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Providing a Method to the Property Tax Allocation Madness: Offering a Way to Create Binding Interpretations of Property Tax Allocation Statutes

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Code Section Affected
Revenue and Taxation Code § 96.1 (amended).
AB 169 (Wiggens); 2001 STAT. Ch. 381.

I. INTRODUCTION

What happens when fifty-eight county controllers are faced with a complex tax statute, without any guidelines on how to implement it, and the State later audits each respective county, informing the controllers that their interpretations were incorrect? For answers, one only need look to California. In Riverside County, for example, Hemet Schools stand to lose as much as $325,000.[1] Not only are schools losing money, other vital services, such as fire departments, are losing money as well.[2] These agencies are losing money because the County Controller and the State Controller have interpreted complex tax laws differently.[3] As a result of the varied interpretations, some government agencies received too much money in the previous years and other agencies did not receive enough money.[4]

Unfortunately, this is not an isolated problem but one occurring throughout California, creating problems for the local governments who rely upon property tax revenue to plan their budgets.[5] Many times local governments are forced to

1. *See* Ioana Patringenaru and Rich Saskal, *New Figures Undo Budgets: Allocations Shift on Property Tax*, PRESS-ENTERPRISE (Riverside, CA), Nov. 28, 2000, at B01 [hereinafter *New Figures Undo Budgets*] (explaining how reallocation will injure certain small southern California communities).

2. *See* Anne Krueger, *Reduced Funding is Top Issue in Fire Board Race*, SAN DIEGO UNION-TRIB., Oct. 25, 2000, at B1 (relaying how the candidates running for the San Miguel Fire District board must do more with less money).

3. *See New Figures Undo Budgets*, *supra* note 1, at B01.

4. *See* Krueger, *supra* note 2, at B1 (reporting how reallocation cost the San Miguel Fire District $710,000 in 1992, and its budget would have been $900,000 more if it had received the shifted tax revenues in 2000); *see also New Figures Undo Budgets*, *supra* note 1, at B01 (describing how Hemet Schools may lose $325,000 and the city of San Jacinto could gain $330,000).

5. SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF AB 169, at 2 (June 14, 2001); *see also* CAL. REV. & TAX. CODE § 96.25 (West 1998) (stating that, due to the misallocation of the property tax revenue, the Legislature deemed the factors applied in allocating property tax revenues in the County of Plumas

repay money that they have already spent, which is difficult because local governments have limited resources.[6] Since the enactment of Proposition 13,[7] counties are less able to raise revenue through property taxes;[8] thus counties must be careful so as not to overspend their budget. In the end, the local governments suffer from different interpretations between the State controller and the County Controller.

II. LEGAL BACKGROUND

According to the California Constitution, property is taxable and must be assessed at fair market value.[9] Article 13 of the California Constitution requires counties to collect property tax on all real property[10] each year unless an explicit exception is met.[11] Due to the passage of Proposition 13, the maximum amount of any *ad valorem* tax[12] on real property is not to exceed one percent of the fair market value.[13]

Once a county has collected the property tax revenue, the revenue must be apportioned and allocated pursuant to the California Revenue and Taxation Code.[14] The California Revenue and Taxation Code provides that each

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for each fiscal year through 1993-94 to be correct, thus forgiving any misallocations); CAL. REV. & TAX. CODE § 96.19 (West Supp. 2001) (stating that the property tax apportionment factors applied in allocating property tax revenues in Riverside County for each fiscal year up to the 1999-2000 fiscal year are deemed to be correct).

6. Memorandum from Rodney A. Dole, State Association of County Auditors, to the Senate Committee on Local Government (Dec. 5, 2000) [hereinafter Dole Memorandum] (copy on file with the *McGeorge Law Review*); *see also* SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF SB 1228, at 1 (May 23, 2001) (stating that when the State Controller audited Tuolumne County's tax allocations, the Controller found that the county had incorrectly computed the property tax revenue shift to the Educational Revenue Augmentation Fund (ERAF) and therefore underpaid the ERAF by over $1.1 million, money which was overpaid to the county's fire districts). Subsequently the County implemented a repayment program to transfer the misallocation from the fire districts to the ERAF. However, fearing financial harm to the fire districts, the County later asked for legislative forgiveness of the errors. *Id.*

7. CAL. CONST. art. XIII, § 1.

8. *See* Dennis Wyatt, *Original Prop. 13 Keeps Housing Taxes Within Reason*, MANTECA BULL., June 10, 2001, at A3 (explaining how budgeting for municipalities has become tougher because if a county overspends its budget, it cannot just raise property taxes to cover the loss as it could in the past).

9. *See* CAL. CONST. art. XIII, § 1 (granting authority to tax all property).

10. *See* RIA SLT CA, *Overview of Real and Personal Property Taxes* 31,005, May 2001 (defining real property to include "the possession of, claim to, ownership of, or right to possession of land, all mines, minerals or quarries, and standing timber, and all rights pertaining thereto, as well as any improvements").

11. CAL. CONST. art. XIII § 1(a)(b); *see also id.* § 3 (listing properties that are exempt from paying a property tax including as property owned by the state, property used exclusively for religious worship, and property used for growing crops).

12. BLACK'S LAW DICTIONARY 1183 (7th ed. 2000) (defining ad valorem tax as "a tax imposed proportionally on the value of something, rather than on its quantity or some other measure").

13. *See* CAL. REV. & TAX. CODE § 110 (West 1998 & Supp. 2001) (specifying that fair market value means the amount of cash that the property would bring if exposed for sale in the open market in a transaction between reasonably informed buyers and sellers).

14. *See* Telephone Interview with Linda Wilkerson, Deputy Auditor, Sonoma County (June 13, 2001) [hereinafter Wilkerson Interview] (notes on file with the *McGeorge Law Review*) (explaining that property taxes

jurisdiction "shall be allocated an amount of property tax revenue equal to the amount of property tax revenue allocated [to them] in the prior fiscal year, modified by any adjustments."[15] Essentially, county auditors must allocate property tax revenues to cities, schools, special districts, and county governments.[16] Counties are also required to shift property tax revenues into special funds, such as the Education Augmentation Revenue Fund.[17] For example, in San Diego County, sixty-two percent of the property tax revenue is currently allocated to schools.[18]

Subsequent to a county controller's allocation of property tax revenue, the State Controller must regularly audit the allocation of property tax revenue.[19] This is done in order to protect the State General Fund's fiscal interest in the Education Revenue Augmentation Fund.[20] After the State Controller completes the audit, he must submit a report including any misallocations discovered to the Legislature.[21] Additionally, the report should contain the State Controller's recommendations regarding corrections of any misallocation found.[22]

Due to the cumulative nature of property tax revenue allocation,[23] the Controller can make a challenge anytime in the future for a past or present year's property tax allocation.[24] If such a challenge occurs, the county is forced to make a correction, which involves reallocating revenue for the past as well as the present year.[25] The county is placed in a precarious financial position[26] because

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are allocated pursuant to the California Revenue and Taxation Code).

15. CAL. REV. & TAX. CODE § 96.1(a) (West 1998).

16. SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS ON AB 169, at 1 (June 14, 2001).

17. *See* Dan Johannes, Note, *Education; School Districts Adjacent to the International Border—Residency of Pupils; Augmentation of Special Education Funding*, 27 PAC. L.J. 697, 698 (1996) (indicating that property tax revenue, not allocated to counties, cities, or special districts as a result of the Revenue and Tax Codes, is to be deposited in each county's Educational Revenue Augmentation Fund).

18. County of San Diego, *Property Tax Allocation 1999/2000* (2001), at http://www.co.san-diego.ca.us/cnty/enty...tax_services/revcharts/alchart0001.html (last visited May 31, 2001) (copy on file with the *McGeorge Law Review*).

19. *See* CAL. GOV'T CODE § 12468 (West Supp. 2001) (specifying that the controller must audit counties with a population in excess of five million annually, for counties with a population greater than 200,000). The audit shall be performed on a three-year cycle, and for counties with less than a population of 200,000 the audit shall be performed on a five-year cycle. *Id.*

20. SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF AB 169, at 1 (June 14, 2001).

21. CAL. GOV'T CODE § 12468(e).

22. *Id.*

23. *See* CAL. REV. & TAX. CODE § 96.1 (West 1998) (asserting that the county is to use the data from the previous year modified by any adjustments for jurisdictional changes or any property in redevelopment in order to obtain the allocation for the current year).

24. Dole Memorandum, *supra* note 6.

25. *Id.*

26. *See id.* (indicating that, due to lapse of time between implementation and discovery of a misallocation, the correction places entities in a precarious financial position); *see also* SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF SB 1228, at 1 (May 23, 2001) (explaining that the State Controller found a $1.1 million mistake when they audited Tolumne County).

more often than not, a local government that received too much money, through no fault of its own, is forced to repay the property tax revenue it has already spent.[27] Sometimes the potential financial hardships resulting from a reallocation is so great that the Legislature may forgive the misallocation.[28] After "forgiveness legislation"[29] is enacted, the county is usually not required to repay the misallocated property tax.[30] Consequently, certain agencies will not be allocated money that they should have received.

III. CHAPTER 381

Chapter 381 seeks to provide a measure of financial stability for recipients of property tax revenue.[31] There are fifty-eight counties in California and frequently each county interprets the statutorily required tax allocation guidelines differently.[32] Chapter 381 does three things in an endeavor to alleviate the reallocation problem.[33]

First, and most importantly, Chapter 381 allows the State Association of County Auditors to interpret the law relating to property tax allocation.[34] If the State Controller or the Department of Finance adopts the State Association of County Auditors interpretation as a regulation pursuant to the procedures articulated in the Government Code.[35] This interpretation will be considered an authoritative source, deemed correct until future clarification by legislation or court decision.[36] This means that the State Controller and all fifty-eight counties will be working with the same allocation method,[37] which may eliminate the

27. SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS ON AB 169, at 1 (June 14, 2001).

28. *Id.*; *see also* CAL. REV. & TAX. CODE § 96.25 (West 1998) (indicating that the property tax apportionment factors applied in allocating property tax revenues in Plumas County for each fiscal year through 1993-94 were deemed correct); *see also* CAL. REV. & TAX. CODE § 96.19 (West Supp. 2001) (providing that the property tax apportionment factors applied in allocating property tax revenue in Riverside County for each fiscal year, up to the 1999-2000 fiscal year, were deemed to be correct).

29. *See* Wilkerson Interview, *supra* note 14 (indicating that the Legislature often passes bills that will deem property tax allocations correct for a certain year, and this is called "forgiveness legislation" because the legislation forgives the county for the misallocation).

30. *Id.*

31. ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF AB 169, at 2-3 (May 2, 2001).

32. Interview with Frances Chacon, Assembly Committee on Local Government, in Sacramento, Cal. (June 7, 2001) [hereinafter Chacon Interview] (notes on file with the *McGeorge Law Review*).

33. *Id.*

34. CAL. REV. & TAX. CODE § 96.1(c)(1) (amended by Chapter 381).

35. *See* CAL. GOV'T CODE § 11340 (West 1992 & Supp. 2001) (declaring that there has been an unprecedented growth of administrative regulations in recent years that have become extremely complex); *see also* CAL. GOV'T CODE § 11340.5 (stating that no agency shall issue any guideline unless the guideline has been adopted as a regulation and filed with the Secretary of State).

36. CAL. REV. & TAX. CODE § 96.1(c)(1) (amended by Chapter 381); Chacon Interview, *supra* note 32.

37. Chacon Interview, *supra* note 32.

problems of reallocation.[38]

Second, Chapter 381 validates any allocation of property tax revenue that has been subject to a previously completed audit by the State Controller.[39] Under Chapter 381, once the State Controller audits a county's revenue allocation, he cannot go back and re-audit that county's allocation for that same year.[40] Instead, whatever the Controller determines during the first audit will be deemed a correct allocation for subsequent years.[41] Furthermore, once the auditor makes his finding, the county must reallocate based on those findings.[42] However, Chapter 381 should not be interpreted to forgive whatever reallocation may have been required prior to its enactment.[43] Thus, if a county was required to reallocate their property tax for 1999 at a date after Chapter 381 was enacted, it is still required to allocate for that year because that duty arose prior to the enactment of Chapter 381.[44] Therefore, counties will have to reallocate property tax revenue as required by the State Controller.[45]

Finally, Chapter 381 provides a system to assist with reallocation if reallocation is required because a court decision or legislative act finds the State Association of County Auditors guidelines incorrect.[46] Chapter 381 provides that if by audit or discovery, beginning on or after July 1, 2001, it is determined that reallocation is required for previous fiscal years, the reallocation may not exceed one percent of the original Proposition 13 property tax assessment.[47] In addition, Chapter 381 provides that the reallocation will be paid over the following three years, instead of all at once.[48] However, if the revenue from the reallocation is going to the Educational Revenue Augmentation Fund,[49] then the county may

38. *See* SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF AB 169, at 2 (June 14, 2001) (indicating that the problems with reallocation are that the property tax revenue has already been spent, and it creates a serious financial strain on local governments to pay back money it has already spent).

39. CAL. REV. & TAX. CODE § 96.1(b) (amended by Chapter 381); *see also* Letter from Pat Leary, Legislative Representative, California State Association of Counties, to Patricia Wiggins, Chair, Assembly Local Government Committee (Apr. 24, 2001) [hereinafter Leary Letter] (on file with the *McGeorge Law Review*) (signifying his approval for Chapter 381 because it will deem correct property tax allocations that were previously audited by the State Controller).

40. CAL. REV. & TAX. CODE § 96.1(b) (amended by Chapter 381).

41. Wilkerson Interview, *supra* note 14; *see also* CAL. REV. & TAX. CODE § 96.1(b) (amended by Chapter 381) (stating that "any allocation of property tax revenue subjected to audit shall be deemed correct").

42. Wilkerson Interview, *supra* note 14.

43. *See id.* (clarifying the point that subsection (b) of Chapter 381 does not forgive past audits; if reallocation is required, the county must still reallocate).

44. *Id.*

45. *Id.*

46. ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF AB 169, at 3 (May 2, 2001); *see also New Figures Undo Budgets*, *supra* note 1 (noting how reallocation will take money away from certain small southern California communities).

47. CAL. REV. & TAX. CODE § 96.1(c)(3) (amended by Chapter 381).

48. *Id.*

49. *See* City of El Monte v. Comm'n on State Mandates, 83 Cal. App. 4th 266, 272, 99 Cal. Rptr. 2d 333, 336 (2000) (describing how the Education Revenue Augmentation Fund (ERAF) legislation was enacted in 1992 in response to a short fall in state revenues brought on by economic recession of that time). The reduced

negotiate the three-year time period with the State Controller.[50]

The one percent reallocation works in the following way:

> [I]f the total value of the real property in [Los Angeles] County is $600 billion it would be subject to the [Proposition] 13 property tax limit of 1 percent which would amount to $6 billion. If there is a misallocation discovered, that $6 billion is then subject to [Chapter 381's] 1 percent cap which would be $60 million. The county's total reallocation or adjustment would amount to $60 million.[51]

Therefore, if Los Angeles County is required to reallocate $65 million, under Chapter 381, it will only have to pay back $60 million.[52]

However, Chapter 381 allows a county auditor to choose not to follow the State Association of County Auditors regulations. In order to do this, the county auditor must express his reasons for not following the regulations.[53] If a county knowingly does not follow the State Association of County Auditors regulations, and the State Controller disagrees with the county's reasons for not following the guidelines, that county will not be eligible for the one-percent reallocation provided by Chapter 381.[54] The non-conforming county will either have to reallocate all of the misallocated revenue or ask for "forgiveness legislation."

IV. ANALYSIS OF THE NEW LAW

Chapter 381 seeks to provide "a measure of financial reliability for recipients of property tax distributions."[55] Prior to the enactment of Chapter 381, each county had to decipher the property tax allocation statutes and formulas, which, as indicated above, caused many problems.[56] By providing binding statewide property tax allocation regulations, Chapter 381 will help reduce misallocations of property tax because the State Controller and the county controllers will all be

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funds meant less state money to schools, so the Legislature enacted the ERAF legislation requiring redevelopment and other local agencies to make additional payments to the ERAF fund in order to help fund schools and community colleges. *Id.*

50. CAL. REV. & TAX. CODE § 96.1(c)(3) (amended by Chapter 381); ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF AB 169, at 3 (May 2, 2001).

51. STAFF COMMITTEE ON LOCAL GOVERNMENT, AB 169-QUESTIONS AND ANSWERS, (Apr. 30, 2001) (on file with the *McGeorge Law Review*).

52. *See* Wilkerson Interview, *supra* note 14 (explaining that the one percent cap works by capping what the county has to pay back).

53. CAL. REV. & TAX. CODE § 96.1(c)(2) (amended by Chapter 381).

54. *Id.*

55. ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT, COMMITTEE ANALYSIS OF AB 169, at 3 (May 2, 2001).

56. *Supra* Part II; *see also* SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS OF AB 169, at 1 (June 14, 2001) (explaining how the calculations counties must follow are complicated and how the State Auditor must audit the counties, often finding misallocations due to counties' misinterpretations of the law).

working with the same interpretation of the statutes.[57] With fewer misallocations by the counties, the local governments that receive property tax revenue will feel confident that the money will not be taken away from them in the future.[58] Chapter 381 also provides financial surety for recipients of property tax revenue by capping the reallocation settlements at one percent of the current year's secured tax levy.[59] Preceding Chapter 381, there was no such cap on the reallocation of property tax revenue.[60]

Since Chapter 381 allows for any reallocation or adjustment to be completed in equal increments within the three fiscal years following discovery of a misallocation, it gives cash-strapped local governments an opportunity to pay back misallocated property tax without going bankrupt.[61] By providing a convenient and feasible way for counties to pay back misallocated property tax revenue, Chapter 381 has the potential to cut down on "forgiveness legislation." The reduction of such legislation may benefit the State as it will actually be paid instead of just forgiving the county and never securing the return of misallocated funds. However, Chapter 381 does not affect a county's ability to ask the Legislature for "forgiveness legislation," nor does it affect a county's opportunity to file a suit if it disagrees with the Controller's audit findings.[62] The fact that a county can still appeal the State Controller's decision and ask for "forgiveness legislation" benefits the counties by providing more options for dealing with their misallocated property tax revenue.

Furthermore, Chapter 381 provides that, once the State Controller audits a county for a certain year, the findings made shall be deemed correct.[63] The State Association of County Auditors recently performed a survey on the effects of Chapter 381, which reflected that if Chapter 381 had been in effect during the last ten years, the law would have had a positive financial impact on the State's General Fund.[64]

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57. *See* SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS ON AB 169, at 2 (June 14, 2001) (listing the changes to existing law provided by Chapter 381).

58. Letter from William H. Siverling, Legislative Representative, State Association of County Auditors, to Patricia Wiggins, Chair, Assembly Local Government Committee, (Apr. 25, 2001) [hereinafter Siverling Letter] (on file with the *McGeorge Law Review*); *see also* SENATE LOCAL GOVERNMENT COMMITTEE, COMMITTEE ANALYSIS ON AB 169, at 2 (June 14, 2001) (expressing that AB 169 helps to increase financial stability for property tax recipients by providing binding guidelines for property tax allocation and by capping settlements for reallocations).

59. CAL. REV. & TAX. CODE § 96.1(c)(3) (amended by Chapter 381).

60. *See supra* Part II (providing legal background relevant to Chapter 381).

61. *See* Siverling Letter, *supra* note 58 (indicating that Chapter 381 will allow three years for counties to repay misallocated property taxes).

62. Wilkerson Interview, *supra* note 14.

63. CAL. REV. & TAX. CODE § 96.1(b) (amended by Chapter 381).

64. *See* Siverling Letter, *supra* note 58 (indicating that a recent survey by the State Association of County Auditors on the effects of Chapter 381 was shared with the State Department of Finance and State Controller).

Although Chapter 381 is likely to provide the aforementioned benefits to counties, a potential loophole exists. In certain counties Chapter 381 may not change the law at all if a county auditor knowingly chooses not to follow Chapter 381.[65] This might create the same type of problems that existed prior to the enactment of Chapter 381,[66] because a county could not want to follow the regulations set up by the State Association of County Auditors, and it will interpret the law in its own way. This, in turn, may lead to different interpretations between the county and State. Thus, when the State audits the county, it may find that the county was incorrect and the county will have to reallocate.[67] Additionally, if the county auditor's reasons for not following the guidelines are not acceptable, that county will lose out on the reallocation cap.[68] However, in all likelihood, counties will follow Chapter 381 because of the benefits it provides[69] and the loss of those incentives if Chapter 381 is not followed.[70] However, the only way to determine if Chapter 381 will be successful is to wait and reexamine the property tax allocation problems after Chapter 381 has been on the books for a couple of years.

V. CONCLUSION

Chapter 381 creates a measure of certainty for entities that are allocated property tax revenue by the counties.[71] It caps the amount of revenue that will have to be reallocated in the case of a misallocation.[72] Chapter 381 also attempts to eliminate the problem of misallocation altogether by providing binding regulations that counties can follow in an effort to allocate the property tax revenue correctly.[73] However, because some counties may choose not to take advantage of the benefits of Chapter 381, Chapter 381 may have a minimal effect on the law or not change it at all.[74]

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65. *See* CAL. REV. & TAX. CODE § 96.1(c)(2) (enacted by Chapter 381) (explaining that if a county knowingly does not follow guidelines, that county's auditor must inform the State Controller of the reasons for not following the guidelines).

66. *See supra* Part II (explaining some problems that occur when counties do not correctly follow the tax allocation procedures).

67. *See* Dole Memorandum, *supra* note 6 (indicating that counties are forced to make corrections to misallocated tax revenue and this includes reallocating revenues for past as well as the present year).

68. CAL. REV. & TAX. CODE § 96.1(c)(2) (enacted by Chapter 381).

69. *See supra* Part III (indicating that if, counties follow Chapter 381, reallocation will be capped at one percent, and that there should be no need for reallocation because counties and State are working with the same interpretation of the statutes).

70. *See* CAL. REV. & TAX. CODE § 96.1(c)(2) (enacted by Chapter 381) (indicating that if a county knowingly does not follow the guidelines, then it may not be able to take part in the reallocation cap).

71. Leary Letter, *supra* note 39.

72. CAL. REV. & TAX. CODE § 96.1(c)(3) (amended by Chapter 381).

73. *Id.*

74. *Id.* § 96.1(c)(2) (indicating that a county auditor need not follow the new guidelines; therefore, the county would not reap the benefits the guidelines provide).