

# STATE OF CALIFORNIA

Report to the California State Legislature

## PROPERTY TAX APPORTIONMENTS

*Calendar Year 2013*



**JOHN CHIANG**  
California State Controller

July 2014



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California State Controller

July 31, 2014

To the Members of the State Legislature  
and the People of California:

Re: Property Tax Apportionments Report to the Legislature for Calendar Year 2013

I am pleased to present the Property Tax Apportionments report for calendar year 2013. This report, prepared pursuant to Government Code section 12468, is intended to help mitigate problems associated with the counties' apportionment and allocation of property tax revenues.

Eight property tax allocation and apportionment audits were initiated in calendar year 2013. These audits will be issued final in calendar year 2014.

In addition, SB 85 (Chapter 5, Statutes of 2010) provided a methodology whereby "negative bailout" counties could cap the amount of their property tax reduction. We performed limited reviews of the implementation of SB 85 by two of the six negative bailout counties to ensure current compliance with SB 85 requirements and to limit future problems.

I hope you find the report informative and useful for future policy decisions. If you have any questions regarding the report, please contact Jeffrey Brownfield, Chief, Division of Audits by telephone at (916) 324-1696.

Sincerely,

*Original signed by*

**JOHN CHIANG**  
California State Controller

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# Executive Summary

This report summarizes issues relative to the allocation and apportionment of property tax revenue. After the passage of Proposition 13 in 1978, the California Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local agencies with a property tax base that would grow as assessed property values increase.

Property tax revenues that local governments receive each year are based on the amount received the prior year plus a share of the property tax growth within their boundaries. Property tax revenues are then allocated to local agencies and schools using prescribed formulas and methods defined in the California Revenue and Taxation Code. This methodology is commonly referred to as the AB 8 process or the AB 8 system. The method has been further refined in subsequent laws passed by the Legislature.

The SCO's property tax audit program began on July 1, 1986, pursuant to Revenue and Taxation Code section 95.6 (now Government Code section 12468). The statute mandates that the SCO perform audits of the allocation and apportionment of property tax revenues by counties and make specific recommendations to counties concerning their property tax administration. The statute also specifies that the SCO is to prepare an annual report summarizing the results of its findings under this audit program. The report is to contain recommendations to the Legislature for legislation to correct any errors in the apportionment and allocation of property tax revenues that were determined as a result of these audits.

We developed and implemented a comprehensive audit program that includes, but is not limited to, a detailed analysis of past and current requirements of property tax laws and an examination of property tax systems, processes, and records at the county level. Each audit encompasses an evaluation of a county's property tax apportionment methodology, allocation procedures, and compliance with applicable laws and regulations. We apply procedures considered necessary and appropriate to provide a basis for reporting on the areas examined.

Government Code section 12468 requires that audits be conducted periodically for each county according to a prescribed schedule based on county population. During 2013, the SCO began audits of eight counties' property tax apportionment and allocation systems, processes, and records. These audits will be issued final in calendar year 2014.

Recent legislation added and amended sections of the Health and Safety (H&S) Code which mandated the winding down of redevelopment agency activities and imposed additional duties on the Controller related to this process. Consequently, resources normally allocated to conducting property tax apportionments and allocation audits were diverted to the performance of asset transfer reviews.

### Recommended Possible Legislative Action

Current statute does not allow counties to charge school and community college districts, the county superintendent of schools, and the Educational Revenue Augmentation Fund (ERAF) for property tax administrative costs. The Legislature may wish to consider legislation to address an apparent conflict between Revenue and Taxation Code section 95.3 and H&S Code sections 34183 and 34188 which may indirectly charge those costs to school and community college districts, the county superintendent of schools, and the ERAF during the winding down of redevelopment agency activities.

A court case decision filed during 2013 resulted in a major tax refund being charged to taxing jurisdictions inside and outside the area where the refund was generated. Consequently, jurisdictions that did not benefit from the initial excessive tax assessment were required to pay a portion of (subsidize) the refund for those jurisdictions that did benefit. The ruling appears to partially negate the concept of “situs” (location of the assessed property) when allocating and apportioning property tax revenues. The Legislature may wish to address the issue of the proper handling of major tax refunds.

# Overview

## Introduction

This report summarizes items for Legislative consideration relative to the allocation and apportionment of property tax revenues. The State Controller's Office (SCO) initiated eight property tax allocation and apportionment audits in calendar year 2013 (San Francisco, Kern, Lassen, Modoc, San Mateo, Trinity, Riverside, Los Angeles). These audits will be issued final in calendar year 2014.

In addition, SB 85 (Chapter 5, Statutes of 2010) provided a methodology whereby "negative bailout" counties could limit the amount of their property tax reduction. We performed limited reviews of the implementation of SB 85 by two negative bailout counties to ensure current compliance with SB 85 requirements and to limit future problems.

## Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local agencies with a property tax base that would grow as assessed property values increase. These methods have been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill 8 (AB 8), which established the method of allocating property taxes for fiscal year (FY) 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

Property tax revenues that local governments receive each fiscal year are based on the amount received the prior year plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local agencies and schools using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 process involves several steps, including, in most instances, the transfer of revenues from schools to local agencies and the development of the tax rate area annual tax increment growth (ATI) factors, which determine the amount of property tax revenues allocated to each entity (local agency and school). The total amount allocated to each entity is then divided by the total amount to be allocated to all entities to determine the AB 8 factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities using the revenue amounts established in the prior year. These amounts are adjusted for growth annually using ATI factors.

In a few counties, the implementation of the AB 8 process resulted in the transfer of the property tax base from the county to schools. These counties are referred to as the "negative bailout counties."

Subsequent legislation has removed revenue generated by unitary and operating nonunitary property and pipelines from the AB 8 system. This revenue is now allocated and apportioned under a separate system.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the ERAF. The fund is subsequently allocated and apportioned by the county auditor according to instructions received from the local superintendent of schools or chancellor of the California community colleges.

Senate Bill (SB) 85 (Chapter 5, Statutes of 2010) provided a methodology whereby the so called “negative bailout” counties could limit the amount of their property tax reduction. The amount the negative bailout counties were required to transfer to schools for FY 2013-14 was capped at the FY 2012-13 level. The amount for succeeding years was the amount of the immediately preceding year. Thus SB 85 established a ceiling and a floor for the amount of the required transfer each year.

The 2011-12 level was determined by comparing the FY 2010-11 level to the FY 2011-12 level and requiring the transfer of the lesser amount. The transfer amount for FY 2012-13 was determined by comparing the FY 2011-12 amount to the FY 2012-13 amount and requiring the transfer of the lesser amount. The transfer amount for FY 2013-14 and each fiscal year thereafter is determined on the basis of the amount applied for the immediately preceding fiscal year

Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner’s name, and value. The types of property tax rolls are:

- Secured Roll—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if unpaid, can be satisfied by the sale of the property by the tax collector.
- Unsecured Roll—Property that, in the opinion of the assessor, does not constitute sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.
- State-Assessed Roll—Utility properties, composed of unitary and nonunitary value, assessed by the State Board of Equalization.
- Supplemental Roll—Property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

## **Audit Program**

The property tax audit program began on July 1, 1986, under Revenue and Taxation Code section 95.6 (now Government Code section 12468). The statute mandates that the State Controller periodically perform audits of the allocation and apportionment of property tax revenues by counties and make specific recommendations to counties concerning their property tax administration. However, the State Controller's authority to compel resolution of its audit findings is limited to those findings involving an overpayment of state funds.

Overpayment of State General Fund money is recoverable by the State under several provisions of law. In addition, the State Controller has broad authority to recover overpayments made from the State Treasury. If an audit finds overpayment of state funds, and the state agency that made or authorized the payment does not seek repayment, the SCO is authorized to pursue recovery through a variety of means (according to Government Code sections 12418–12419.5). The specific remedy employed by the SCO depends on the facts and circumstances of each situation.

The SCO developed and implemented a comprehensive audit program to carry out the mandated duties. The comprehensive audit program includes, but is not limited to, a detailed analysis of past and current requirements of property tax laws and an examination of property tax records, processes, and systems at the county level.

These property tax apportionment audits have identified and aided in the correction of property tax underpayments to public schools. The underallocation of property taxes by individual counties to their public schools results in a corresponding overpayment of state funds to those schools by the same amount. This, in turn, causes public schools in other counties to receive less state funding because the total funds available are limited. Subsequent legislation forgave some counties for underpayments to schools without requiring repayment or assessment of penalties. However, the legislation required that the cause of the underallocations, as identified by the audits, be corrected.

## **Audit Scope**

Each audit encompasses an evaluation of a county's property tax apportionment methodology, allocation procedures, and compliance with applicable laws and regulations. The auditors used procedures considered necessary to provide a basis for reporting on the areas examined. In conducting the audits, the auditors focused on the following areas to determine if:

- The apportionment and allocation of the ATI was in accordance with Revenue and Taxation Code sections 96 through 96.5;
- The methodology for redevelopment agencies' base-year calculations and apportionment and allocation of the ATI was in accordance with Revenue and Taxation Code sections 96.4 and 96.6, and H&S Code sections 33670 through 33679;
- The effect of jurisdictional changes on base-year tax revenues and the ATI was in accordance with Revenue and Taxation Code section 99;

- The apportionment and allocation of property tax revenues from supplemental assessments was in accordance with Revenue and Taxation Code sections 75.60 through 75.71;
- The apportionment and allocation of state-assessed unitary and operating nonunitary property taxes was in accordance with Revenue and Taxation Code section 100;
- The computation and apportionment of property tax revenues to low- and no-tax cities was in accordance with Revenue and Taxation Code section 98;
- The computation and collection of local jurisdictions' property tax administrative costs was in accordance with Revenue and Taxation Code sections 95.2 and 95.3;
- The computation and apportionment of property tax revenues to the ERAF was in accordance with Revenue and Taxation Code sections 97 through 97.3; and
- The payment from ERAF was made in compliance with Revenue and Taxation Code section 97.68, commonly known as the "Triple Flip," and section 97.70, commonly known as the "VLF Swap."

## **Conclusion**

Generally, the property tax allocation and apportionment system operates as intended. In the interest of efficiency and cost control for both the counties and the State, we submit legislative recommendations to assist in initiating changes that will help improve the system.

## Items for Legislative Consideration

### **Educational revenue augmentation fund**

Revenue and Taxation Code section 95.3 allows a county to charge for the cost of administering the property tax program in the county. While the county computes the school and community college districts and the county superintendent of schools (schools) and Educational Revenue Augmentation Fund (ERAF) shares of these costs, statute does not allow the county to collect these shares. School entities and the ERAF are thus held harmless from administrative cost charges. The Legislature has stated the intent to reimburse the costs attributable to school entities and the ERAF “by a future act of the Legislature that makes an appropriation for purposes of that reimbursement.”

H&S Code section 34183 allows the county auditor- controller to deduct from the RPTTF administrative costs allowed under H&S Code section 34182 and Revenue and Taxation Code section 95.3 prior to making the prioritized distributions that follow. As a result, any balance to be distributed pursuant to section 34188 is reduced, thus reducing all taxing agencies (including schools) and the ERAF’s shares of residual revenues. Consequently, schools and the ERAF are paying a portion of the administrative costs.

#### Recommendation

The H&S Code sections referred to above are not appropriations; therefore, the Legislature may wish to consider legislation regarding the charging of administrative costs allowed under H&S Code section 34182 and Revenue and Taxation Code section 95.3 to schools and the ERAF as a result of H&S Code sections 34183 and 34188.

### **Property tax reassessments**

A basic concept of property taxation is that taxes on real property are determined by the situs of the property. A formula is set out in the Revenue and Taxation Code for determining and allocating real property tax revenues assessed in a county that will be apportioned to each taxing agency located in the particular county. That formula is necessarily based or contingent on the situs of the assessed parcels of realty located in each of the tax rate areas.

In a recent court case the court apparently partially negated the concept of situs in the allocation and apportionment of property taxes. Prior to the culmination of the successful assessed valuation appeal, the county correctly computed the statutory formula percentages for distribution of tax assessments to all taxing agencies. Subsequent to the appeal the county applied the same county-wide formula percentages in adjusting a proportionate share of the refunds resulting from the valuation appeal to be assumed by every taxing agency.

In this situation, however, the initial application of the statutory formula was defective. The accurate assessed valuations of properties are an essential component of the statutory allocation formula. Because it was subsequently established that the valuation of the property was erroneous, it necessarily follows that the initial calculations of the statutory formula percentage allocations were erroneous.

In these circumstances the only reasonable approach appears to be to recalculate the statutory allocation formula using the correct assessed valuation.

It should be noted that in the past, because of the minor effect on tax allocations, the SCO has allowed counties to use prior calculated formula percentages for minor assessment adjustments. These happen each year and do not significantly affect the tax allocations of individual taxing agencies.

In the recent case the court ruled that the county could continue to use the erroneous percentages to calculate each taxing agency's share of the refund. The effect is to partially negate the concept of situs in allocating and apportioning property taxes. The partial negation of situs means that agencies that did not receive revenues from the erroneously assessed properties are forced to subsidize the other taxing agencies that did benefit from the excessive assessment.

#### Recommendation

The Legislature may further wish to address the proper method of calculating how major tax reassessments should be accounted for, recognizing that minor adjustments occur in many tax rate areas each year and do not significantly affect the allocation of property taxes, unlike major reassessments.

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