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California Property Tax Exemptions, Exclusions, Immunities, and Restrictions on Fair Market Valuation--Or, Whatever Became of Full Value Assessment?

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During the Proposition 13 campaign in 1978, the late Howard Jarvis was fond of saying that the property tax would generate plenty of money for the support of local government, despite the one percent limit specified in his initiative. Taken literally, Mr. Jarvis' assertion is certainly true. The estimated current fair market value of privately-owned tangible property in the State of California is in excess of $1.5 trillion.[1] Levying a full one percent tax rate on all of this property would generate over $15 billion—far in excess of the

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1. Publicly-owned and intangible properties are not subject to property taxes in the State of California. *See* text accompanying notes 10-14 & 64-73. The total value of privately-owned tangible property in the State of California was determined by estimating the full value of such property in Los Angeles County and developing a ratio to the current roll value. That ratio is 1.58 which, when multiplied against the total state roll of $988 billion, produces a statewide full value estimate of $1.57 trillion. *See* 1984-85 CAL. ST. BD. EQUAL. ANN. REP., Table 5 [hereinafter cited as SBE ANN. REP.].

estimated $10 billion in property tax collected by all California counties in the 1985-86 fiscal year,[2] and more than enough to cover all the costs of so-called property related services, for which property taxes have been the traditional source of support.

However, as the $5 billion difference between those numbers demonstrates, today's California property tax system comes nowhere near generating the amount of revenue that a flat one percent tax rate would produce without existing exemptions, exclusions, and special valuation rules. Throughout its history, the California property tax system has accumulated an incredible number of these exemptions and exclusions which greatly reduce the amount of revenue generated. In addition, the roll-back and freeze provisions of section 2 of Proposition 13 itself massively restrict the application of its one percent limit (especially in light of the liberal interpretations adopted by the Legislature and the State Board of Equalization (hereinafter State Board) in their implementation of section 2).

In fact, the history of California property tax law has been a long process of reducing the property tax base through constitutional amendments, legislative enactments, State Board rules, and court interpretations.[3] If the process continues unabated, by the end of the century we may have more value exempt than on the assessment rolls. The purpose of this article is to summarize briefly the scope of these exemptions and other limitations, to illustrate some of the problems inherent in the administration of our current property tax exemption system, and to make some recommendations for reform of that system.

I. Our Ever-Expanding Exemptions

A. *Prior to 1930*

California's first constitution, adopted in 1849, broadly stated that "Taxation shall be equal and uniform. . ."[4] California's first Legislature

2. This estimate is based on the 1984-85 revenue factored by the increase in net taxable value for 1985-86. SBE Ann. Rep., *supra* note 1, at 40.

3. In § 6.5 of their classic work on California property taxes, Kenneth Ehrman and Sean Flavin list four principle reasons for exempting property: Administrative convenience (low value property), use in providing services the government might otherwise have to supply (Welfare Exemption), subsidizing favored economic activity (fishing boats), or substitution of an alternative method of taxation (personal property of financial institutions). K. Ehrman & S. Flavin, Taxing California Property § 6.5, at 142-43 (2d ed. 1979). To these might be added: Elimination of taxes perceived to be onerous (Proposition 13), and assistance to organizations engaged in moral and spiritual activities (Church and Religious Exemptions).

4. Cal. Const. art. XI, § 13 (1849, repealed 1879).

nevertheless exempted property used for churches, cemeteries, libraries, and scientific institutions,[5] but in 1868 the California Supreme Court struck down these exemptions in *People v. McCreery*.[6] The amended Constitution of 1879 left out the "equal and uniform" requirement for ad valorem taxation and exempted growing crops, public schools, and government-owned property.[7] A constitutional amendment in 1894 exempted public libraries, free museums, fruit and nut-bearing trees, and grapevines.[8]

This began an ever-expanding series of constitutional amendments and legislative enactments to exempt or exclude property from taxation. Early in this century additional exemptions were added for churches in 1900, veterans in 1911, vessels and colleges in 1914, orphanages in 1920, and immature trees and cemeteries in 1926.[9]

B. Personal Property

In 1933, a constitutional amendment gave the Legislature authority to exempt personal property from taxation.[10] This authority was used by the Legislature to exempt possessory interests in personal property (1941) and individually-owned personal property (1969).[11] All business inventory was exempted in 1980.[12] Essentially, the only tangible personal property left on the assessment roll is business machinery and equipment, boats, and airplanes (plus "in lieu" taxation of motor vehicles).

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5. 1850 Cal. Stat. ch. 52, sec. 5.
6. 34 Cal. 432 (1868).
7. CAL. CONST. art. XIII, § 1 (1879, amended 1894); 1880 Cal. Am. Code ch. 31, at 5 (amending CAL. POL. CODE §§ 3607-3861) (code sections are statutory enactments implementing the constitutional provisions).
8. CAL. CONST. art. XIII, § 1 (1894, amended 1910); 1895 Cal. Stat. ch. 218, at 304 (amending CAL. POL. CODE §§ 3607-3900) (code sections are statutory enactments implementing the constitutional provisions).
9. CAL. CONST. art. XIII, § 1½ (1900, amended 1952); 1903 Cal. Stat. ch. 18, at 21 (enacting CAL. POL. CODE § 3611) (churches). CAL. CONST. art XIII, § 1¼ (1911, amended 1944); 1915 Cal. Stat. ch. 178, at 351 (enacting CAL. POL. CODE § 3612) (veterans). CAL. CONST. art. XIII, § 1a (1914, amended 1952); 1915 Cal. Stat. ch. 629, sec. 1, at 1216 (enacting CAL. POL. CODE § 3613) (colleges). CAL. CONST. art. XIII, § 4 (1914, amended 1932); 1943 Cal. Stat. ch. 994, at 2910 (enacting CAL. REV. & TAX. CODE § 209.5); CAL. REV. & TAX. CODE § 209 (enacted 1939) (vessels). CAL. CONST. art. XIII, § 1½ (1920); 1939 Cal. Stat. ch. 154, sec. 207, at 1282 (enacting CAL. REV. & TAX. CODE § 207) (orphanages). CAL. CONST. art. XIII, § 12¾ (1894, amended 1926); CAL. REV. & TAX. CODE § 211 (enacted 1939) (immature trees). CAL. CONST. art. XIII, § 1b (1926); CAL. REV. & TAX. CODE § 204 (cemeteries).
10. CAL. CONST. art. XIII, § 14 (1910, amended 1933) (current version is CAL. CONST. art. XIII, § 2).
11. CAL. REV. & TAX. CODE §§ 107, 224 (West 1970).
12. CAL. REV. & TAX. CODE § 219 (West 1970).

With regard to intangible personal property, the only categories ever subject to tax, such as solvent credits, notes, debenture bonds, deeds of trust, and mortgages, had all been exempted by 1967.[13] In addition, the intangible value of much tangible property has been exempted. In 1968 the value of movie prints was restricted to the value of the film, and in 1972 the value of computer software was restricted to the value of the material on which it is recorded.[14]

C. The Welfare Exemption

In 1944 the voters approved a constitutional amendment establishing a broad Welfare Exemption. The original language of the Exemption read as follows:

> In addition to such exemptions as are now provided in this Constitution, the Legislature may exempt from taxation all or any portion of property used exclusively for religious, hospital or charitable purposes and owned by community chests, funds, foundations or corporations organized and operated for religious, hospital or charitable purposes, not conducted for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.[15]

The history of the Exemption has been one of legislative expansion and broad interpretation by the courts. As currently set forth in sections 214-214.13 of the Revenue and Taxation Code, the Welfare Exemption today accounts for the bulk of exempt property in the State of California.[16]

1. Nonprofit Requirement

The constitution and section 214 are very clear that only property owned and used by nonprofit organizations is to be exempt. Neither operating profits nor the property remaining upon termination of the nonprofit use may inure to the benefit of any individual.[17]

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13. CAL. CONST. art. XIII, § 1 (1879); CAL. REV. & TAX. CODE § 212 (West 1970).
14. CAL. REV. & TAX. CODE §§ 988, 995 (West 1970 & Supp. 1987).
15. CAL. CONST. art. XIII, § 1C (1944). The current exemption is found in California Constitution article XIII, § 4.
16. *See infra* note 46.
17. CAL. REV. & TAX. CODE § 214(2), (6) (West 1970). *See also* CAL. REV. & TAX. CODE § 214.3 (West 1970). That section provides that property used solely for charitable or hospital use for a minimum period of 30 years shall qualify for the Welfare Exemption irrespective of any reversionary provision in the title of the property regarding liquidation, dissolution, or abandonment. The State Board staff is unaware of any instance in which property owners have taken advantage of this provision.

Initially, section 214 denied the exemption where the exempt property itself was operated at a profit even though the profit might be devoted entirely to the exempt activity.[18] The Legislature later loosened that restriction, and today profit may be derived as long as it is ancillary to the overall charitable thrust of the activities.[19]

2. Exclusivity Requirement

The second major requirement of both the constitution and section 214 is that exempt property be used "exclusively" for the exempt purpose. This requirement has been liberally construed by the California courts. "Exclusive" is not accorded the dictionary meaning of "sole." Commercial uses are permitted as long as the primary use is for the exempt purpose.[20] Perhaps the most extreme application of this principle occurred in *San Francisco Boys' Club v. County of Mendocino*.[21] In that case, almost 2000 acres of property owned by the Boys' Club was held to be exempt despite the fact that the property was used by the Club for camping purposes only during ten weeks in the summer, and two-thirds of the property was used for logging during the rest of the year.

In addition, exempt organizations are allowed to separate out their nonexempt activities and preserve the exemption for the balance of the property. This practice was approved by the California Supreme Court in two 1950 cases, *Y.M.C.A. v. County of Los Angeles*,[22] and

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18. 1945 Cal. Stat. ch 241, sec. 1, at 706 (enacting CAL. REV. & TAX. CODE § 214(3)). The original language contained the following restriction: "The property is not used or operated by the owner or by any other person for profit regardless of the purposes to which the profit is devoted." *Id.* Sutter Hospital in Sacramento was denied its exemption on this basis, and the denial was upheld by the courts. Sutter Hospital v. City of Sacramento, 39 Cal. 2d 33, 244 P.2d 390 (1952).

19. A 1953 statute substituted the present provisions of § 214(a)(3) for former Revenue and Taxation Code § 214(1). For hospitals, this rule is quantified by Revenue and Taxation Code § 214(a)(1), which provides that a hospital shall not be deemed to be organized for profit unless operating revenues (exclusive of gifts, endowments and grants-in-aid) exceed 110% of operating expenses. 1953 Cal. Stat. ch. 730, sec. 1, at 1994.

20. Peninsula Covenant Church v. County of San Mateo, 94 Cal. App. 3d 382, 396, 156 Cal. Rptr. 431, 438 (1979). As put by the court in that case:

> The word "exclusively" as used in section 214 generally means solely. While the courts have not defined "exclusive use" in such a restrictive manner, we believe that the clear meaning of section 214 is that, at the very least, the exempt purpose must be the primary use made of the property.

Id.

21. 254 Cal. App. 2d 548, 62 Cal. Rptr. 294 (1967).

22. 35 Cal. 2d 760, 221 P.2d 47 (1950).

Cedars of Lebanon Hospital v. County of Los Angeles.[23] A 1968 amendment to section 214 recognizes the permissibility of segregation by requiring that exempt property be "used for the actual operation of the exempt activity and . . . not exceed an amount of the property reasonably necessary to the accomplishment of the exempt purpose."[24]

3. *Use Requirements*

A third major Welfare Exemption requirement is that the property be used for hospital, scientific, religious, or charitable purposes.[25] Only the hospital category has (so far) been free of controversy.

"Religious" uses are not as easy to define. To begin with, under our doctrine of the separation of church and state, it is not constitutionally permissible to inquire into the truth of religious beliefs,[26] and the State Board guidelines in this area are necessarily very broad.[27] An equally difficult problem, raised recently in the Legislature, is whether or not religious organizations can constitutionally be required to file claim forms in order to secure the exemption of their property. Current legislation does require minimal reporting from all religious organizations claiming an exemption.[28] The judicial rationale for requiring reporting by religious organizations, and allowing inquiry to determine the accuracy of that reporting, is that such requirements constitute only an incidental burden on the exercise of religion.[29] In any case, current statutes and State Board guidelines

23. 35 Cal. 2d 729, 221 P.2d 31 (1950).

24. CAL. REV. & TAX. CODE § 214(3) (West Supp. 1987).

25. Although the general language of Revenue and Taxation Code § 214 includes "scientific" purposes, organizations attempting to qualify for the Welfare Exemption based on the use of property for scientific purposes must demonstrate that they meet all of the requirements for the exemption of charitable organizations. CAL. REV. & TAX. CODE § 214(a)(7) (West 1970).

26. Saint Germain Found. v. County of Siskiyou, 212 Cal. App. 2d 911, 28 Cal. Rptr. 393 (1963). *See* Fellowship of Humanity v. County of Alameda, 153 Cal. App. 2d 673, 693, 315 P.2d 394, 406 (1957).

27. *See* STATE BOARD OF EQUALIZATION ASSESSOR HANDBOOK, AH 267—WELFARE EXEMPTIONS (Dec. 1985). State Board, Letter to Assessors: 1986 Exemption Guidelines, 86/55 (July 30, 1986) (copy on file at *Pacific Law Journal*).

28. In 1981 the Legislature added Revenue and Taxation Code § 257 which eliminated the need for annual filing. CAL. REV. & TAX. CODE § 257 (West Supp. 1986). New Revenue and Taxation Code § 207 also streamlined the claims process for churches and church schools that were formerly required to file both a Welfare Exemption claim for the school and a Church Exemption claim for the church. CAL. REV. & TAX. CODE § 207 (West Supp. 1987).

29. Society of Krishna Consciousness v. County to Los Angeles, 112 Cal. App. 3d 582 (1980) (decision not officially published). The court stated that the filing requirements were "but an incidental burden on the Society's exercise of its religion, which burden the Society may avoid by not claiming the welfare exemption with regard to its property." *Id.* at 590.

appear to set forth workable solutions to most of the potentially sensitive problems that arise in this area.[30]

Defining "charitable purposes" has been a much more difficult problem. In *Cedars of Lebanon Hospital v. County of Los Angeles,*[31] the California Supreme Court came down on the side of a strict construction of the Welfare Exemption. However, the Court went on to say that "strict" does not mean "narrow," but rather "fair and reasonable."[32] The supreme court in *Y.M.C.A. v. County of Los Angeles*[33] rejected the narrow concept of charity—"as confined solely to the relief of the needy" in favor of a broader interpretation "comprehending as well activities which are humanitarian in nature and rendered for the general improvement and betterment of mankind."[34] In *Lundberg v. County of Alameda,*[35] the opinion by Chief Justice Gibson comes full circle and gives a "broad construction" to the word "charitable" in a case upholding the constitutionality of a new provision of section 214 which exempted certain educational institutions.[36]

In cases involving activities which might otherwise have been the responsibility of local government, such as primary and secondary education and care of the aged, the courts have upheld exemptions even where some of the individual beneficiaries were middle and upper class persons able to pay substantial fees for the services involved.[37] In another line of cases, generally involving activities open to the public, the courts have extended the meaning of "charitable"

30. The potential abuse of the Church Exemption (Revenue and Taxation Code § 206) is highlighted in the contradictory history of the exemption status of the Universal Life Church, famous for its mail-order ministers. The church was originally granted a federal income tax exemption in 1976, after the United States District Court recognized the tenets of the Church as "religious." Universal Life Church v. United States, 372 F. Supp. 770 (E.D. Cal. 1974). Ten years later, the Internal Revenue Service removed the church from its list of exempt organizations and contributions to the Church are no longer deductible. *See* Lowe, *IRS Snuffs Out Tax Exemption for Mail Order Religious Titles,* Los Angeles Daily Journal, Aug. 29, 1984, at 3, col. 5-6.

31. 35 Cal. 2d 729, 735, 221 P.2d 31 (1950).

32. *Id.* at 735, 221 P.2d at 35.

33. 35 Cal. 2d 760, 221 P.2d 47 (1950).

34. *Id.* at 768, 221 P.2d at 52. A recent newspaper article points out that only about 10% of the "charities" exempt for federal income tax purposes by the Internal Revenue Service are primarily concerned with aiding the poor. Johnson, *IRS Seeks to Impose Curbs on Lobbying by Charities,* Los Angeles Times, Jan. 1, 1987, at 1, col. 5-6.

35. 46 Cal. 2d 644, 298 P.2d 1 (1956).

36. *Id.* at 651, 298 P.2d at 6.

37. Fredericka Home for the Aged v. County of San Diego, 35 Cal. 2d 789, 221 P.2d 68 (1950); Sarah Dix Hamlin School v. City & County of San Francisco, 221 Cal. App. 2d 336, 34 Cal. Rptr. 376 (1963); Fifield Manor v. County of Los Angeles, 188 Cal. App. 2d 1, 10 Cal. Rptr. 242 (1961).

under the Welfare Exemption to include many types of activities that promote the "general welfare" of the community. For example, in *Stockton Civic Theatre v. Board of Supervisors,*[38] a community theater presenting amateur theatricals was found by the supreme court to be charitable, and the Court of Appeals for the Second District approved an exemption for the very professional productions of Los Angeles' Greek Theatre.[39]

A paragraph in a 1979 opinion by Justice Feinberg[40] sums up the current law as follows:

> From these decisions, two dependent variables emerge as particularly important to the determination of the court: the nature of the use of property, and the degree to which the activity is open to the community as a whole. If the use is one which is deemed particularly necessary to the welfare of the community or is a service which the government otherwise would be compelled to provide for the community, such as a hospital or elementary school, it may be considered a charitable purpose even though only a small number of people are directly benefited. If, on the other hand, the activity serves educational or humanitarian goals and is open to all or virtually all of the community, it may be exempt even though there are significant collateral benefits, such as amusement and entertainment.[41]

4. *Incidental Uses*

A final problem area in Welfare Exemption interpretation arises in connection with property uses not in themselves charitable but

38. 66 Cal. 2d 13, 423 P.2d 810 (1967).

39. Greek Theatre v. County of Los Angeles, 76 Cal. App. 3d 768, 142 Cal. Rptr. 919 (1978). In the closing paragraphs of his opinion, Justice Thompson stated: "While the judicial pyramid does not permit us to do so . . . , there is reason to reconsider the broad scope of the rule of Stockton Civic Theatre. . . . If we wre not precluded . . ., we would apply a narrower test of charitable activity. . . ." *Id.* at 784, 142 Cal. Rptr. at 927.

40. Peninsula Covenant Church v. County of San Mateo, 94 Cal. App. 3d 382, 399, 156 Cal. Rptr. 431, 440 (1979) (citations omitted).

41. *Id.* A different analysis of the requirements of the Welfare Exemption is contained in a decision of the State Board, *In re Crystal Cathedral of the Reformed Church in America,* Cal. St. Bd. Equal. (Feb. 29, 1984) (copy on file at *Pacific Law Journal*). The opinion of the State Board majroity in that case makes competition with commercial enterprises the critical factor in determining the availability of the Welfare Exemption. With all due respect, this is a unique and probably erroneous view of the law—as the dissent by State Board Member William Bennett vigorously asserts. If competition were the key, the current effort by health club owners to seek the revocation of the exemptions granted to various Y.M.C.A.s with similar health facilities would have a great likelihood of success. In fact, it would be surprising to see the Y.M.C.A.s lose their exempt status with the law as it stands today. Neither the State Board staff nor any of the affected assessors have shown any inclination to change the exempt status quo with regard to existing Y.M.C.A. programs and facilities.

which are, once again in the language of the *Y.M.C.A* opinion, "incidental to and reasonably necessary for the accomplishment of its exempt purposes."[42]

Many of the cases involving "incidental uses" concern residential property occupied by persons engaged in charitable and religious activities. In the *Y.M.C.A.* case the supreme court exempted dormitory facilities as being "reasonably necessary" in carrying out the Y.M.C.A.'s program "directed to the elevation and betterment of young men and boys,"[43] and in *Cedars of Lebanon* housing facilities for the hospital staff were similarly found to be exempt.[44]

In addition to the broad sweep of the judicial interpretations set forth above, the Legislature has also been at work. Numerous specific exemptions of particular activities similar to those covered by the Welfare Exemption have been added to the Revenue and Taxation Code. A current State Board publication on exemptions lists 63 separate exemptions, most of them covering the property of various types of nonprofit activity felt by the Legislature to be sufficiently beneficial to the public to warrant a property tax exemption.[45] The revenue loss for any specific exemption always sounds small in relation to the public benefit provided. However, in toto, the Welfare Exemption and its narrower counterparts involve in excess of $200 million in potential revenue.[46]

II. Valuation Restrictions (Proposition 13)

For most of California's history, residential property taxes have not been a major political problem. Prior to World War II home

42. Y.M.C.A. v. County of Los Angeles, 35 Cal. 2d 760, 771, 221 P.2d 47, 51 (1950).
43. *Id.* at 767, 221 P.2d at 52.
44. Cedars of Lebanon Hospital v. County of Los Angeles, 35 Cal. 2d 729, 221 P.2d 31 (1950).
45. State Board, Letter to Assessors: 1986 Exemption Guideines, 86/55, at 2, 227 (July 30, 1986) (copy on file at *Pacific Law Journal*). A similar letter summarizing all current exemptions is issued by the State Board annually.
46. As shown in Table 8 of the 1984-85 State Board Annual Report, the current assessed value of charitable and religious exempt property is approximately $19 billion, broken down as follows:

Type	Exempt Amount
Welfare	$11,726,057,000
Religious	3,519,384,000
College	3,073,636,000
Church	668,016,000

SBE Ann. Rep., *supra* note 1, at A-8, A-9. These numbers, however, are based on historical values for the properties in question, many of them decades old. No effort is made in most assessors' offices to estimate the current fair market value of such exempt property.

ownership was at lower levels than is true today, and informal split rolls (not to mention occasional outright corruption) generally kept taxes on single-family residences at comparatively low levels. Even after World War II, the tremendous volume of home building kept prices low, and the increase in residential property taxes during the 1950s and 1960s was actually below the rate of inflation. Since that time and prior to 1978, however, residential inflation has soared and property tax "reforms," together with computerized procedures and better administration, resulted in rapidly rising property taxes for homeowners.

In an effort to deal with this problem, the Legislature, in 1968, put on the ballot a constitutional amendment creating a $3000 Homeowners' Exemption. This amendment was overwhelmingly approved by the voters, as was a similar amendment in 1974 to increase the Homeowners' Exemption to $7000.[47]

As residential inflation increased during the late 1970s, property tax relief for homeowners became an overriding political issue,[48] especially since a growing state surplus provided the wherewithal for the Governor and the Legislature to deal with the problem. Relief was not provided and the Jarvis-Gann Initiative (Proposition 13), was the result. The proposition passed overwhelmingly in 1978 despite the dire predictions from opponents of the drastic impact the initiative would have on local government.[49]

Section 1 of Proposition 13, limiting property tax rates in California to one percent, is its best known provision and is the primary reason for the drastic drop in property tax revenues.[50] The average property tax rate in the State prior to 1978 was 2.67%.[51] Less well understood, but equally significant over the long-run, was section 2 of the Proposition which restricted the manner of appraising Cali-

47. The current provisions of the Homeowner's Exemption are contained in article XIII, § 3(k) of the California Constitution. This exemption was created by Propositions 1a (1969) and 6 (1974). These Propositions were placed on the ballot as the legislative response to efforts by former Los Angeles County Assessor Philip E. Watson to put a cap on property tax rates (Proposition 9 in 1968 and Proposition 14 in 1972) and by then-Governor Ronald Reagan to establish a limit on State revenue (Proposition 8 in 1974).

48. For example, in his 1977 State of the State Message, Governor Edmund G. Brown, Jr. made property tax reform number one on his legislative agenda. *Report to the Legislature,* Ass'y J., 1977-78, Jan. 6, 1977, at 159.

49. The Proposition 13 vote was 4,188,953 in favor and 2,281,888 against. It comprises article XIIIA of the California Constitution.

50. Total California property tax revenues in 1977-78 were approximately $10.3 billion. The revenue in 1978-79 was only $5 billion. SBE Ann. Rep., *supra* note 1, at 40.

51. SBE Ann. Rep., *supra* note 1, at 40.

fornia property for assessment purposes. Assessed values were rolled back to their 1975 levels with provision for a maximum two percent annual inflation increase. Only newly constructed properties, or those with ownership changes, are reappraised and assessed at their current fair market value.

Not to be outdone, the Legislature has enacted a number of exclusions from the change-in-ownership reappraisal requirement of Proposition 13.[52] These "exemptions" have been created despite having no specific basis in the language of the Proposition and despite the long-established rule that the Legislature does not have the authority to create real property exemptions.[53] These exemptions are of doubtful constitutionality, despite an Attorney General's opinion supporting certain exemptions created shortly after the passage of Proposition 13.[54]

At the State Board level, utilities and oil companies have not fared as well as other taxpayers in the rules adopted by the State Board for the implementation of Proposition 13. The State Board has been steadfast in its opposition to the efforts of the owners of state-assessed properties, primarily public utilities, to secure the protection of section 2 of Proposition 13, despite initial language of the Proposition which appears to exclude them from its coverage. The supreme court upheld the State Board's position on this issue.[55] The State Board adopted a middle position with regard to the procedure for assessing hydrocarbon reserves under Proposition 13, in the face of legal attacks by both oil companies and assessors asserting positions more favorable to their interests. Again, the State Board prevailed in court.[56] In other areas, State Board rules and guidelines frequently follow the tendency of the Legislature to favor taxpayers in dealing with situations not specifically covered by statute.[57]

52. There are 23 specific exclusions. CAL. REV. & TAX. CODE §§ 61-69 (West Supp. 1987). *See* Pope, *Proposition 13: An Administrative Nightmare,* LOS ANGELES LAW., Oct. 1981, at 10.

53. Article XIII, section 1 requires that all property be taxed, "unless otherwise provided by this constitution or the laws of the United States." CAL. CONST. art. XIII, § 1 (1894). Consequently, the Legislature has no authority to exempt real property. McKay v. San Francisco, 113 Cal. 392 (1896). *See also* CAL. REV. & TAX. CODE § 201 (West 1970). The Legislature has express authority to exempt personal property. *See* text accompanying notes 10-14.

54. 63 Op. Att'y Gen. 304 (1980). *See* Morris, *Proposition 13: Constitutional Problems,* LOS ANGELES LAW., Oct. 1981, at 11.

55. ITT World Communications, Inc. v. County of San Francisco, 37 Cal. 3d 859, 210 Cal. Rptr. 226 (1985).

56. Lynch v. Board of Equalization, 164 Cal. App. 3d 94, 210 Cal. Rptr. 335 (1985).

57. For example, State Board rule 462(1)(3) expands the interspousal transfer exclusion

This favorable Legislative-State Board climate for taxpayers under Proposition 13 has resulted in a relatively small amount of litigation with regard to the assessment aspects of Proposition 13. The reported cases have generally supported the legislative and State Board implementation provisions. The constitutionality of the roll-back and freeze provisions of section 2 was upheld in *Amador Valley Joint Union High School District v. State Board of Equalization.*[58] In addition to the cases upholding the State Board interpretations of the Proposition discussed above, Los Angeles County was unsuccessful in its effort to overturn a State Board staff letter spelling out procedures favorable to taxpayers involved in multi-year construction projects.[59]

Although Proposition 13 is by far the most important in terms of impact on assessed value, it is by no means the only significant restriction on the use of fair market value as the standard for the assessment of California property. The Williamson Act, adopted in 1965, restricts the valuation of much open space, including agricultural land, to use value.[60] Timber has been taken off the assessment rolls and replaced by a yield tax on harvested trees.[61] In addition, there are valuation restrictions on nonprofit golf courses,[62] historically significant properties,[63] enforceably restricted properties,[64] single-family residences in commercial zones,[65] and properties subject to wildlife habitat contracts.[66]

III. Immune Property (Public Ownership)

A final concept that greatly affects the overall impact of California's property tax is the concept of immunity for publicly-owned

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of Revenue and Taxation Code § 63 to include transfers pursuant to post-divorce amendments to marital settlement agreements. Similarly, a December 18, 1984 letter from State Board staff to the Los Angeles County Office of Assessor attaches a memorandum concluding that the transfer of valuable development rights between adjacent land owners is not a change in ownership, although the transfer of easements or water rights would involve a reappraisable change. One State Board member was heard to remark, during a discussion of these issues, that the voters had voted for low taxes in 1978 and that therefore disputes arising in the implementation of Proposition 13 should generally be resolved in favor of lower taxes. (State Board rules are found in the California Administrative Code, Title 18).

58. 22 Cal. 3d 208, 583 P.2d 1281 (1978).

59. Pope v. State Bd. of Equalization, 146 Cal. App. 3d 1132, 194 Cal. Rptr. 883 (1982). For a discussion of this case, see text accompanying notes 93-96.

60. Cal. Const. art. XIII, § 8; Cal. Gov't Code §§ 51200-51295 (West 1983). *See* Cal. Rev. & Tax. Code § 421 (West Supp. 1987).

61. Cal. Const. art. XIII, § 3(j); Cal. Rev. & Tax. Code § 423.5 (West 1970).

62. Cal. Const. art. XIII, § 10; Cal. Rev. & Tax. Code § 52 (West Supp. 1987).

63. Cal. Const. art. XIII, § 8; Cal. Rev. & Tax. Code §§ 439-439.4 (West Supp. 1987).

64. Cal. Rev. & Tax. Code § 402.1 (West Supp. 1987).

65. Cal. Const. art. XIII, § 9; Cal. Rev. & Tax. Code § 401.4 (West Supp. 1987).

66. Cal. Const. art. XIII, § 8; Cal. Rev. & Tax. Code § 423.7 (West Supp. 1987).

property. As a general rule, all publicly-owned property is immune (under the provisions of the United States Constitution) or exempt (under the provisions of the California Constitution) from property taxation in the State of California. Federally-owned property is immune from state and local taxation unless expressly waived by an act of Congress.[67] Similarly, the California Constitution exempts all property owned by the State or by local government bodies.[68] The only exception is for land owned by a local government outside its own boundaries.[69] Over fifty percent of the land area of the State of California escapes property tax due to these immunities.

The immunity of publicly held property is well understood and generally does not cause major problems in the administration of the property tax in California. Two peripheral areas do, however, raise significant issues. The first such area is the concept of "possessory interests" in publicly-owned property. Under California law, when a private party owns a leasehold interest in publicly-owned real property, the value of that lease is subject to property tax.[70] The longer the lease, the closer the value of the "possessory interest" to the value of the underlying publicly-owned fee.[71] The term contained in the lease document is normally used in determining the value of the possessory interest. However, State Board rule 23 sets forth a number of factors which may be used by assessors to find different "reasonably anticipated terms" under appropriate circumstances. In the only appellate court case involving rule 23, the trial court and the court of appeals rejected the use by the assessor of a longer term than provided in the leases of ten airlines, at Los Angeles International Airport, on the basis of the facts presented to the Appeals

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67. *See* K. EHRMAN & S. FLAVIN, *supra* note 3, § 5.2.

68. CAL. CONST. art. XIII, § 3.

69. CAL. CONST. art. XIII, § 11. *See also* CAL. REV. & TAX. CODE § 987 (West Supp. 1987). In past years Los Angeles and San Francisco acquired substantial amounts of land in Inyo, Mono and Tuolume Counties to obtain the appurtenant water rights and thereby secure additional water supplies. These acquisitions removed much value from the assessment rolls of those counties. Section 11 was enacted primarily to restore their tax bases. *See* K. EHRMAN & S. FLAVIN, *supra* note 3, § 6.11.

70. CAL. REV. & TAX. CODE § 107 (West Supp. 1987). It has been held that Revenue and Taxation § 107 does not apply to possessory interests in personal property. General Dynamics Corp. v. County of Los Angeles, 51 Cal. 2d 59, 330 P.2d 794 (1958). This omission is of great significance to California's defense industry, which uses large amounts of government-owned tools, equipment, and materials.

71. The basic case upon which current State Board valuation rules are based is De Luz Homes v. County of San Diego, 45 Cal. 2d 546, 290 P.2d 544 (1955). The *De Luz* approach, basing valuation on exchange value rather than use value, may result in adjoining fee owners, short-term lessees and long-term lessees in possession of parcels having the same value paying substantially different amounts of property tax.

Board.[72] This case has not been well received by assessors, and State Board rule 23 continues to require use of the "reasonably anticipated term" standard in appropriate circumstances.[73]

The other major problem area with regard to immunities arises under the commerce clause and the export-import clause of the United States Constitution. Under those clauses, goods moving in interstate or foreign commerce are not subject to property taxes. In *Low v. Austin*,[74] the California Supreme Court had allowed California's property tax to apply to imported goods. This action was reversed on appeal to the United States Supreme Court which interpreted the export-import clause as banning the property taxation of imported goods. A century later, in *Michelin Tire Corp. v. Wages*,[75] the Supreme Court overruled the *Low* case and held that nondiscriminatory property taxes may be applied to imported goods as soon as they leave the stream of transportation. The courts have interpreted transit immunity narrowly; only goods actively moving in interstate or foreign commerce, or at least committed to a carrier for that purpose, are immune from property tax.[76]

IV. The Current System Is an Administrative Nightmare

In theory, California's property tax system has a well-structured procedure for spelling out the details of the exemptions, exclusions and special valuation rules contained in articles XIII and XIIIA of the California Constitution. The courts, of course, have the final say as to the interpretation of those constitutional provisions. Basic statutory provisions are set forth in the Revenue and Taxation Code.[77] More detail is supplied, and gaps are filled, by rules adopted by the State Board. These rules have the force of law and are binding on both assessors and assessment appeals boards.[78] The State Board also

72. American Airlines, Inc. v. County of Los Angeles, 65 Cal. App. 3d 325, 135 Cal. Rptr. 261 (1976).

73. Cal. St. Bd. Equal. Prop. Tax R. 23, Cal. Admin. Code tit. 18, § 23 (1987). In Todd Shipyards v. Assessment Appeals Bd. No. 2, Civ. Case No. C505-511 (Los Angeles Super. Ct., July 10, 1984), a Superior Court applied the "reasonably anticipated term" standard of rule 23. *See* State Board, Letter to Assessors: The Ramifications of *American Airlines, Inc. v. County of Los Angeles* Decision, 77/52 (Mar. 28, 1977) (copy on file at *Pacific Law Journal*).

74. 80 U.S. 29 (1872).

75. 423 U.S. 276 (1976).

76. *See* K. Ehrman & S. Flavin, *supra* note 3, § 5.8.

77. Cal. Rev. & Tax. Code §§ 60-69, 70-74, 201-234 (West Supp. 1987).

78. Cal. Gov't Code § 15606 (West Supp. 1987). Cal. Rev. & Tax. Code § 538 (West Supp. 1987) requires assessors to seek declaratory relief from the courts should they disagree with the rules and procedures of the State Board.

prescribes the content of forms used by assessors, issues detailed instructions to them in the interest of promoting statewide uniformity in assessment practices, and surveys each assessor's office on a regular basis to insure compliance with State requirements.[79] In contrast to valuation decisions, with respect to which assessors and county appeals boards have the final say, the State Board is the final authority with regard to the Welfare Exemption. An assessor cannot approve a Welfare Exemption denied by the State Board. However, an assessor may deny an exemption despite a contrary State Board opinion.[80] As a practical matter, State Board staff opinions are given great weight in making Welfare Exemption decisions at the local level.

Despite this fine-sounding procedure, and the centralized appellate authority of the State Board over the Welfare Exemption, the existing system of exemptions, exclusions, immunities, and valuation restrictions is a haphazard morass.[81] As described below, the concepts are often vague, at other times technical and arbitrary, and all too frequently complex and overlapping. In toto, they can be a trap for the unwary and particular applications need to be reviewed in detail (often in consultation with local and State Board staff) before a final determination can be made.

A. Vague

Perhaps the premier example of vagueness in California property tax exemption law is the concept of "charitable" in the Welfare Exemption. As indicated above, the courts have given the concept a liberal interpretation, and, in a number of cases, have gone even further to allow exemptions to property used for purposes not charitable in themselves but "incidental" to the accompanying charitable use. This, obviously, adds a second uncertain level to an already vague concept.

The courts have recently had difficulty in applying these principles to parsonages and the living quarters of religious devotees. In *Serra Retreat v. County of Los Angeles*,[82] the California Supreme Court applied the Welfare Exemption to exempt the residential quarters of

79. CAL. GOV'T CODE §§ 15606, 15608, 15640-15644 (West 1980 & Supp. 1987).
80. CAL. REV. & TAX. CODE § 254.5 (West Supp. 1987).
81. For an excellent overview of the present system, see K. EHRMAN & S. FLAVIN, *supra* note 3, chs. 5 & 6.
82. 35 Cal. 2d 755, 221 P.2d 59 (1950).

Franciscan priests and lay-brothers who operated a laymen's religious retreat house. In dicta, the Court distinguished "parsonage cases where the provision of housing for the pastor or minister on church property does not stem from claims of institutional necessity as contrasted with mere considerations of residential convenience."[83] That dicta has been followed to deny exemption to parsonages, and is contained in current State Board guidelines.[84]

However, in *First United Methodist Church v. County of Los Angeles,*[85] the court of appeal overruled the State Board and the trial court and granted an exemption to two parsonages owned by the Methodist Church and furnished to its ministers. That opinion focused on the Church's use of the houses to further its purposes and treated the residential use by the ministers as secondary. A hearing was denied by the supreme court, but the opinion was ordered depublished. In *International Society for Krishna Consciousness v. County of Los Angeles,*[86] the second district allowed an exemption for the living quarters of Hare Krishna devotees despite their working time being spent primarily on nonexempt publishing activities. Again, the supreme court denied a hearing, but ordered that the opinion not be officially published.

Just what message the supreme court is trying to convey here is not entirely clear. The results in these cases turn on whether the residential (incidental) use is looked at from the point of view of the exempt organization or from the viewpoint of the employee-beneficiary. At some point the supreme court (or the Legislature) needs to resolve the issue in a definitive manner. In the meantime, these cases are an invitation for all similarly situated taxpayers to question the State Board guidelines[87] and file appeals if assessors continue to deny their exemptions.[88]

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83. *Id.* at 759, 221 P.2d at 61.
84. *See* State Board, Property Tax Information for Church Exemptions, Religious Exemptions and Religious Aspects of the Welfare Exemption, at 10 (Aug. 1985) (copy on file at *Pacific Law Journal*).
85. 161 Cal. App. 3d 1091 (1984) (decision not officially published).
86. 112 Cal. App. 3d 582 (1980) (decision not officially published).
87. The State Board has advised assessors to continue to use its existing guidelines. State Board, Letter to Assessors Only, CAO 85/05 (Mar. 26, 1985) (copy on file at *Pacific Law Journal*).
88. Another residential exemption problem illustrates the lack of uniformity that often results from the vagueness of the applicable rules. At present, the practice with regard to the residences of college and university presidents varies widely from county to county. In Los Angeles County, all are exempt (despite an abortive effort made 10 years ago to include all such residences on the roll). Among the other large counties checked, two have them on the

Another source of vagueness in property tax law is the language of Proposition 13.[89] Less than 400 words long, the Proposition totally revolutionized California assessment practices with the imposition of value ceilings that change only when there is "new construction" or a "change in ownership." Applying these general concepts to a complex commercial society has been a difficult task for California lawmakers. For example, how does the concept of "new construction" (or "change in ownership") apply to the assessment of hydrocarbon reserves? Exploration is done, new deposits are located, wells are drilled, oil and gas is brought to the surface and removed, deposits move underground, water injection and other secondary and tertiary recovery methods take place, wells are capped and abandoned, new technologies for recovery are developed, and (perhaps most difficult of all to quantify and assess) estimated reserves are adjusted upward and downward as the fluctuating price of oil influences the amount of underground deposits that are cost-effective to produce. After the passage of Proposition 13 in 1978, many assessors took the position that the multifarious activities taking place in the oil and gas fields amounted to continuous new construction which warranted reappraising hydrocarbon reserves annually. Some oil and gas producers, on the other hand, argued that all the oil and gas underground was in existence in 1978, and that when oil and gas equal to the assessed value in that year had been pumped up, the assessment should drop to zero. Not willing to take a position in this dispute between the oil companies and local government, the Legislature failed to take action. It was not until the following year that the State Board completed rule 468 instructing assessors on how to handle oil and gas reserves. Rule 468 takes a middle position between the oil companies and assessors, directing assessors to value existing reserves at the 1975 level but allowing them to add new reserves at current values, including those resulting from changes in the price of oil. The rule was attacked both by the oil industry and many assessors. The resulting litigation, *Lynch v. Board of Equalization*,[90] was decided by the trial court in 1981, and in 1985 at the appellate level.[91] This lengthy process underlines the problems asses-

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roll in full and two allocate the residences in question between nonexempt residential uses and exempt education uses. *See* Church Divinity School v. County of Alameda, 152 Cal. App. 2d 496, 314 P.2d 209 (1957).

89. CAL. CONST. art. XIIIA.

90. 164 Cal. App. 3d 94, 210 Cal. Rptr. 335 (1985).

91. The impact in Kern County, had *Lynch* been decided in favor of the oil companies,

sors and taxpayers have in attempting to resolve the ambiguities in the provisions of articles XIII and XIIIA. They are constitutional, and cannot be finally resolved at the local, State Board or even legislative level. Only four votes on the California Supreme Court achieve final certainty.[92]

Assessors and taxpayers are faced with an even more difficult situation when the Legislature and the State Board fail to act to resolve ambiguous concepts. Again, Proposition 13 situations are illustrative. Revenue and Taxation Code section 71, an early legislative provision implementing Proposition 13, is ambiguous with regard to the treatment of multi-year construction projects. Many assessors believed that legislative intent and good appraisal practice required waiting until the final completion of the project and then doing a unitary appraisal of the entire improvement. State Board staff issued a contrary instruction to assessors in 1980, calling for separate appraisal of each portion of the project as it is completed.[93] This "Assessors' letter" was litigated in Los Angeles County and an appellate decision was rendered in favor of the State Board.[94] Efforts by assessors to secure legislation settling this issue in favor of their position were unsuccessful, due in no small part to the vigorous opposition by State Board staff in the Legislature.[95] Even so, the State Board itself has never adopted a rule resolving the matter.[96]

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would have been catastrophic. The "Oil Roll" in Kern County is currently approximately $15 billion. About $9 billion of that roll segment would have been eliminated if the position of the oil companies had been adopted (approximately one-third of the County's entire assessment roll).

92. Six justices were on the November 4, 1986 ballot for confirmation. Three were rejected. Needless to say, the philosophical view point of the Court may be substantially impacted by that result.

93. State Board, Letter to Assessors, 80/77 (May 8, 1980) (copy on file at *Pacific Law Journal*).

94. Pope v. State Bd. of Equalization, 146 Cal. App. 3d 1132, 194 Cal. Rptr. 883 (1983).

95. Language favoring the County's position was originally part of Senate Bill 1108 (later deleted), and also part of Assembly Bill 3358 (Floyd) and Senate Bill 1231 (McCorquodale), all in the 1983-84 Regular Session of the State Legislature.

96. A similar problem exists eight years after passage of Proposition 13 with regard to the term "major rehabilitation," which triggers reappraisal under Revenue and Taxation Code § 71. State Board rules do not define "major rehabilitation" in specific terms. State Board guidelines distinguish "major rehabilitation" from correction of "deferred maintenance" and suggest the use of an "85% good" standard. Assessors are unsure as to the exact meaning of those terms, particularly as applied to relatively new improvements (which may be close to "85% good" at all times and often already exceed their existing assessed values with or without the construction work at issue). One large county relies largely on an "extension of economic life" standard. Another requires a value increase of at least 50%. Many counties simply leave the matter to "appraisal judgment." As in the case of multi-year new construction, the courts may have to deal with this problem by default.

Similarly, some commercial property owners have attempted to use the broad language of Revenue and Taxation Code section 62(e) as a basis for asserting that major sale and leaseback transactions are not "changes in ownership" under Proposition 13. The State Board has issued contrary instructions.[97] Assessors were able to secure the passage of legislation supporting the State Board position, at least prospectively.[98] This legislation, however, was vetoed by the Governor and the matter remains up in the air in the absence of a State Board rule (or future legislation) resolving the issue once and for all.

B. Technical and Arbitrary

As with federal income tax law, property tax rules are frequently technical and arbitrary and not subject to common sense analysis. For example, the articles of incorporation of nonprofit corporations must follow a certain format prescribed by the State Board or risk not securing the exemption to which they would normally be entitled.[99] As well advised an entity as the Los Angeles Olympic Organizing Committee had problems with its exemption status because of difficulties with its articles of incorporation.

The change-in-ownership provisions enacted by the Legislature and the accompanying rules adopted by the State Board to implement section 2(a) of Proposition 13 are replete with arbitary requirements that frequently result in unintended or inconsistent property tax consequences. The following examples are illustrative:

1. *Spousal Transfers.*—The State Board and the legislature have been unable to decide whether spouses should be treated as two persons or as a single entity for change-in-ownership purposes. Pursuant to Revenue and Taxation Code section 63, transfers of property between spouses are not subject to reappraisal, apparently on the theory that the family is a single economic entity. However, State Board instructions provide that if spouses purchase all the shares of a stock there is no reappraisal, apparently on the opposite theory that spouses are separate individuals and neither one has acquired more than fifty percent of the shares.[100]

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97. State Board, Letter to Assessors, 85/128 (Dec. 5, 1985) (copy on file at *Pacific Law Journal*).

98. A.B. 2528, 1985-86 Leg., 2d Reg. Sess. (vetoed Sept. 12, 1986).

99. CAL. REV. & TAX CODE §§ 214.01, 254.5 (1970); CAL. ST. BD. EQUAL. PROP. TAX R. 136, CAL. ADMIN. CODE tit. 18, § 136 (1987).

100. CAL. REV. & TAX. CODE § 63 (West Supp. 1987); State Board, Letters to Assessors, 83/17 (July 15, 1983), and 85/33 (Mar. 5, 1985) (copies on file at *Pacific Law Journal*).

2. *Tenancy in Common Versus Joint Tenancy.*—Joint tenants may be added or removed from title without reappraisal consequences as long as the original owner(s) remain as joint tenants. The same transactions done by tenants in common would each cause partial reappraisals.[101] Lay persons attempting simply to add or subtract family members to and from title frequently run afoul of this distinction.
3. *Legal Entity Rules.*—The rules governing legal entities are particularly technical and need careful analysis to be sure of the property tax consequences of a complex transaction. For example, if one corporation is acquired by another corporation, the real property of the acquired corporation is reappraised. However, if a group of entities (or persons) makes the acquisition, with no one of them obtaining over a fifty percent interest, there is no reappraisal.[102]
4. *Step Transactions.*—If two persons own property and transfer a one-third interest to another person, that one-third interest will be reappraised. However, if the two original owners form a corporation, transfer the property to the corporation, transfer one-third of the shares of the corporation to the other person, and then dissolve the corporation with all three sharing equally in the property, reappraisal can be avoided. This procedure could be reversed to avoid reappraisal when ownership is to be reduced from three owners to two owners.[103]

Perhaps the most egregious example of an arbitrary requirement in connection with Proposition 13 is the first amendment to the Proposition, passed in the fall of 1978, which provides for special assessment rules for properties affected by disaster "as declared by the Governor."[104] The unreasonableness of that constitutional restriction has resulted in its being totally ignored. The sections of the Revenue and Taxation Code and the State Board rules implementing the disaster provisions both omit the quoted limitation and provide

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101. CAL. REV. & TAX. CODE §§ 62(f), 65 (West Supp. 1987).

102. CAL. REV. & TAX. CODE § 64(c) (West Supp. 1987); CAL. ST. BD. EQUAL. PROP. TAX R. 462(j), CAL. ADMIN. CODE tit. 18, § 462(j) (1987).

103. Opinion letter, from Eric F. Eisenlauer, State Board Tax Counsel, to Gary W. Maeder, Esq., Sept. 9, 1986 (copy on file at *Pacific Law Journal*). The inter-spousal transfer exclusion could be used in a similar way to avoid reappraisal. Suppose a father wishes to transfer property to his son. He could go through a marriage ceremony with the son's fiance, transfer the property to her and then divorce her. No reappraisal. She could then marry the son and transfer the property to him. Again, no reappraisal. Examples like these give some credence to the comment of one prominent Los Angeles property tax lawyer who stated that he could structure any transfer to avoid a change-in-ownership reappraisal.

104. November 1978 California Ballot Pamphlet, Proposition Eight (now part of CAL. CONST. art. XIIIA, § 2(a)).

relief to all properties affected by disasters, with or without the gubernatorial declaration.[105]

C. Complex and Overlapping

Probably the best example of overlap involves property used for church purposes which may qualify for either the Church Exemption, the Religious Exemption, or the Welfare Exemption. For the most part, this is a distinction without a difference, but not always. For example, the Religious Exemption has a one-time only filing requirement while the Church and Welfare Exemptions require annual filings and may be lost if filing dates are missed.[106] Also, the two latter exemptions require both ownership and use while the Church Exemption sometimes only requires use, a vital distinction in the case of leased property.[107] Obviously, a thorough knowledge of these niceties is necessary if the owners of potentially exempt property are to be able to take maximum advantage of existing law.

An excellent example of factual complexity in a particular case is the opinion of the State Board segregating the exempt from the nonexempt uses of the Crystal Cathedral property in Orange County. In its decision in that case dealing with the 1979-82 period, the State Board disallowed claimed exemptions for thirty-seven rooms and part of the sanctuary in the Cathedral itself for 1982, all of the Fellowship Hall for 1982 and areas in the Hall used by a profit-making corporation for 1979-81, most of the Arboretum for 1982 and Arboretum areas used by the for-profit corporation during 1979-81, a bookstore for 1980-82, and areas used by the for-profit corporation on three floors of the Hour of Power Building in 1979-81.[108] Obviously, church officials and the Orange County Office of Assessor have their work

105. CAL. REV. & TAX. CODE § 51(c) (West Supp. 1986); CAL. ST. BD. EQUAL. PROP. TAX R. 461, CAL. ADMIN. CODE tit. 18, § 461 (1987).

106. STATE BOARD, PROPERTY TAX INFORMATION FOR CHURCH EXEMPTIONS, RELIGIOUS EXEMPTIONS AND RELIGIOUS ASPECTS OF THE WELFARE EXEMPTION (Aug. 1986) (copy on file at *Pacific Law Journal*). Notwithstanding the filing deadline, Revenue and Taxation Code § 270 permits late filing. CAL. REV. & TAX. CODE § 270 (West supp. 1987).

107. *See* PROPERTY TAX INFORMATION FOR CHURCH EXEMPTIONS, *supra* note 106, at 1.

108. *In re Crystal Cathedral of the Reformed Church in America,* Cal. St. Bd. Equal. (Feb. 29, 1984) (copy on file at *Pacific Law Journal*). In *Society for Krishna Consciousness v. County of Los Angeles,* the trial court granted a partial exemption based on a time allocation of the use of the premises in question. The practical difficulty of applying any such standard is obvious. The taxpayer conceded as much and did not pursue that argument on appeal. 112 Cal. App. 3d 582 (1980) (opinion not officially published).

cut out for them in keeping proper track of the many activities on the Cathedral property in the future.

A complex situation involving an entire line of business arose subsequent to the United States Supreme Court's decision in *Michelin Tire Corp. v. Wages*,[109] which removed the property tax immunity previously accorded to imports. Assessors reacted, following the advice of the State Board, by levying escape assessments on importers for all years within the statute of limitations. Importers sought and obtained legislative relief in the form of Revenue and Taxation Code section 226 which prohibited the retroactive application of *Michelin.* Los Angeles County, having made numerous early assessments in anticipation of *Michelin,* in turn secured an amendment to section 226 allowing retroactive assessments already made where "it would be equitable to do so." The fairness of this exception was, needless to say, attacked in court, and the court of appeal held in *Sears, Roebuck & Co. v. County of Los Angeles*,[110] that section 226 should not be applied when the taxpayer believed that its goods were immune and priced them accordingly. The difficulties of applying this subjective standard are obvious. Fortunately for property tax administrators, the 1980 action of the Legislature granting a 100% exemption to business inventory has eliminated the possibility of further problems in this area.

The provisions governing whether or not changes in the ownership of legal entities trigger the reappraisal of the real property owned by those entities involve both theoretical and factual complexity. The Legislature failed to choose between the entity theory and the ultimate ownership theory of ownership in Revenue and Taxation Code sections 61, 62, and 64. For some purposes, the corporation and partnership entities are treated as the owners of their taxable property, and for other purposes the stockholders and partners are treated as the owners. The same lack of consistency is contained in State Board rule 462(j), one of the most complex subdivisions of the State Board's change-in-ownership rule. However, these theoretical problems in the underlying legal provisions pale in comparison to the difficuty of applying them to the complex commercial society in which we live. For example, in one Los Angeles County case, an Assessment Appeals Board held that a forty percent change in ownership had occurred in a situation that called for either a one hundred percent reappraisal

109. 423 U.S. 276 (1976). *See supra* notes 75-76 and accompanying text.
110. 85 Cal. App. 3d 763, 149 Cal. Rptr. 750 (1978).

or none. The complexity of the ownership interests in question was so great that the county and the taxpayer accepted that result rather than pursue the matter to trial in the Superior Court.[111]

D. Expensive to Administer

Needless to say, this complex system of exemptions, exclusions, restrictions and immunities is cumbersome and expensive to administer. The Exemption Section of the Los Angeles County Office of Assessor has ninety-two employees and a total budget of $1.2 million. In addition, approximately forty employees are engaged in public service and roll adjustment activities related to these limitations, at an annual cost in excess of $1 million. The statewide cost of similar activities in all assessors' offices would be at least three times as much, plus approximately one percent of the $122 million expended by the State Board in 1984-1985.[112] The cost to the private sector of complying with the legal requirements is probably at least as large.

V. Recommendations for Reform

A simple and orderly system of exemptions and other limitations for California's property tax is too much to hope for in the foreseeable future. As with many of our tax rules, special interest groups of all sorts find tax exemptions and exclusions the easiest way politically to obtain governmental support. Subsidies that would be objectionable, if not unconstitutional, as appropriations from the public treasury are much easier to achieve through property tax exemptions. Many sessions of the Assembly and Senate Revenue and Taxation Committees are largely taken up with proposals for new exemptions which would receive short shrift as budget items in the Assembly and Senate fiscal committees. Once in, exemptions are hard to remove, as any member of the Legislature (or any politician (fool)hardy enough to suggest the possibility of making any substantial change in Proposition 13) can attest. Hence the more modest recommendations for reform set forth below; any one of which

111. Hexalon v. County of Los Angeles, Civ. Case No. 516-403 (Los Angeles Super. Ct., Jan. 15, 1985). *See also* Title Ins. & Trust Co. v. County of Riverside, Civ. Case No. 144-292 (Riverside Super. Ct., Jan. 15, 1985). In that case, a Superior Court Judge refused to follow the requirement of State Board rule 462(j) that changes in ownership of a parent corporation also apply to its subsidiaries on the basis that Cal. Rev. & Tax. Code § 64(c) does not expressly require that result.

112. This cost is estimated at 25% of the total State Board Assessment Standards expenditure. SBE Ann. Rep., *supra* note 1, at A-3.

would be a major step in the direction of better public understanding and less expensive administration of California's property tax system.

A. Sunsetting

With the revenue loss from exemptions and other limitations as large as it is, the most obvious general approach would be to abolish them all and lower Proposition 13's basic one percent rate by a corresponding amount. In theory, this approach would have great appeal since the reduction would exceed thirty percent. A two-thirds of one percent rate applied to all privately-owned tangible property in California would generate as much revenue as the existing property tax structure does today.[113]

As with all tax reform proposals, the political realities intrude. Despite the fact that some of our founding fathers may have thought property tax exemption for churches an unconstitutional subsidy of religion, the religious exemption has a 200 year history that is hardly likely to be terminated any time soon.[114] Similarly, the budgets of many private schools, hospitals, and other nonprofit institutions would be severely strained by having to pay property tax, and these organizations would not be wanting for champions against any effort to remove their exemptions.

As a practical matter, the most that could be hoped for in this area would probably be a sunset procedure in which exemptions would terminate unless renewed by a vote of the Legislature or the people every so often. This procedure might eliminate some of the more archaic exemptions, and would at least help to underline the "cost" of the present system to the legislators and voters on a regular basis.[115]

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113. *See* notes 1-2 and accompanying text.

114. In Walz v. Tax Comm'n, 397 U.S. 664 (1969), the United States Supreme Court found that the legislative purpose of property tax exemptions for churches was neither the advancement nor the inhibition of religion. Accordingly, the Court held that such exemptions do not violate the first amendment of the United States Constitution. *Id.* at 672-80.

115. California has been making slow progress in this area for a number of years. In 1971 the Legislature directed the Department of Finance to report every two years on the "tax expenditures" in the state's tax structure (defined as deductions, credits, exclusions, exemptions, and preferential rates). 1971 Cal. Stat. ch. 1762, at 3810-11. This report was made a part of the Governor's Budget in 1977. 1976 Cal. Stat. ch. 575, sec. 2, at 1416. In 1985, the Legislature provided the report be made on an annual basis. 1984 Cal. Stat. ch. 268, sec. 23.5, at 71; CAL. GOV'T CODE § 13305 (West Supp. 1987). The report, however, is lacking in completeness since it does not generally include constitutional provisions, and will exclude "general tax expenditures" in the future. *See 1986-87 California Governor's Budget*, at 83 (Jan. 10,

B. Regular Reappraisal of Business Property

Any effort to change the rollback and freeze provisions of Proposition 13 as applied to homeowners appears not to be politically feasible for the foreseeable future.[116] A more realistic proposal in this area might be the regular reappraisal of business property as initially suggested last year by the Governor's Tax Reform Commission.[117] With regard to the fairness of limiting regular reappraisal to business property, most residential property turns over regularly and is generally reappraised at least once a generation on the death of the owners.[118] In contrast, business property is normally owned by corporations and partnerships and may never be reappraised. Moreover, residential property is bought primarily for its use value to the owner, which does not change over time. Business property, on the other hand, generally generates income which does, in most cases, increase with inflation over the long run.

Regular reappraisal of business property would equalize the property tax base of competitors (now often glaringly divergent) and enable the Legislature to repeal the most complex of the change-in-ownership rules. This scheme could be made revenue-neutral by being coupled with the repeal of the property tax on business personal property (the least cost-effective aspect of the current property tax system), and with the inclusion of limits on the percentage of increased taxes for reappraised property in any one year.

C. Administrative Simplifications

All property tax exemptions could be consolidated into a single general exemption which, once granted, would not require annual renewal. The sole requirement would be use by organizations

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1986). The Legislature has gone one step further and directed the Legislative Analyst to establish a process for reviewing all "tax exceptions" (similarly defined) with a view toward the possible preparation of a "Tax Exception Budget Revision Bill" in each general session of the Legislature. 1985 Cal. Stat. res. ch. 70, at _____.

116. Proposition 13 continues to have overwhelming public support. *See* CALIFORNIA AND THE AMERICAN TAX REVOLT: PROPOSITION 13 FIVE YEARS LATER (T. Schwadron ed. 1984); Ryavec & Dougherty, *Putting Fairness Back Into Proposition 13*, Los Angeles Herald Examiner, Feb. 13, 1985, at A13.

117. TAX REFORM ADVISORY COMMISSION REPORT, at 49-52 (Feb. 11, 1985).

118. However, Proposition 58, approved by the voters in the 1986 General Election, eliminates reappraisal for most property transfers between parents and children. November 1986 California Ballot Pamphlet, Proposition 58 (now CAL. CONST. art. XIIIA, § 2(g)-(i)).

entitled to specified income tax exemptions under federal or state law.[119] To reduce possible abuse, the consolidated reporting form could require a declaration under penalty of perjury that the property is being used solely for the exempt purpose, and organizations could be required to report when the exempt use was terminated, with substantial penalties for failure to report. A regular audit rotation could be established to check compliance. This procedure could be administered locally, as are other property tax matters, without the current necessity of procuring final decisions at the State Board level in Sacramento.

The Homeowners' Exemption should be excepted from any such procedure. Responsibility for administering the Homeowners' Exemption could be shifted to the State Franchise Tax Board. Eligible homeowners would simply check a box on their state income tax returns and be entitled to a standard credit. This procedure would not only save the large administrative costs incurred in administering the Homeowners' Exemption programs by the counties, but would also eliminate the State Board computerized cross-checking procedure for the purpose of preventing multiple Homeowners' Exemption claims by individuals owning properties in more than one county. Alternatively, all single-family dwelling units might simply be given an automatic equivalent exemption.

VI. CONCLUSION

The size and complexity of the present system of property tax limitations and the political muscle of the affected organizations make reform of the system difficult. Reform would require a concentrated effort by property tax administrators, legislators and staff, and interested organizations, such as the State Bar, perhaps aided by the Law Revision Commission, to achieve success. Despite the cumbersome nature of the present system and its expense to administer, the "if it ain't broke, don't fix it" philosophy is likely to prevail over all but the most determined reform efforts. Unfortunately, a major scandal or public perception of wide-spread abuse is probably the necessary precursor of significant reform in this area.

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119. *See* CAL. REV. & TAX CODE § 214.8 (West Supp. 1987). This new section requires that all Welfare Exemption organizations provide an exemption letter from either the Internal Revenue Service or the State Franchise Tax Board. *Id.*