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# California Property Tax Discussion

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# Introduction

## **This presentation will cover the following:**

- Background of Proposition 13 and Proposition 8 “decline in value” appeals
- When you should appeal current assessments
- The appeal process
- The 2020 “Split Roll” Ballot Initiative

# Proposition 13 Basics

- Proposition 13 established an “acquisition value” property tax system.
- Base year values established by the fair market value upon a change in ownership may be increased by no more than 2% per year.
- The base year value adjusted for this inflation factor is often called a “trended” or “factored” base year value.
- That ceiling often becomes a floor – assessors increase assessments automatically by 2% per annum even if a property has declined in value.

# Transfers of Interests in Legal Entities

## General rule:

- Transfers of interests in legal entities that own real property do not cause a change in ownership of the property.

## Exception:

- If the transfer causes a person or entity to obtain, directly or indirectly, majority control or ownership of the legal entity

## Definition of “control”:

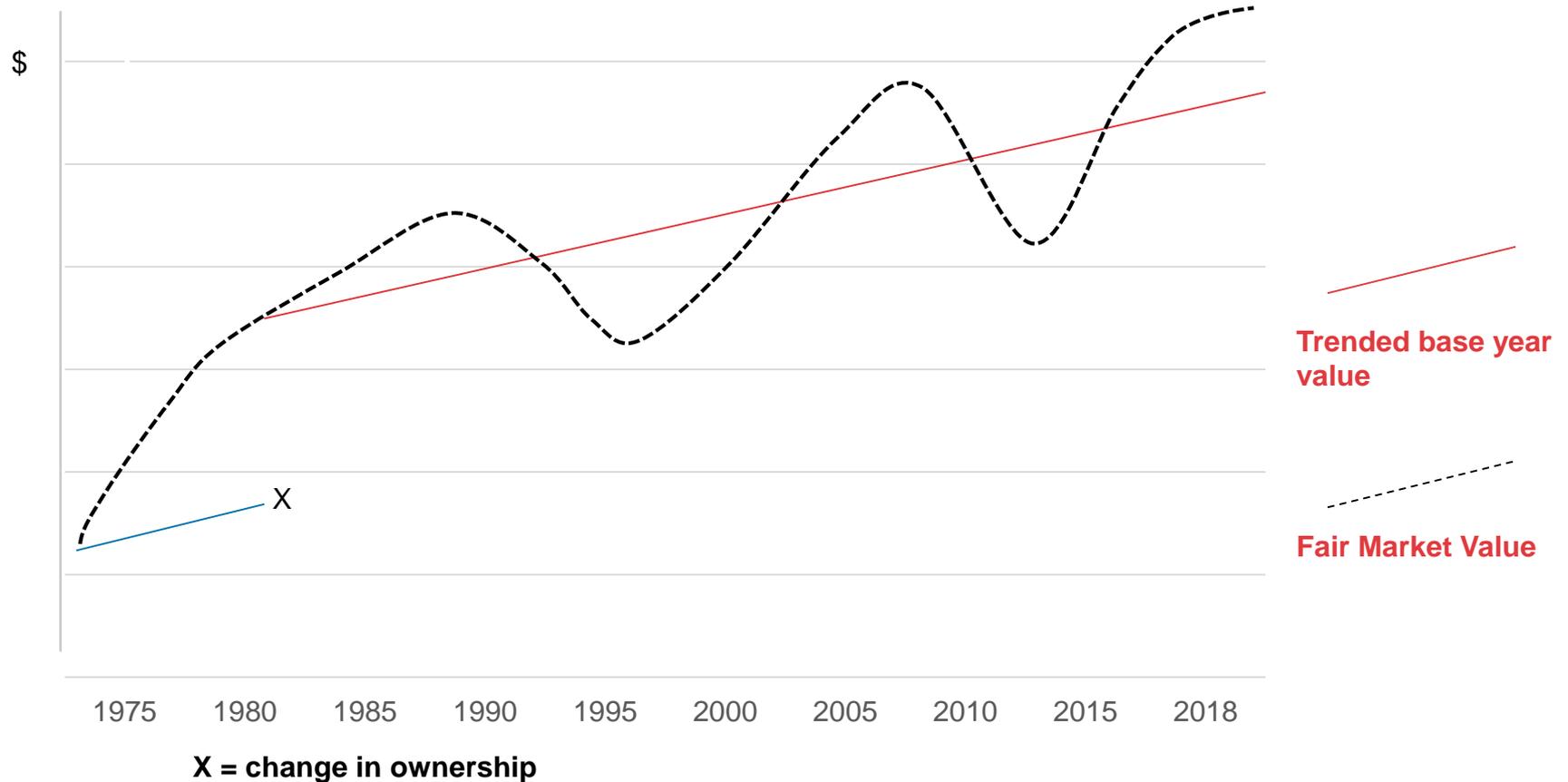
- More than 50% of both the profits and capital interests of a partnership or LLC
- More than 50% of the voting rights of a corporation
- Control can be indirect – PAM vs. FAM

# Prop. 8 and the Fair Market Value Ceiling

- Shortly after the passage of Proposition 13, the voters also passed Proposition 8, which provided that, regardless of the base year value, property should not be assessed at an amount above its current fair market value as of each lien date (*i.e.*, January 1).
- Thus, in California today, a taxpayer is entitled to have real property assessed annually at the lesser of (1) its trended base year value, or (2) its current fair market value.

# Prop. 8 and the Fair Market Value Ceiling

## Proposition 13 – Trended Base Year Values



# Measuring Prop. 8 Declines in Value

- To qualify for a Proposition 8 assessment, the taxpayer must show that the value of the *entire* real property parcel has fallen below the trended base year value.
- It is insufficient to show that a portion of the property (e.g. the improvements) has suffered a decline in value when the value of the entire property (the improvements and the underlying land together) are still at the trended base year value or higher.

# Economic Rent Versus Contract Rent

- “Economic rent” is that which the property would command assuming that a new lease were negotiated under competitive conditions on or around the lien date.
- Assessments may decline even when actual income does not.
- In valuing property encumbered by a lease, the assessor is required to value the real property as if it were not so encumbered and could obtain “economic rent” (*i.e.*, current market rents), whether economic rent exceeds or falls short of the actual contract rent.

*Cal. Code Regs. tit. 18, § 8(d).*

# Economic Rent Versus Contract Rent

- While the actual contract rent may be disregarded, income that is regulated by the government (e.g., rent control or zoning restrictions) must be used. *Rev. & Tax. Code § 402.1.*
- Income that includes value derived from intangible assets must also be removed.
- Although the principle of economic rent is well-established in California property tax law, it easily could result in an assessment of property at a value that is more than anyone would be willing to pay for it, or less than what the property would sell for.

# California Property Tax Assessment Appeals

# When You Should Appeal Current Assessments

- A property's trended base year value may be higher than its current fair market value for several reasons:
  - The base year value was set by a change in ownership or new construction that occurred during a period of high market values, and declines or stagnation in market values have occurred since then.
  - The base year value was set long ago, and although it has been increased by no more than 2% per year, the trended base year value exceeds the market value of the property due to obsolescence in the property.
  - The base year value was set above the proper fair market value at the time of the change in ownership or new construction.

# The Appeal Process

## When should you file an appeal?

- For regular assessments, applications must be filed (e.g., postmarked) no later than November 30<sup>th</sup> of each year in most counties, but several counties have adopted an earlier deadline of September 15<sup>th</sup> on a yearly basis. If either deadline falls on a weekend or holiday, applications must be filed by close of the next business day.

# The Appeal Process

- An application may also be filed within 12 months following the month in which a taxpayer is notified of the assessment if the assessor will stipulate that there has been an error in the assessed value.
- For escape assessments or supplemental assessments, the application generally must be filed within **60 days** from the date of the notice of assessment.
- Base year values can be challenged by filing an appeal of the supplemental assessment establishing the new base year value, or by filing an appeal during the regular assessment period (July 2 through either September 15 or November 30, depending on the county) for the year in which the supplemental assessment is placed on the assessment roll or in any of the three succeeding years.
- For state-assessed property, the deadline to file appeals with the State Board of Equalization is July 20<sup>th</sup> for unitary property and September 20<sup>th</sup> for non-unitary property.

# The Appeal Process

## Assembling the team

- The Attorney
- The Appraiser
- Other Experts
- In-house management
- Hearing support

# The Appeal Process

## Settlement negotiations

- Most appeals are resolved through settlement negotiations with the assessor prior to proceeding to any adversarial hearing.
- The long, slow “lean” – the taxpayer must push the assessor to settle.
- What to leave on the table?

# The Appeal Process

## Judicial Review

- Issues of fact decided by the Board (e.g., what is the proper market rent or cap rate) are given substantial deference by the reviewing court and are difficult to overturn.
- Issues of law (e.g., whether the assessor used an improper valuation methodology or improperly included intangible values in the assessment) are reviewed *de novo* by the courts.

# 2020 “Split-Roll” Ballot Initiative

# Split-Roll

## Overview

- This coming election, California voters will be presented with a ballot initiative (Proposition 15) to strip commercial and industrial properties of the property tax protection that those properties' owners currently receive under Proposition 13.
- If passed, the Initiative would “split” the property tax roll (creating a “Split-Roll”) by requiring that commercial and industrial properties (subject to certain exceptions), as well as vacant land not intended for housing or commercial agriculture, be taxed based on the properties' current market values, with reassessments occurring at least every three years.

# Split-Roll

## Criticism of Split-Roll

- It is expected that the number of commercial/industrial reassessments could potentially increase 12-fold.
- Under a Split Roll system, the amount of revenue raised in any given year would depend heavily on the strength of the State's real estate market in that year, making this new revenue more volatile than property tax revenues have been historically under Prop 13.
- Thus, before voters decide whether to fundamentally alter the state's property tax system once again, it would be wise to consider the likely negative impacts such a change would have on the ability of local civil servants to adequately administer the California property tax system, and the increased volatility to public revenues.

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