

[Senate Bill 1498](#) (Committee on Governance and Finance)

Date: 4/18/2018 (amended)

Program: Property Taxes

Sponsor: Author

Revenue and Taxation Code Section 469

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This analysis is limited in scope to the property tax assessment related provisions.

Summary: This bill provides an alternative method of meeting the annual audit requirements to allow the assessor some discretion in the number of audits completed each fiscal year.

Fiscal Impact Summary: No fiscal impact.

Existing Law: Under existing property tax law, an annual ad valorem tax is imposed on all assessable property used in a trade or business. In determining these assessments each year, taxpayers typically report the cost of such property to the local county assessor on a "business property statement"; as provided for by Revenue and Taxation Code (RTC) section 441. The business property statement shows all taxable business property, both real and personal, which is owned, claimed, possessed, controlled, or managed by the person filing the property statement.

To encourage the accurate and proper reporting of such property, county assessors are required to annually audit a certain number of taxpayers in the county each year; the number varying by county. Of these required audits, 50 percent must be performed on taxpayers selected from a pool of those taxpayers that have the largest assessments of locally assessable trade fixtures and business tangible personal property in the county.¹ The remaining 50 percent of the required audits shall be selected in a manner that is fair and equitable to all taxpayers and may be based on evidence of underreporting as determined by the assessor.

For example, in a county where the assessor is required to conduct 100 audits per year, the assessor must conduct 50 audits of taxpayers from the pool of taxpayers with the largest assessments and 50 audits of other taxpayers, at a minimum each year.

Proposed Law: This bill provides an alternative that allows the assessor discretion in the number of audits to be completed each fiscal year as long as the four-year total number of audits in each category are completed within a four-year period.

In General: Audit Objective. A property tax *audit* is a means of collecting data relevant to the determination of taxability, situs, and value of property. It is used to verify an assessee's reported cost on the required annual property statement and other information which may influence the assessment of taxable property. An *audit program* is a system used to select and conduct these audits. Both are used to sample property tax assessments to ensure that taxable property and related information have been accurately reported by the assessee and have been properly assessed by the assessor.

¹ Taxpayers in the pool of taxpayers with the largest assessments are required to be audited at least once within each four-year period following the latest fiscal year covered by a preceding audit.

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The primary objective of the property tax audit is to determine that a correct assessment has been made. The auditor applies generally accepted auditing standards and utilizes generally accepted accounting and appraisal principles in performing these audits. Audits, and the audit program as a whole, help to identify problems, correct inaccurate existing assessments, and increase the likelihood that future assessments will be accurate through improved reporting by the assessee and improved understanding of the property by the assessor's office.

Audit Selection. Property Tax Rule 192 prescribes the computation establishing minimum required audit production and provides the basis for the audit selection process. Letter To Assessors (LTA) No. 2009/049 provides a list of the minimum annual property tax audits required to be conducted by each county, which includes the significant number of audits and the number of audits required from the pool of largest assessments.

Role of Board of Equalization (BOE). The Government Code requires the BOE to survey each county assessor's office at least once each five years. The purpose of the survey is to determine the adequacy of the procedures and practices the county assessor uses in valuing property and to evaluate the assessor's performance of mandated duties. The survey concentrates on statutory mandates and revenue-related issues. The surveys are conducted as follows: For each county, BOE staff conducts an audit of the assessor's procedures and practices. The staff then publishes an assessment practices survey report that summarizes the findings and includes recommendations for improvement. In addition, each year the BOE staff perform appraisal samples of five county assessment rolls as a component of the survey or as a stand-alone report. A statistically representative sample is drawn from the county assessment roll. BOE staff audits and appraises each property in the sample and compares the results to the assessor's values. Staff then expands the results to determine whether the total assessment roll complies with statutory standards.

Background: Assembly Bill 550 (Ch. 297, Stats. of 2008) amended Revenue and Taxation Code section 469 and became effective on January 1, 2009. This bill changed the requirements for what was commonly known as a *mandatory audit*. The bill deleted the requirement that an assessor must audit, at least once every four years, all taxpayers that own, claim, possess, or control locally assessable trade fixtures and business tangible property with a full value of \$400,000 or more.

Commentary:

1. **Alternative Manner to Satisfy Audit Requirements.** This bill provides an alternative that allows the assessor discretion in the number of audits to be completed each fiscal year as long as the four-year total number of audits *in each category* are completed within a four-year period. For example, in a small county where the assessor is required to conduct 10 audits per year, the assessor will now have the latitude to best use her/his resources to complete 40 required audits in a four-year period, rather than being required to conduct 10 audits (five audits of taxpayers from the pool taxpayers with the largest assessments and five audits of other taxpayers) each year.
2. **To "conduct" an audit or to "complete" an audit?** Existing law requires the assessor to *conduct* a significant number of audits each year, while this bill, as written, allows the assessor the discretion to *complete* the same four-year total number of audits required any time within the same four-year period. However, in the assessment context, the words *conduct* and *complete* can be understood to have very different meanings. To "conduct" an audit can mean to initiate the process of reviewing a taxpayer's books and records (including the use of a waiver to

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perform and complete the audit outside the statute of limitations deadline) without requiring that audit findings be rendered and enrolled within the same fiscal year as the taxpayer was selected for audit. To "complete" an audit is commonly understood to mean that the audit must be both initiated and finished (audit findings rendered and enrolled, where applicable) within the same fiscal year as the taxpayer was selected for audit.

By requiring that the audits be completed, any audits in progress (findings not yet rendered and enrolled at the end of the four-year period, even if under waiver) would *not* be counted toward the number of audits the county is required to have completed within the four-year period.

We also note that confusion exists under the current language of section 469 as to whether the requirement that the assessor "conduct a significant number of audits" is intended to mean: (1) that an audit of the books and records must be completed (findings rendered and enrolled) within the fiscal year the taxpayer was selected for audit, or (2) that an audit must be completed or under a waiver of the statute of limitations in order to be counted. Thus, it may be beneficial to define "conduct" and "complete" in order to clarify what actions are required to meet the "conduct" standard and the "complete" standard, or to clarify that only one standard is intended and define that standard.

3. **Audit Cycle.** This bill appears to create a rolling four-year period in which assessors must complete a specified number of audits. Should there be a start point, other than the first fiscal year following the effective date of the legislation, for a four-year cycle in which assessors must complete the required number of audits?
4. **BOE Survey Program.** This bill appears to create a rolling four-year period in which assessors must complete a specified number of audits *with no specified number of audits per year*. When surveying an assessor's office, BOE staff would have difficulty in determining whether an assessor is meeting the requirement to conduct a specified number of audits within a four-year period.

Costs: The BOE would incur absorbable costs in revising handbooks, regulations, and informing and advising local county assessors, the public, and staff of the law changes.

Revenue Impact: This measure does not have any direct revenue impact. Any reduction or increase would be associated with the findings of the audits. Audits can result in (1) no change to assessed value, (2) an increase in assessed value resulting in a tax bill for additional taxes via an escape assessment, or (3) a decrease in assessed value resulting in a property tax refund of taxes previously paid.

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