

Daily Journal Print Publications
<http://www.dailyjournal.com>
 © 2002 The Daily Journal Corporation. All rights reserved.

• select Print from the File menu above

Real Estate Journal - Apr 8, 2002

Proposition 13 Turned on Its Head

An Orange County court decision eliminates fairness in the assessment process

BY THEODORE F. BAYER

A recent decision by the Orange County Superior Court demonstrates just how quickly some Californians can forget their own recent history and the potentially devastating effects that their cultural amnesia can have.

In *County of Orange v. Orange County Assessment Appeals Board No. 3 (Pool)*, the trial court held that the 2 percent limitation on annual increases in property tax assessments mandated under Proposition 13 also applies to annual increases in the tax assessments for a property whose assessed value previously was reduced to reflect a cyclical downturn in the local real estate market.

The decision - and an Assembly bill introduced in January in an attempt to codify the decision - not only makes a mockery of Proposition 13 but also unwittingly threatens its continued viability.

A Brief History

Let us revisit California in the mid-1970s.

Real estate values were skyrocketing and, as a result of a long-standing practice of alternating and frequent increases in both assessed values and property tax rates, California property owners faced spiraling property taxes and, in certain extreme cases, the potential loss of their homes.

When attempts to secure a legislative solution failed, the voters took matters into their own hands. In June 1978, Californians by an overwhelming majority passed Proposition 13. Its controversial yet simple formula revolutionized the taxation of real estate in California.

Proposition 13 introduced the concept of "acquisition value" into the assessment process and established limits both on assessed value as well as the rate at which taxes on the assessed value are computed.

To local governments, the initiative was blasphemy. Scores of counties and certain cities initiated a legal challenge that rapidly made its way to the California Supreme Court.

In a decision rendered in September 1978, the court upheld the initiative, observing that "this 'acquisition value' approach to taxation finds reasonable support in a theory that the annual taxes which a property owner must pay should bear some rational relationship to the original cost of the property, rather than relate to an unforeseen, perhaps unduly inflated, current value. Not only does an acquisition value system enable each property owner to estimate with some assurance his future tax liability, but also the system may operate on a fairer basis than a current value approach."

The court validated the desire of property owners to gain predictability by creating a direct connection between the amount they were willing to pay to purchase or to improve their property and their maximum property tax liability, thereby eliminating any tax impact of quixotic spikes in a property's market value.

The Legislature quickly enacted a statutory scheme that reflected the simplicity of Proposition 13.

A property's acquisition value became its "base year value," which would establish the upper limit on a property's assessed value. The base-year value of every California property was set at its previously assessed value for the 1975-76 tax year, arbitrarily designated in the initiative as the starting point. That value would remain in effect unless and until there was a change of ownership or new construction. At such time, a new base-year value would be set that reflected the then-current acquisition value - as evidenced by the price paid to purchase the property or the cost of the new improvements.

Once a base-year value was established, it thereafter could be increased ("indexed," in the parlance of Proposition 13) by not more than 2 percent annually. Finally, the amount of the resulting tax was limited to 1 percent of assessed value.

Simplicity has its limitations, however. The Legislature realized that Proposition 13, in its single-minded focus on seemingly ever-increasing property values and property taxes, had created uncertainty as to whether a property's assessed value could ever be decreased. So, in November 1978, Proposition 8, an initiative sponsored by the Legislature to address this apparent ambiguity, was readily approved by the voters.

Proposition 8 confirmed that the establishment of a property's base-year value under Proposition 13 does not preclude a subsequent reduction in its assessed value to reflect damage or destruction caused by disaster, misfortune or calamity or "other factors causing a decline in its market value."

Seen in an historical context, Proposition 8 was nothing more than a reaffirmation that Proposition 13's acquisition-value approach merely sets the upper limit on a property's assessed value.

Lost in the hysteria over Proposition 13 was the fact that the "fair market value" standard that had governed property tax assessment in California for more than a century was not repealed by the initiative.

Accordingly, if a property should suffer damage by fire, destruction by earthquake or even devaluation by reason of its physical obsolescence or market conditions and, as a result, its fair market value is lowered below its acquisition value, Proposition 13 did not deprive the owner of the right to have the property assessed at the lower, fair market value.

And, while Proposition 13 imposed not only an acquisition-value limitation on a property's assessed value but also a 2 percent ceiling on annual increases to that limitation, neither Proposition 13 nor Proposition 8 created any such limitation on reductions in assessed value.

The *Pool* decision affects a perverse revision of this history.

Seizing on nothing more than a single phrase in the constitutional amendment authorized by Proposition 13 and amended to reflect the intent of Proposition 8, the trial court took Proposition 13's 2 percent ceiling on annual increases in the acquisition-value limitation - clearly intended to protect property owners against the effects of market inflation - and superimposed it on subsequent annual increases in assessed values that, under Proposition 8, have been reduced as a result of market deflation.

In effect, the court created a "super" Proposition 13, with an across-the-board 2 percent limit on annual increases in assessed value. Neither the history of the initiatives nor the constitutional amendments or their implementing statutes and regulations support this distortion of Proposition 13's acquisition-value approach.

The Folly of 'Pool'

The history and intent of Proposition 13 are well-documented. As a result, the essence of the legislative enactments adopted in 1978 and 1979 to implement the initiative has remained, in large part, intact.

The judge apparently gave little weight to that history and made no discernible effort to ascertain the intent of either the voters or the Legislature. Instead, the court focused on the language of Article XIII 2(b) of the Constitution.

On the basis of the phrasing of that provision, coupled with a complete misreading of Rev. & Tax. Code Section 51, the court extrapolated an "intent" of the initiatives: in no event would any assessed value increase exceed 2 percent per year (except in situations not presented by the facts of the case).