



PROPERTY TAX APPRAISAL RULES

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Notes

Introduction: There are some peculiar appraisal rules for property tax appeals. As long as you know about them in advance and provide for them in your appraisal, there will be no problem. But if you do not take them into account, your entire appraisal could be thrown out.

1. Property Tax Fiscal Year Begins July 1.
 - Value date for fiscal year is preceding January 1, the "lien date."
 - Value date for change in ownership is the date of the change in ownership.
 - Value date for completion of construction is the date of the completion of construction.
2. Proposition 13.
 - a. Change in ownership reassessment.
 - b. New construction reassessment.
 - i. Repair v. new construction.
 - ii. Asbestos abatement exclusion.
 - iii. Offsite improvements.
 - iv. Date new construction completed.
 - c. Establishment of base year value – four years within which to contest.
 - d. Two percent inflation factor.
 - e. Proposition 8 declines in value – no



Notes

change in base year value. Thus, increase in assessed value from Proposition 8 value to factored base year value can be more than two percent.

- f. Each year Assessor should determine fair market value and factored base year value, compare the two and enroll the lower.
3. Application for Changed Assessment.
 - a. July 2 through September 15 or November 30 depending upon the County.
 - b. Local Board of Equalization or Assessment Appeals Board.
 4. Four-Year Statute of Limitations on Escape and Supplemental Assessments.
 5. The Hearing Process.
 - a. Very similar to a court trial to a judge.
 - b. Written findings.
 - c. Reporter.
 - d. Subpoenas.
 - e. Protecting trade secrets; Revenue and Taxation Code section 408.
 - f. Expert valuation testimony needed.
 - g. Can appeal unfavorable decision to Superior Court, but for factual issues standard of review is the substantial evidence test. The judge must affirm the AAB if there is any evidence in the record upon which a reasonable person would rely that supports the AAB decision even if the judge disagrees with the decision. Thus, on factual issues the hearing is it.



Notes

6. The Value Concept. Property Tax Rule 2.
Normal Definition of Fair Market Value With a Few Twists.
 - a. Unencumbered fee simple interest.
 - b. Only legally enforceable government restrictions may be considered.
 - c. Purchase price presumption.

7. Comparative Sale Approach to Value. Rule 4.
 - a. Preferred method if reliable market data available.
 - b. Since it is the unencumbered fee interest that is being valued, factor out of the purchase price the impact of above or below market rent leases.
 - c. Adjustments that **must** be considered:
 - Time.
 - Physical attributes.
 - Location.
 - Legally enforceable restrictions.
 - Income.
 - For subdivisions: cost of subdividing, area required for streets, selling expenses, normal profit and interest.
 - If these adjustments are not considered, appraisal is legally deficient.
 - d. Post-lien date evidence – 90 day rule for comparable sales. If appraisal relies upon sale that occurred more than 90 days after the lien date, it can be thrown out as legally deficient.
 - Sale may be used for settlement purposes.



Notes

8. Cost Approach to Value. Rule 6.
 - a. Preferred only if neither reliable sales and income data are available.
 - b. Special purpose structures.
 - c. Replacement Cost New Less Depreciation ("RCNLD").
 - d. BOE "Percent Good" and Inflation Tables.
 - e. Entrepreneurial profit.
 - f. Construction period interest imputed based upon market data.
 - g. External obsolescence.

9. Income Approach to Value. Rule 8.
 - a. Discounted cash flow or capitalization of income.
 - b. Market, not contract, income and expenses.
 - c. Market vacancy rate.
 - d. Expenses do not include amortization, depreciation, depletion, debt retirement, interest, royalties, income taxes.
 - e. Property tax is not an expense, but discount rate or capitalization rate is increased by the tax rate.
 - f. Expenses include income from working capital.
 - g. Only two ways to derive discount or capitalization rate:
 - i. Derived from the marketplace by comparing purchase price to buyers cash flow projections.
 - ii. Band of investment method



Notes

("WACC").

- Market debt/equity ratio
 - Market rate of return on debt (BAA rate)
 - Market rate of return on equity
 - Capital Asset Price Model ("CAPM")
- h. Rate derived from any other method, for example the built-up method, can result in appraisal being thrown out as legally deficient.

Conclusion: There are some peculiar appraisal rules for property tax appeals. As long as you know about them in advance and provide for them in your appraisal, there will be no problem. But if you do not take them into account, your entire appraisal could be thrown out.

Rule 1. GENERAL APPLICATION.

Reference: Sections 110, 110.1, 401, Revenue and Taxation Code; *Carlson v. Assessment Appeals Board No. 1* (1985) 167 Cal.App.3d 1004; *Dennis v. County of Santa Clara* (1989) 215 Cal.App.3d 1019.

The rules in this subchapter govern assessors when assessing, county boards of equalization and assessment appeals boards when equalizing, and the State Board of Equalization, including all divisions of the property tax department.

History: Adopted June 21, 1967, effective July 23, 1967.
Amended July 27, 1982, effective December 30, 1982.

Rule 2. THE VALUE CONCEPT.

Reference: Article 2, Chapter 3, Part 2, Division 1, Revenue and Taxation Code.
Sections 110, 110.1, 401, Revenue and Taxation Code.

(a) In addition to the meaning ascribed to them in the Revenue and Taxation Code, the words "full value," "full cash value," "cash value," "actual value," and "fair market value" mean the price at which a property, if exposed for sale in the open market with a reasonable time for the seller to find a purchaser, would transfer for cash or its equivalent under prevailing market conditions between parties who have knowledge of the uses to which the property may be put, both seeking to maximize their gains and neither being in a position to take advantage of the exigencies of the other.

When applied to real property, the words "full value," "full cash value," "cash value," "actual value," and "fair market value" mean the prices at which the unencumbered or unrestricted fee-simple interest in the real property (subject to any legally enforceable governmental restrictions) would transfer for cash or its equivalent under the conditions set forth in the preceding sentence.

(b) When valuing real property (as described in paragraph (a)) as the result of a change in ownership (as defined in Revenue and Taxation Code, Section 60, et seq.) for consideration, it shall be rebuttably presumed that the consideration valued in money, whether paid in money or otherwise, is the full cash value of the property. The presumption shall shift the burden of proving value by a preponderance of the evidence to the party seeking to overcome the presumption. The presumption may be rebutted by evidence that the full cash value of the property is significantly more or less than the total cash equivalent of the consideration paid for the property. A significant deviation means a deviation of more than 5% of the total consideration.

(c) The presumption provided in this section shall not apply to:

(1) The transfer of any taxable possessory interest.

(2) The transfer of real property when the consideration is in whole, or in part, in the form of ownership interests in a legal entity (e.g., shares of stock) or the change in ownership occurs as the result of the acquisition of ownership interests in a legal entity.

Rule 2. (Contd.)

(3) The transfer of real property when the information prescribed in the change in ownership statement is not timely provided.

(d) If a single transaction results in a change in ownership of more than one parcel of real property, the purchase price shall be allocated among those parcels and other assets, if any, transferred based on the relative fair market value of each.

History: Adopted June 21, 1967, effective July 23, 1967.
Amended December 17, 1975, effective January 25, 1976.
Amended October 9, 1984, effective September 20, 1985.
Amended July 24, 1991, effective September 25, 1991.

Rule 3. VALUE APPROACHES.

Reference: Article 2, Chapter 3, Part 2, Division 1, Revenue and Taxation Code.
Sections 110, 401, Revenue and Taxation Code.

In estimating value as defined in section 2, the assessor shall consider one or more of the following, as may be appropriate for the property being appraised:

(a) The price or prices at which the property and comparable properties have recently sold (the comparative sales approach).

(b) The prices at which fractional interests in the property or comparable properties have recently sold, and the extent to which such prices would have been increased had there been no prior claims on the assets (the stock and debt approach).

(c) The cost of replacing reproducible property with new property of similar utility, or of reproducing the property at its present site and at present price levels, less the extent to which the value has been reduced by depreciation, including both physical deterioration and obsolescence (the replacement or reproduction cost approach).

(d) If the income from the property is regulated by law and the regulatory agency uses historical cost or historical cost less depreciation as a rate base, the amount invested in the property or the amount invested less depreciation computed by the method employed by the regulatory agency (the historical cost approach).

(e) The amount that investors would be willing to pay for the right to receive the income that the property would be expected to yield, with the risks attendant upon its receipt (the income approach).

History: Adopted June 21, 1967, effective July 23, 1967.

Rule 4. THE COMPARATIVE SALES APPROACH TO VALUE

Reference: Sections 110, 110.1, 110.5, 401, Revenue and Taxation Code.
Article XIII A, Sections 1, 2; California Constitution.

When reliable market data are available with respect to a given real property, the preferred method of valuation is by reference to sales prices. In using sales prices of the appraisal subject or of comparable properties to value a property, the assessor shall:

(a) Convert a noncash sale price to its cash equivalent by estimating the value in cash of any tangible or intangible property other than cash which the seller accepted in full or partial payment for the subject property and adding it to the cash portion of the sale price and by deducting from the nominal sale price any amount which the seller paid in lieu of interest to a lender who supplied the grantee with part or all of the purchase money.

(b) When appraising an unencumbered-fee interest, (1) convert the sale price of a property encumbered with a debt to which the property remained subject to its unencumbered-fee price equivalent by adding to the sale price of the seller's equity the price for which it is estimated that such debt could have been sold under value-indicative conditions at the time the sale price was negotiated and (2) convert the sale price of a property encumbered with a lease to which the property remained subject to its unencumbered-fee price equivalent by deducting from the sale price of the seller's equity the amount by which it is estimated that the lease enhanced that price or adding to the price of the seller's equity the amount by which it is estimated that the lease depressed that price.

(c) Convert a sale to the valuation date of the subject property by adjusting it for any change in price level of this type of property that has occurred between the time the sale price was negotiated and the valuation date of the subject property.

(d) Make such allowances as he deems appropriate for differences between a comparable property at the time of sale and the subject property on the valuation date, in physical attributes of the properties, location of the properties, legally enforceable restrictions on the properties' use, and the income and amenities which the properties are expected to produce. When the appraisal subject is land and the comparable property is land of smaller dimensions, and it is assumed that the subject property would be divided into comparable smaller parcels by a purchaser, the assessor shall allow for the cost of subdivision, for the area required for streets and alleys, for selling expenses, for normal profit, and for interest charges during the period over which it is anticipated that the smaller properties will be marketed.

History: Adopted June 21, 1967, effective July 23, 1967.
Amended July 27, 1982, effective December 30, 1982.

**Rule 6. THE REPRODUCTION AND REPLACEMENT COST
APPROACHES TO VALUE.**

Reference: Sections 110, 401, Revenue and Taxation Code.

(a) The reproduction or replacement cost approach to value is used in conjunction with other value approaches and is preferred when neither reliable sales data (including sales of fractional interests) nor reliable income data are available and when the income from the property is not so regulated as to make such cost irrelevant. It is particularly appropriate for construction work in progress and for other property that has experienced relatively little physical deterioration, is not misplaced, is neither over- nor underimproved, and is not affected by other forms of depreciation or obsolescence.

(b) The reproduction cost of a reproducible property may be estimated either by (1) adjusting the property's original cost for price level changes and for abnormalities, if any, or (2) applying current prices to the property's labor and material components, with appropriate additions for entrepreneurial services, interest on borrowed or owner-supplied funds, and other costs typically incurred in bringing the property to a finished state (or to a lesser state if unfinished on the lien date). Estimates made under (2) above may be made by using square-foot, cubic-foot, or other unit costs; a summation of the in-place costs of all components; a quantity survey of all material, labor, and other cost elements; or a combination of these methods.

(c) The original cost of reproducible property shall be adjusted, in the aggregate or by groups, for price level changes since original construction by multiplying the cost incurred in a given year by an appropriate price index factor. When detailed investment records are unavailable for earlier years or when only a small percentage of the total investment is involved, the investments in such years may be lumped and factored to present price levels by means of an index number that represents the assessor's best judgment of the weighted average price change. If the property was not new when acquired by its present owner and its original cost is unknown, its acquisition cost may be substituted for original cost in the foregoing calculations.

(d) The replacement cost of a reproducible property may be estimated as indicated in (b)(2) of this section by applying current prices to the labor and material components of a substitute property capable of yielding the same services and amenities, with appropriate additions as specified in subsection (b)(2).

(e) Reproduction or replacement cost shall be reduced by the amount that such cost is estimated to exceed the current value of the reproducible property by reason of physical deterioration, misplacement, over- or underimprovement, and other forms of depreciation or obsolescence. The percentage that the remainder represents of the reproduction or replacement cost is the property's percent good.

(f) When the allowance made pursuant to paragraph (e) exceeds the amount included in the depreciation tables used by the assessor, the reasons therefor shall be noted in the appraisal record for the property and the amount thereof shall be ascertainable from the record.

Rule 6. (Contd.)

History: Adopted September 1, 1967, effective October 7, 1967.
Amended February 16, 1970, effective March 26, 1970.
Amended February 18, 1971, effective March 24, 1971.
Amended February 16, 1977, effective February 18, 1977.
Amended December 19, 1997, effective January 18, 1998.

Rule 8. THE INCOME APPROACH TO VALUE.

Reference: Sections 110, 401, Revenue and Taxation Code.

(a) The income approach to value is used in conjunction with other approaches when the property under appraisal is typically purchased in anticipation of a money income and either has an established income stream or can be attributed a real or hypothetical income stream by comparison with other properties. It is the preferred approach for the appraisal of land when reliable sales data for comparable properties are not available. It is the preferred approach for the appraisal of improved real properties and personal properties when reliable sales data are not available and the cost approaches are unreliable because the reproducible property has suffered considerable physical depreciation, functional obsolescence or economic obsolescence, is a substantial over- or underimprovement, is misplaced, or is subject to legal restrictions on income that are unrelated to cost.

(b) Using the income approach, an appraiser values an income property by computing the present worth of a future income stream. This present worth depends upon the size, shape, and duration of the estimated stream and upon the capitalization rate at which future income is discounted to its present worth. Ideally, the income stream is divided into annual segments and the present worth of the total income stream is the algebraic sum (negative items subtracted from positive items) of the present worths of the several segments. In practical application, the stream is usually either

(1) divided into longer segments, such as the estimated economic life of the improvements and all time thereafter or the estimated economic life of the improvements and the year in which the improvements are scrapped and the land is sold, or

(2) divided horizontally by projecting a perpetual income for land and an income for the economic life of the improvements, or

(3) projected as a level perpetual flow.

(c) The amount to be capitalized is the net return which a reasonably well informed owner and reasonably well informed buyers may anticipate on the valuation date that the taxable property existing on that date will yield under prudent management and subject to such legally enforceable restrictions as such persons may foresee as of that date. Net return, in this context, is the difference between gross return and gross outgo. Gross return means any money or money's worth which the property will

Rule 8. (Contd.)

yield over and above vacancy and collection losses, including ordinary income, return of capital, and the total proceeds from sales of all or part of the property. Gross outgo means any outlay of money or money's worth, including current expenses and capital expenditures (or annual allowances therefor) required to develop and maintain the estimated income. Gross outgo does not include amortization, depreciation, or depletion charges, debt retirement, interest on funds invested in the property, or rents and royalties payable by the assessee for use of the property. Property taxes, corporation net income taxes, and corporation franchise taxes measured by net income are also excluded from gross outgo.

(d) In valuing property encumbered by a lease, the net income to be capitalized is the amount the property would yield were it not so encumbered, whether this amount exceeds or falls short of the contract rent and whether the lessor or the lessee has agreed to pay the property tax.

(e) Recently derived income and recently negotiated rents or royalties (plus any taxes paid on the property by the lessee) of the subject property and comparable properties should be used in estimating the future income if, in the opinion of the appraiser, they are reasonably indicative of the income the property will produce in its highest and best use under prudent management. Income derived from rental of properties is preferred to income derived from their operation since income derived from operation is the more likely to be influenced by managerial skills and may arise in part from nontaxable property or other sources. When income from operating a property is used, sufficient income shall be excluded to provide a return on working capital and other nontaxable operating assets and to compensate unpaid or underpaid management.

(f) When the appraised value is to be used to arrive at an assessed value, the capitalization rate is to include a property tax component, where applicable, equal to the estimated future tax rate for the area times the assessment ratio.

(g) The capitalization rate may be developed by either of two means:

(1) By comparing the net incomes that could reasonably have been anticipated from recently sold comparable properties with their sales prices, adjusted, if necessary, to cash equivalents (the market-derived rate). This method of deriving a capitalization rate is preferred when the required sales prices and incomes are available. When the comparable properties have similar capital gains prospects, the derived rate already includes a capital gain (or loss) allowance and the income to be capitalized should not include such a gain (or loss) at the terminus of the income estimate.

(2) By deriving a weighted average of the capitalization rates for debt and for equity capital appropriate to the California money markets (the band-of-investment method) and adding increments for expenses that are excluded from outgo because they are based on the value that is being sought or the income that is being capitalized. The appraiser shall weight the rates for debt and equity capital by the respective amounts of such capital he deems most likely to be employed by prospective purchasers.

Rule 8. (Contd.)

(h) Income may be capitalized by the use of gross income, gross rent, or gross production multipliers derived by comparing sales prices of closely comparable properties (adjusted, if necessary, to cash equivalents) with their gross incomes, gross rents, or gross production.

(i) The provisions of this rule are not applicable to lands defined as open-space lands by Chapter 1711, Statutes of 1967, nor are they applicable in all respects to possessory interests.

History: Adopted December 12, 1967, effective January 18, 1968.
Amended December 15, 1976, effective January 21, 1977.
Amended September 27, 1977, effective November 25, 1977.
Amended July 27, 1982, effective December 30, 1982.

Rule 10. TRADE LEVEL FOR TANGIBLE PERSONAL PROPERTY.

Reference: Chapter 147, Statutes of 1966, First Extraordinary Session.
Sections 110, 401, Revenue and Taxation Code.

(a) In appraising tangible personal property, the assessor shall give recognition to the trade level at which the property is situated and to the principle that property normally increases in value as it progresses through production and distribution channels. Such property normally attains its maximum value as it reaches the consumer level. Accordingly, tangible personal property shall be valued by procedures that are consistent with the general policies set forth herein.

(b) Except as provided by the following subdivisions, tangible personal property held by a consumer shall be valued at the amount of cash or its equivalent for which the property would transfer to a consumer of like property at the same trade level if exposed for sale on the open market. This value shall be estimated in accordance with regulations 4, 6, and 8. If a cost approach is employed, the cost shall include the full economic cost of placing the property in service. Full economic cost (i.e., replacement or reproduction cost), includes costs typically incurred in bringing the property to a finished state, including labor and materials, freight or shipping cost, installation costs, sales or use taxes, and additions for market supported entrepreneurial services (with appropriate allowances for trade, quantity, or cash discounts). Full economic cost does not include extended service plans or extended warranties, supplies, or other assets or business services that may have been included in a purchase contract.

(c) Tangible personal property leased, rented, or loaned for a period of six months or less, having a tax situs at the place where the lessor normally keeps the property as provided in regulation 204, shall be valued at the amount of cash or its equivalent for which it would transfer to other lessors or retailers of like property. The value may be estimated by reference to the price at which the lessor could be expected to sell the property at fair market value to other lessors or retailers of like property. If


Robert R. Rubin | *Of Counsel*
Professional Experience

Bob is a member of the firm's Business Services Practice Group. His practice emphasizes the resolution of federal, state and local tax controversies including income, employment, franchise, estate, gift and excise taxes, real and personal property taxes, and sales and use taxes.

In more than 30 years of practicing tax law, Bob has represented health care organizations regarding almost every income tax, employment tax, property tax and sales and use tax issue, including: IRS Coordinated Examination Program (CEP) audits; property tax cases involving the property tax welfare exemption; as a participant with the Attorney General's Health Care Task Force that investigated charity care minimums; as a registered lobbyist; in sales and use tax audits; in seeking Attorney General consent for transfers of hospitals; in addressing nonprofit income tax issues including unrelated business taxable income (UBTI); excess benefit transactions (intermediate sanctions), executive compensation, private inurement, private benefit and debt financed property.

He is a frequent speaker on taxation for the American Bar Association, State Bar of California and Sacramento County Bar Association. Bob is also McDonough's Internal Revenue Service Circular 230 coordinator.

Representative Matters

Property tax cases involving silica deposits and geothermal steam facility including administrative hearings, refund action in Superior Court, appeal to Fourth District Court of Appeals.

IRS Offer in Compromise based upon Doubt as to Collectability with Special Circumstances.

Internal Revenue Code section 1031 reverse improvement exchange modeled after IRS Letter Ruling 200251008.

Property tax appeal of prestigious private country club golf course.

Design IRS Circular 230 and IRC 36694 Compliance Plan.

Sought IRS determination that 501(c)(3) entity with inadequate public support was not a private foundation, but rather a supporting organization.

Major sales and use tax case involving national equipment leasing company.

Tax Court case involving Internal Revenue Code section 174 research and development deduction.

California Franchise Tax Board residency case involving a professional athlete.

Sale of property by Native American on Reservation.

Acquisition of aircraft exempt from sales and use tax.

FIN 48 Compliance

Property tax case involving professional sport team and facility.

Unrelated business taxable income analysis for educational foundation of a trade association.

Admitted to Practice

State Bar of California, 1985

State Bar of Wisconsin, 1976

United States District Court,
Eastern District of California

United States District Court,
Eastern and Western Districts of
Wisconsin

United States Tax Court

United States Claims Court

United States Court of Appeals,
Ninth Circuit

United States Supreme Court

Education

George Washington University
LL.M., Taxation, 1979

Marquette University
Law School
J.D., *cum laude*, 1976

Marquette University
B.S., Business Administration,
1973
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Prior Experience

Senior trial attorney, Office of Chief Counsel, Internal Revenue Service.

Leadership Positions/Affiliations

Member, American Bar Association – Tax Section, Employment Tax and Court Procedure Committees

Member, State Bar of California – Tax Section, State and Local Tax and Tax Procedures Committees

Member, Wisconsin State Bar – Nonresident Lawyers Division

Member, Sacramento County Bar Association – Tax Section

Board Member, The First Tee of Greater Sacramento

Adjunct Professor, McGeorge School of Law (1985-1992)

Manager/Coach, Arden and Pocket Little League (1994-2002)

Coach, Sacramento Country Day School and Jewish Community Center Youth Basketball (1996-1999)

Honors/Awards

Recognized as a *2004 Northern California Super Lawyer®*