

[Assembly Bill 885](#) (Irwin)

Program: Property Taxes

Sponsor: California Assessors' Association

Revenue and Taxation Code Section 70

Effective: January 1, 2020

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Summary: For purposes of the new construction exclusion for property that has been reconstructed after an improvement was damaged or destroyed by misfortune or calamity on or after January 1, 2017, this bill provides that "substantially equivalent" means the reconstructed improvement does not exceed 120 percent of either the size or full cash value of the improvement before the damage or destruction.

Fiscal Impact Summary: This bill would reduce annual property tax revenues at the basic 1 percent tax rate on average by as much as \$820 per replacement home and by as much as \$5,000 per commercial replacement property.

Existing Law: Under existing law, real property is generally reassessed to its current fair market value whenever it has undergone a change in ownership or new construction has been completed. The value initially established or reassessed upon a change in ownership or completion of new construction is referred to as the property's "base year value."¹ The assessment of real property may be temporarily reduced to reflect reductions in value due to damage, destruction, depreciation, obsolescence, removal of property, or other factors causing a decline in value.²

A reduction in value for disaster, misfortune, or calamity³ applies to major disasters affecting many properties, such as an earthquake, flood, or wildfire, as well as a disaster affecting an individual property, such as a home fire. The reduced value of a damaged property will continue until the real property is reconstructed. The reconstruction of real property that has been damaged or destroyed by disaster, misfortune, or calamity is not subject to reassessment as new construction if the property is reconstructed in a timely fashion and the reconstruction is substantially equivalent under section [70\(c\)](#) on the lien date after completion of construction, if the following requirements are met:

- The property is reconstructed in a timely fashion; and
- The property after reconstruction is substantially equivalent to the property prior to the damage or destruction.

New construction following damage to real property by a calamity or misfortune is not eligible for disaster relief if the rebuilt improvements are not substantially equivalent to the property prior to damage or destruction. Only that portion of the reconstruction that exceeds substantially equivalent to the property prior to damage or destruction will have a new base year value.

In those counties where the board of supervisors has adopted an ordinance⁴ authorizing the disaster relief provisions of section [170](#), relief may be applied immediately as of the date of the disaster, misfortune, or

¹ Revenue and Taxation Code (RTC) section [110.1](#).

² Section [51\(b\)](#).

³ The term *misfortune or calamity* is defined by case law. The court of appeal, in *T.L. Enterprises, Inc. v. County of Los Angeles* (1989) 215 Cal.App.3d 876, held that a misfortune or calamity is a sudden, unforeseeable event.

⁴ Sections 51(b) and 70(c) provide lien date relief for counties that have not adopted a section 170 ordinance. As of March 13, 2019, all counties except Fresno County have enacted disaster relief ordinances pursuant to section 170.

This staff analysis is provided to address various administrative, cost, revenue, and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

calamity if the loss in a property's market value is \$10,000 or more.⁵ Under section 170, when property has been fully repaired, restored, or reconstructed, as of the date of completion of construction, the assessor will restore the lower of (1) the full cash value, (2) the damaged property's factored base year value, or (3) its factored base year value as adjusted pursuant to section 70(c).

Proposed Law: For property that has been reconstructed after the improvement was damaged or destroyed by misfortune or calamity, this bill provides that "substantially equivalent" means that, to qualify for exclusion from reassessment, the improvement after reconstruction does not exceed 120 percent of either of the following:

- The size of the improvement before the damage or destruction, or
- The full cash value of the full cash value of the improvement before damage or destruction.

This bill provides that these provisions apply to real property damaged or destroyed by misfortune or calamity on or after January 1, 2017.

In General: As related to this exclusion, the term "substantially equivalent" is not currently defined by statute or rule. In Assessors' Handbook Section [410](#), *Assessment of Newly Constructed Property*, Chapter 5, the State Board of Equalization (BOE) provides two examples of reconstruction that is not substantially equivalent to the original property, and thus would not be eligible for this new construction exclusion.⁶

Example 1. A taxpayer owned a 1,200 square-foot residence that was totally destroyed when his property was flooded. He timely replaced the damaged property with a 3,500 square-foot residence. The additional square footage which exceeded the original 1,200 square-foot structure was assessed as new construction. Under these circumstances, the rebuilt structure will have two base year values. The pre-existing base year value will continue for the 1,200 square-foot portion of the rebuilt structure, and the additional 2,300 square feet will be appraised at market value as of the date of completion and a separate base year value will be established for that portion.

Example 2. A taxpayer owns a vacation home which is destroyed by a fire. He decides that building a motel on his property in place of his vacation home would be more profitable. Under these circumstances, the taxpayer's replacement of the home with a motel is not eligible for disaster relief. The reconstructed property is not substantially equivalent to the property prior to the damage or destruction. Accordingly, the motel is considered new construction.

Background: Article XIII A of the California Constitution, as approved by the voters in June 1978, did not contain any language indicating that property values might decline in value for any reason, including disasters. To remedy this problem and alleviate tax burdens on the ensuing "new construction" for disaster-damaged property, Proposition 8 amended article XIII A in November 1978 to provide that: (1) the full cash value base may from year to year not only reflect the inflation rate, but "may be reduced to reflect substantial damage, destruction or other factors causing a decline in value," and (2) when property is damaged or destroyed through a disaster, reconstruction of the property is excluded as "new construction" when the restored structure is comparable in value to the original. (art. XIII A, [section 2\(a\)](#)). The legislation implementing these provisions is found in section 70(c).

⁵ Section 170(b).

⁶ Assessors' Handbook Section 410, pages 48-49.

The BOE enacted Property Tax Rule [463](#) to implement the new construction statutes. Rule 463(f) addressed disaster relief and provided that newly constructed property does not include any land, improvement, or fixture that is restored, reconstructed, or repaired in a timely manner following a disaster and which is substantially equivalent in size, use, and quality to that which existed prior to the disaster. Subdivision (f) was removed from Rule 463, effective June 12, 1998.⁷

Commentary:

1. **Author's Statement.** AB 885 would provide much needed tax relief to property owners who have lost their home or business in a natural disaster. Those who wish to rebuild on the same parcel of land would receive the same tax relief that is currently allowed to those who relocate elsewhere in the county.
2. **Summary of Amendments.** The **August 30, 2019** amendment made a nonsubstantive, grammatical change to the Legislature's statement of findings and declarations.
3. **Misfortune or Calamity.** The terms *misfortune* or *calamity* refer to sudden events associated with natural forces such as hurricanes, floods, and fires. This is not limited to events that result in a Governor-proclaimed state of emergency. Damage resulting from neglected maintenance would not qualify as misfortune or calamity.
4. **Rebuilding with a Larger Improvement.** Issues have arisen where homeowners who had their property destroyed by fire have rebuilt homes that are larger in size than the destroyed home. Under current law, the additional square footage must be reassessed to current market value as of the date of completion of construction. This additional value is added to the existing base year value of the destroyed home.
5. **Substantially Equivalent.** This bill provides that a reconstructed improvement is substantially equivalent if the reconstructed improvement does not exceed 120 percent of *either* size *or* full cash value of the improvement before the damage or destruction. Thus, a reconstructed improvement would qualify if it meets either of these criteria.
6. **Retroactive Application.** While this bill, if enacted, would take effect on January 1, 2020, AB 885 specifically provides that it applies to real property damaged or destroyed by misfortune or calamity on or after January 1, 2017.

Costs: The BOE will incur absorbable costs to update its documents, website materials, and provide guidance to assessors.

Revenue Impact: The revenue impact of AB 885 is difficult to estimate. First, we do not know the number of replacement properties resulting from future disasters. Second, it is difficult to calculate revenue impact based on the size of the replacement property, as provided. However, using statewide average assessed values, staff can compare the average value of an original property against a replacement property reconstructed at 120 percent of the original value to get an estimate of the difference in value and the subsequent revenue impact.

- **Residential Property.** The 2018-19 average assessed value of a home statewide is \$412,000. Under the provisions of AB 885, its replacement could be valued at 120 percent of that original

⁷ See Letters To Assessors No. [98/07](#) and No. [98/48](#).

value, or as much as \$494,400, which is an increase in value of \$82,400. Therefore, average revenue loss at the basic 1 percent property tax rate is:

$$\$82,400 \times 1\% = \$824 \text{ per home}$$

- **Commercial Property.** The average assessed value of a commercial property in California is about \$2.3 million. Under AB 885, an average replacement property could be valued at 120 percent of that original value, or as much as \$2.8 million, an increase in value of \$500,000. Average revenue loss at the basic 1 percent property tax rate is:

$$\$500,000 \times 1\% = \$5,000 \text{ per commercial property}$$

Revenue Summary. This bill would reduce annual property tax revenues at the basic 1 percent tax rate on average by as much as \$820 per replacement home and by as much as \$5,000 per commercial replacement property.

Qualifying Remarks. This revenue estimate assumes owners choose larger or more valuable replacement properties without regard to any statutory changes. AB 885 is not limited to Governor-declared disasters. This revenue estimate does not account for any changes in economic activity that may or may not result from the enactment of the proposed law.