obispo was improperly received in evidence since it related to conditions as they existed several weeks after the lien date. If that evidence had been excluded Taxpayer argues, there would then be no factual basis for the findings at the assessment appeals board.

In rejecting this attack on post-lien date evidence, the court responded at pages 694-695 and 697-699. Reference was made to *Knoff v. City Etc. of San Francisco* (1969) 1 Cal.App. 3d 184, *Michael Todd v. County of Los Angeles* (1962) 57 Cal. 2d 684, *De Luz Homes, Inc. v. County of San Diego, supra, Mahoney v. City of San Diego* (1926) 198 Cal. 388, *Kaiser Co. v Reid* (1947) 30 Cal. 2d 610, and *County of Riverside v. Palm-Ramon Development Co.* (1965) 63 Cal. 2d 534.

While these or some of these cases approve the use of post-lien date information when other than comparable sales valuation methods are used, we are not aware of any case that gives a bright-line test of what post-lien date information might be timely or untimely, acceptable or unacceptable, useable or unusable, etc. As indicated above, this might depend on whether a taxpayer has provided the assessor with the necessary information to employ the capitalization of income method based upon the taxpayer's submission. Where a taxpayer has not provided such information, *Domenghini v. County of San Luis Obispo, supra.* states that the assessor may estimate the value of the taxpayer's property based upon the information in his or her possession.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon you or the assessor of any county.

Sincerely,

Lou Ambrose
Tax Counsel

LA:tr
prop/precdnt/astandiv/00/03lou

cc: Mr. Dick Johnson, MIC:63
Mr. David Gau, MIC:64
Mr. Charles Knudsen, MIC:62
Ms. Jennifer Willis, MIC:70

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