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September 6, 2000

Honorable Dick Frank
County Assessor
County Government Center, Room 100
San Luis Obispo, CA 93408

Attn: Ms. Barbara L. Edginton

Dear Ms. Edginton:

This is in response to your request of the Legal Division for some guidelines for interpreting Revenue and Taxation Code section 69.4, the transfer of base year value provision for contaminated property. You have posed several groups of questions with respect to the standards which may be applicable in the implementation of section 69.4, which we summarize and address below.

Section 69.4 must be read in the context of the more detailed provisions of subdivision (i) of section 2 of Article XIII A of the California Constitution, hereinafter section 2(i), which was enacted as Proposition 1 by the voters on November 3, 1998. Section 2(i) provides property tax relief in one of two forms for qualified contaminated properties. Qualifying owners may elect to replace the contaminated property, as defined, with a qualified replacement property, transferring the base year value from the contaminated property to the replacement property; or they may elect to repair or replace structures on the same contaminated property that are damaged or destroyed in the course of the remediation of the environmental problems. In this second case, qualified repairs or replacements would be excluded from new construction for property tax assessment purposes.

You first ask a number of questions about the value comparisons between the original contaminated property or structure and the replacement property or structure. Specifically, you ask, if the value of the replacement property or structure exceeds that of the original property or structure, is the claimant ineligible for the exclusion (similar to Revenue and Taxation Code section 69.5)? If the claimant is eligible, would the eligibility be only for the value of the original property/structure and anything over the original value should be assessed at current market value? You further ask if the claimant would be eligible if the replacement property/structure value was within 120% of the original property/structure value (similar to Revenue and Taxation Code section 68), and anything over that value would be assessed at current market value? Finally, you ask how important is square footage and quality class in determining comparability?

Initially, we would note that the Legislature has not comprehensively defined the terms and criteria set forth in section 2(i), as it has with respect to the transfer of base year value and new construction exclusions set forth in section 2 of Article XIII A. Further the Board of Equalization has not promulgated rules or regulations interpreting section 2(i). Therefore, it is not possible for us to definitively respond to your questions about the various possible interpretations of section 2(i) and section 69.4, which initially implemented section 2(i). We offer the following observations. Given the lack of legislative or administrative interpretation of the subject property tax exclusions, it is our view that the courts would uphold any reasonable interpretation of these sections by the assessor.

In responding to your questions, we also reiterate that there are two separate property tax relief provisions in section 2(i) and section 69.4: one, a transfer of base year value provision if the owner of the contaminated property elects to sell or otherwise transfer the property; and the other, an exclusion from new construction if the owner elects to repair or reconstruct a substantially damaged or destroyed structure on the same contaminated property after the remediation of the environmental problems there. We note this because the comparison tests are different for each provision. With respect to the transfer of base year value provision (section 2(i)(1)(A)), the replacement real property must have “a fair market value that is equal to or less than the fair market value of the qualified contaminated property if that property were not contaminated.” Sec. 2(i)(1)(A)(i). Under the exclusion from new construction provision, “the repaired or replacement structure [must be] similar in size, utility, and function to the original structure.” Sec. 2(i)(1)(B).

In this regard, the comparability test for the transfer of base year value set forth in section 2(i) is comparable to that set forth in Article XIII A, sec. 2(a) and Revenue and Taxation Code section 69.5 with respect to transfers of base year value by persons over the age of 55 years (“dwelling of equal or lesser value”); and in Article XIII A, sec. 2(e) and Revenue and Taxation Code section 69.3 with respect to property substantially destroyed by a disaster (“property of equal or lesser value”). Pursuant to those provisions, as you note, the claimant is ineligible for the exclusion if the value of the replacement property exceeds that of the original property, as defined by the Legislature. On the other hand, the comparability test for the repaired or replacement structure new construction exclusion is comparable to that set forth in Article XIII A, sec. 2(d) and Revenue and Taxation Code section 68 with regard to property taken by eminent domain (“comparable property” “similar in size, utility, and function”), which the Legislature permits as a transferable value, with any value over and above that comparable value assessed at current market value.

We note, further, that portion of the ballot argument in favor of Proposition 1 recognizing the comparability of that proposal to the disaster relief provisions implemented by section 69.3. In his argument, the measure’s author says, “Under the current law, we already protect innocent homeowners who lose their home to natural disasters. If an earthquake, fire or flood destroys your home, you are allowed to rebuild or buy a new home without losing your existing Proposition 13 tax protection. *This same degree of fairness* should be extended to those people whose property is destroyed by health and life-threatening toxic waste buried on their residential property.” (Emphasis added.)

Finally, since the Legislature has yet to define “a fair market value that is equal to or less than the fair market value of the qualified contaminated property if that property were not contaminated” and “similar in size, utility, and function” in the context of section 2(i) contaminated property, we are unable to meaningfully address the importance of square footage and quality class in determining comparability.

You next ask “in determining the current market value of the original property (to determine comparability to the replacement property/structure), what criteria should be used? Is it the current market value of the property as it exists at the time of sale? Or should a value be found by looking at comparable properties that are not contaminated, and determining value as it would be had the contamination not reduced its value?” The latter is the proper approach.

The test is not the “current market value” of the original property. As is set forth in section 2(i), the test in the transfer of base year value option is “a fair market value that is equal to or less than *the fair market value of the qualified contaminated property if that property were not contaminated.*” Sec. 2(i)(1)(A)(i). Less helpfully, as described above, the test for the new construction exclusion for repaired or replacement structures is that they be “similar in size, utility, and function to the original structure.” Sec. 2(i)(1)(B).

Finally, you posit the following factual situation: Property owner A owns two lots across the street from each other. Before the contamination was discovered, one lot was vacant, and the other had two structures, the first a single family residence (A’s principal place of residence), and a garage that had a living unit over it. Both structures were demolished due to the remediation. A now intends to rebuild, but he will rebuild on the lot which formerly was vacant. In addition, the replacement structure will be a commercial building (a retail store) with a living unit above. You ask whether or not the base year value of the original residence could be transferred to the residential unit above the store?

Again, without legislative or regulatory definition of the requirements of section 2(i) and section 69.4, it is not possible to provide a definitive analysis of the question you pose. However, under current law, it is our opinion that the rebuilding you describe would not be eligible for relief under either of those sections for two reasons.

First, in our view, the law requires a sale of the contaminated property and the acquisition of replacement property. Since both properties were owned by the same person both before and after the contamination, the vacant property does not meet this requirement. Clause (ii) of paragraph (1)(A) of section 2(i) provides:

- (ii) This subparagraph applies only to replacement property that is acquired or newly constructed within five years after ownership in the qualified contaminated property is sold or otherwise transferred.

While the two properties were in common ownership, they are separate properties.

Second, in our view, the requirements for the new construction exclusion for repaired or replacement structures found in subparagraph B of section 2(i)(1) cannot be met, because there were no structures on the vacant lot that were destroyed or substantially damaged as a result of the

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remediation of the environmental problems. That subparagraph commences “[i]n the case in which the remediation of the environmental problems on the qualified contaminated property requires the destruction of, or results in substantial damage to, a structure located on the property . . .” This test is not met. The new structures are not “the repair of a substantially damaged structure, or the construction of a structure replacing a destroyed structure *on the qualified contaminated property.*” (Emphasis added.)

Therefore, in our opinion, neither form of property tax relief provided for in section 2(i) and section 69.4 is available in the factual situation you present.

The views expressed in this letter are advisory only; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

/s/ Daniel G. Nauman

Daniel G. Nauman
Senior Tax Counsel

DGN:tr
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cc: Mr. Dick Johnson, MIC:63
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