California State

Board *of* Equalization

Legislative Bill Analysis

Legislative, Research & Statistics Division

Senate Bill 1498 (Committee on Governance and Finance)
Date: 8/6/2018 (amended)
Program: Property Taxes
Sponsor: Author
Revenue and Taxation Code Section 469
Effective: January 1, 2019

Mark Durham (Chief) 916.319.9220
Glenna Schultz (Analyst) 916.274.3362
Chris Butler (Revenue) 916.323.3800

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.

Summary of Amendments: Since our previous analysis, the amendments to this bill affect code sections not related to property tax assessment and are outside the purview of the State Board of Equalization.

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 significant audits in each category are completed within a four-year period. This bill also provides that the first four-year period will begin with the 2019-20 fiscal year.

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

[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.

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.

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.

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. **Summary of Amendments.** The **August 6, 2018** amendments affect code sections not related to property tax assessment. The **June 19, 2018** amendments clarify that, for purposes of the alternative method, the four-year total of the significant number of audits may be audited at any time within the four-year period and that the first four-year period for this alternative method begins with the 2019-20 fiscal year.

2. **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.

3. **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 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.

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.

4. **More Stringent Requirements.** 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.

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.