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Prop. 15 Is A Little Ambiguous
(Enough to Bother Lawyers; Not Enough To Bother Voters)

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On May 29, 2020, Prop. 15 qualified for the November ballot. The measure would create a "split roll" property tax—preserving our current (acquisition value) property tax regime for agricultural land, residential property, and lower-value commercial and industrial properties, while reverting to the pre-Proposition 13 (ad valorem) tax regime for higher-value commercial and industrial properties.

Split-roll alternatives are as old as Proposition 13 itself. As soon as Howard Jarvis and Paul Gann qualified their radical measure for the 1978 ballot, the California legislature proposed a competing measure, Proposition 8, which would have lowered the tax rate only on owner-occupied residential property. Proposition 8 gained the support of almost all top spokesmen for both parties, labor unions, teachers' associations, the League of Women Voters, and most other groups, but failed anyway. See Sean Flavin, Taxing California Property, § 2:2. Since then, split-roll measures have continued to pop up periodically.

Before Proposition 13, the tax base for the property tax was the property's current fair market value. Proposition 13 capped this base: it could not exceed the property's fair market value as of the last change in ownership or new construction, adjusted for inflation. Proponents of a split-roll tax argue that current law is a mess of loopholes which favors sophisticated taxpayers, disproportionately burdens unsophisticated residential owners, and deters owners from improving their properties. According to a USC study, more than $11 billion in local property taxes per year go uncollected due to under-assessment. Opponents of a split-roll tax argue that the tax increase would lead to lost economic output, decreased employment, and increased instability for local government finances.

SUMMARY OF PROPOSITION 15

Proposition 15 contains these provisions:

a. It exempts all residential property, regardless whether owner-occupied.

b. It exempts all "land that is used for producing commercial agricultural commodities" (though not agricultural structures or improvements—such as barns, dairies, processing plants and wineries, and certain crops and orchards).

c. It temporarily exempts a property from reassessment if at least 50% is occupied by a small business (i.e., fewer than 50 full-time employees; independently owned and operated; and owns real property located in California).

d. It exempts property if "the owner … make[s] a claim and certif[ies] annually" that both these conditions are satisfied:

    i. It is a *low-value property*—that is, a "commercial [or] industrial real property with a fair market value of" up to $3,000,000 plus inflation.

    ii. The carve-out for owners who *fail the aggregate property test* does not apply. Specifically, the exemption becomes unavailable (i.e., "real property that would otherwise comply with [the exemption] shall be subject to reassessment") if "any of the direct or indirect beneficial owners of such real property own a direct or indirect beneficial ownership interest(s) in other commercial and/or industrial real property located in the State, which such real property in the aggregate (including the subject property) has a fair market value in excess of" $3,000,000 plus inflation.

e. It contains several accommodations to reduce the burden on the county assessors:

    i. New assessments will be phased-in over several years;

    ii. courts may review factual findings only on a limited standard of review;

    iii. new tax revenues will first go to the counties, to reimburse them for their extra administrative costs.

    These accommodations are important. In March 2019, the California Assessor's Association wrote that a split-roll measure could cost counties between $380 million and $470 million in the first five to ten years, and that a failure to fund these costs "could have a devastating impact on the operations of California assessors and their ability to deliver quality customer service to taxpayers." It is unclear whether the 2020 measure adequately addresses these concerns.

ANALYSIS

Most discussion about Proposition 15 has focused on its economic impact. I'm not qualified to opine on that. However, I do think the text is ambiguous in places. These relate to the exemption for low-value properties, and the carve-out under the aggregate property test:

1. How is an owner's "aggregate property" defined? If he owns a partial interest in a property, should this only include that partial interest, or should it include the interests he doesn't own? The text suggests the latter (its says: "which such real property in the aggregate," rather than "which such interests in real property in the aggregate").

2. How will joint ventures work? If a single co-owner of a low-value property fails the aggregate property test, will that cause reassessment as to the interests owned by the other investors in the same low-value property? The language goes both ways.

    - Evidence that all interests get reassessed: The measure says that, if "any" owner of a low-value property fails the aggregate property test, the low-value property property loses its exemption. And the low-value property refers to the 100% interest, not a partial interest.

    - Evidence that only that individual's interests get reassessed: For a property to enjoy the exemption, "the owner" needs to file. There is no consideration for the possibility of multiple co-owners. This only makes sense if the term "property" includes partial interests.[1] Thus, the exemption is available to partial interests; thus, if the aggregate property test is failed, the exemption is lost only as to that partial interest.

3. Who is a "beneficial owner?" Conventionally, this means a trust beneficiary (see RTC 63.1(c)(9); Property Tax Rule 462.160; Assessor's Handbook generally), but not the owner of an interest in a business entity (i.e., partners and shareholders).

4. Who is an "indirect beneficial owner?" In statutory interpretation, we try to give all words meaning. How do we do that here? Does "beneficial owner" now include the owner of an interest in a business entity?

5. When an individual is completing the certification, how will he disclose other properties owned in trust for his benefit? In some cases, beneficiaries don't know what assets are in the trust; they may not have the right to know; they may not even know the trust exists.

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[1] Taken to its logical extreme, this would suggest that a $15 million "property" can avoid reassessment if owned by fifteen equal co-owners. That is clearly wrong. Still, I believe it's appropriate to define "property" to include partial interests, for the limited purpose of deciding how the exemption is claimed and how the aggregate property test applies. Interpreting a poorly drafted statute is like trying to climb stairs drawn by M.C. Escher; it can be done, but only if you're allowed to use scissors.

RECOMMENDATION

I don't mean to suggest that these ambiguities are grounds for voting against the measure. My intended audience for this article is lawyers, not voters.

However, if it does pass, the legislature will need to clarify. Here are my proposed answers to these questions:

1. Notwithstanding the text, "aggregate property" should be limited to the owner's interest (i.e., his proportional interest, unreduced by minority discounts). This is simply a matter of common sense; the opposite interpretation is hard to justify.

2. If a single co-owner of an under-$3,000,000 property fails the aggregate property test, that should cause his interest to be reassessed, but not the interests of his co-owners. Otherwise, joint investors in these properties will need to do due diligence on all the "direct and indirect beneficial owners" before letting them join the deal.

3. "Beneficial ownership" should be limited to title ownership, as well as current beneficiaries who are "beneficial owners" of a trust with title ownership. We should stick with the definition as it has always been used.

4. "Indirect" beneficial ownership shouldn't be interpreted any differently: It should include trust beneficiaries, but not owners of business entities. Notwithstanding the maxim of statutory interpretation, I can see no helpful way to give this word meaning.

5. When trust beneficiaries complete the annual certification, they should be asked to attach a similar certification from the trustees of all trusts they know of. If anything more is requested, the diligence may prove impossible; certifications can't be signed; deals may fall apart.

One thing is certain: The legislature will need to draft the aggregate property rules carefully. If it doesn't, brace yourself for a wave of tax lawyers, touting loopholes—real and purported—to hack these rules. Trust me. We're already working on it.