

SAN MATEO COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2013, through June 30, 2017



BETTY T. YEE
California State Controller

March 2020



BETTY T. YEE
California State Controller

March 10, 2020

The Honorable Juan Raigoza, Auditor-Controller
San Mateo County
555 County Center, 4th Floor
Redwood City, CA 94063

Dear Mr. Raigoza:

The State Controller's Office (SCO) audited the methods employed by San Mateo County to apportion and allocate property tax revenues for the period of July 1, 2013, through June 30, 2017. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found instances of noncompliance with California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we determined that San Mateo County incorrectly calculated the:

- Computation and distribution of property tax revenues;
- Reimbursement of property tax administrative costs; and
- Vehicle License Fee adjustments.

The county has disputed certain facts related to the conclusions and recommendations contained in this audit report. SCO has an informal audit review process by which to resolve a dispute of facts. To request a review, the county should submit, in writing, a request for a review and all information pertinent to the disputed issues within 60 days after receiving this audit report.

The request and supporting documents should be submitted to Richard J. Chivaro, Chief Counsel, State Controller's Office, Post Office Box 942850, Sacramento, California 94250. In addition, please provide a copy of the request letter to Lisa Kurokawa, Chief, Compliance Audits Bureau, State Controller's Office, Division of Audits, Post Office Box 942850, Sacramento, California 94250.

If you have any questions, please contact Ms. Kurokawa by telephone at (916) 327-3138.

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

The Honorable Juan Raigoza
Auditor-Controller

-3-

March 10, 2020

JLS/hf

cc: Shirley Tourel, Assistant Controller
San Mateo County
Warren Slocum, Chairperson
San Mateo County Board of Supervisors
Matthew Slaughter, Property Tax Division Manager
San Mateo County
Richard J. Chivaro, Chief Counsel
State Controller's Office

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Audit Report

Summary

The State Controller's Office (SCO) audited the methods employed by San Mateo County to apportion and allocate property tax revenues for the period of July 1, 2013, through June 30, 2017.

Our audit found instances of noncompliance with California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we determined that the county incorrectly calculated the:

- Computation and distribution of property tax revenues;
- Reimbursement of property tax administrative costs; and
- Vehicle License Fee (VLF) adjustments.

Background

After the passage of Proposition 13 in 1978, the California State Legislature (Legislature) enacted new methods for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts. The main objective was to provide local government agencies, school districts, and community college districts with a property tax base that would grow as assessed property values increased. The method has been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for fiscal year (FY) 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

Property tax revenues that local government agencies receive each fiscal year are based on the amount received in the prior year plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local government agencies, school districts, and community college districts using prescribed formulas and methods defined in the Revenue and Taxation Code.

The AB 8 process involves several steps, including the transfer of revenues from school and community college districts to local government agencies (AB 8 shift) and the development of the tax rate area (TRA) annual tax increment (ATI) apportionment factors, which determine the amount of property tax revenues to be allocated to each jurisdiction.

The total amount to be allocated to each jurisdiction is then divided by the total amount to be allocated to all entities to determine the AB 8 factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities using the revenue amounts established in the prior year. These amounts are adjusted for growth annually using ATI factors.

Subsequent legislation removed from the AB 8 process revenues generated by unitary and nonunitary properties, regulated railway companies, and qualified electric properties. These revenues are now apportioned and allocated under separate processes.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the fund. The fund is subsequently apportioned and allocated to school and community college districts by the county auditor according to instructions received from the county superintendent of schools or the chancellor of the California community colleges.

Revenues generated by the different types of property tax are apportioned and allocated to local government agencies, school districts, and community college districts using prescribed formulas and methods, as defined in the Revenue and Taxation Code. Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner's name, and value. The types of property tax rolls are:

- *Secured Roll*—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if the taxes are unpaid, the obligation can be satisfied by the sale of the property by the tax collector.
- *Unsecured Roll*—Property that, in the opinion of the assessor, does not have sufficient permanence or other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties composed of unitary and operating nonunitary value assessed by the State Board of Equalization (BOE).
- *Supplemental Roll*—Property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property tax revenues, Senate Bill 418, which requires the State Controller to audit the counties' apportionment and allocation methods and report the results to the Legislature, was enacted in 1985.

Apportionment and allocation of property tax revenues can result in revenues to an agency or agencies being overstated, understated, or misstated. Misstated revenues occur when at least one taxing agency receives more revenue than it was entitled to, while at least one taxing agency receives less revenue than it was entitled to.

The agency that received less tax revenue than its statutory entitlement would have standing to require that adjustments be made by the county, either on a retroactive or prospective basis. SCO does not have enforcement authority or standing to require the county to take corrective action with respect to misallocation of tax revenues, unless the

misallocation resulted in overpaid state funds (funds intended for the ERAF, school districts, or community college districts). SCO has authority to recover misallocations resulting in overpaid state funds pursuant to Government Code (GC) sections 12410, 12418, and 12419.5.

GC section 12410 provides the State Controller with broad authority to “superintend the fiscal concerns of the state.” GC section 12418 provides the State Controller with the authority to “direct and superintend the collection of all money due the State, and institute suits in its name” against all debtors of the State. GC section 12419.5 provides the State Controller with the authority to offset any amounts due the State against any amounts owing the debtor by the State.

Revenue and Taxation Code (RTC) section 96.1(b) allows a reallocation of current audit findings and unresolved prior audit findings.

RTC section 96.1(c)(3) limits a cumulative reallocation or adjustment to one percent of the total amount levied at a one-percent rate of the current year’s original secured tax roll. For reallocation to the ERAF, school districts, or community college districts, a reallocation must be completed in equal increments within the following three fiscal years, or as negotiated with the State Controller.

Objective, Scope, and Methodology

The objective of our audit was to determine whether the county complied with Revenue and Taxation Code, Health and Safety Code, and Government Code requirements pertaining to the apportionment and allocation of property tax revenues.

The audit period was July 1, 2013, through June 30, 2017.

To achieve our objective, we:

- Interviewed key personnel to gain an understanding of the county’s process for apportioning and allocating property tax revenues;
- Reviewed the county’s written procedures for apportioning and allocating property tax revenues;
- Performed analytical reviews to assess the reasonableness of property tax revenues;
- Judgmentally selected a non-statistical sample of five from approximately 157 taxing jurisdictions within the county for all fiscal years in the audit period (the actual number of taxing jurisdictions, which include the ERAF, can vary from year to year based on jurisdictional changes). Errors found were not projected to the intended (total) population. Then, we:
 - Recomputed apportionment and allocation reports to verify computations used to develop property tax apportionment factors;
 - Tested TRA reports to verify that the correct TRA factors were used in the computation of the ATI;

- Reviewed supplemental property tax administrative costs and fees to determine whether recovery costs associated with administering supplemental taxes were based on actual costs and did not exceed five percent of revenues collected, as prescribed in statute;
- Verified computations used to develop supplemental property tax apportionment factors;
- Verified unitary and operating nonunitary and unitary regulated railway property computations used to develop apportionment factors;
- Reviewed Redevelopment Property Tax Trust Fund deposits;
- Reviewed property tax administration cost reports and recomputed administrative costs associated with work performed for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts;
- Reviewed ERAF reports and verified computations used to determine the shift of property taxes from local government agencies to the ERAF and, subsequently, to school and community college districts;
- Reviewed the Sales and Use Tax letter and recomputed VLF computations used to verify the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues;
- Reviewed reports to determine any increases in property tax revenues due cities having low or nonexistent property tax amounts; and
- Reviewed BOE jurisdictional change filing logs and their impact on the tax apportionment and allocation system.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow to develop appropriate auditing procedures. We did not evaluate the effectiveness of internal controls relevant to the apportionment and allocation of property tax revenues. We did not audit the county's financial statements.

We conducted this audit under the authority of GC section 12468, which requires the SCO to audit the apportionment and allocation of property tax revenues. A property tax bill contains the property tax levied at a one percent tax rate pursuant to the requirement of Proposition 13. A bill may also contain special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city. The scope of our audit

is concerned with the distribution of the one percent tax levy. Special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city are beyond the scope of our audit and were not reviewed or audited.

Conclusion

Our audit found that San Mateo County did not comply with California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we determined that the county:

- Incorrectly computed and distributed property tax revenues;
- Incorrectly calculated the reimbursement of property tax administrative costs; and
- Incorrectly calculated the VLF adjustments.

These instances of noncompliance are described in the Findings and Recommendations section of this audit report.

Follow-up on Prior Audit Findings

The county has satisfactorily resolved the findings noted in our prior audit report, for the period of July 1, 2006, through June 30, 2013, issued March 21, 2014.

Views of Responsible Officials

We issued a draft audit report on June 28, 2019. Juan Raigoza, Auditor-Controller, responded by letter dated December 6, 2019 (Attachment), agreeing with Finding 3 and disagreeing with Findings 1 and 2. The county's complete response is included as an attachment to this audit report.

Restricted Use

This audit report is solely for the information and use of San Mateo County, the Legislature, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this audit report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

March 10, 2020

Findings and Recommendations

FINDING 1— Computation and Distribution of Property Tax Revenue

During testing of the county’s property tax revenue computation and distribution process, we found that the county incorrectly included unsecured aircraft assessed values in its computation of the ATI for FY 2013-14 through FY 2016-17, which resulted in misallocated AB 8 revenues to all affected entities in the county. We did not quantify the monetary impact due to the various components involved in the calculation.

The inclusion of the unsecured aircraft in ATI was due to a differing interpretation of the statutes.

RTC sections 96 through 96.5 provide the legal requirements for the computation of ATI and the apportionment and allocation of property tax revenues.

ATI is the difference between the total amount of property tax revenues computed each year using the equalized assessment roll and the sum of the amounts allocated pursuant to RTC section 96.1(a). Each TRA will receive an increment based on its share of the incremental growth in assessed valuations. ATI added to the tax computed for the prior fiscal year will develop the apportionments for the current fiscal year.

Recommendation

We recommend that the county:

- Update and implement policies and procedures to exclude unsecured aircraft assessed values from its computation of the ATI; and
- Recalculate the ATI computation for FY 2013-14 through FY 2016-17 and make monetary adjustments, if the amounts are significant.

County’s Response

We respectfully disagree with the above recommendation and have attached for your consideration our analysis which supports our position to continue to include unsecured aircraft assessed values when calculating AB 8 factors (see Attachment A).

SCO Comment

Our finding and recommendation remain unchanged.

On December 4, 2019, the Counties of San Joaquin, San Mateo, and Los Angeles submitted a joint statement disputing the SCO directive for the three counties to exclude noncommercial aircraft assessed value growth from the calculation of the property tax allocation factors (commonly known as the AB 8 factors) under RTC sections 96.1 and 96.5. The counties requested that the SCO provide a detailed legal analysis for the counties’ consideration, or remove the finding.

On January 15, 2020, SCO staff counsel provided its legal analysis to the three counties regarding the SCO's position that noncommercial aircraft assessed values should be excluded from the calculation of the property tax allocation factors. In summary, some reasons cited for the SCO's conclusion are 1) the longstanding BOE interpretation; 2) the views of the California Association of County Auditors, contained in the *Property Tax Managers Manual*; and 3) the fact that including the aircraft assessed values contravenes the legislative purpose of the AB 8 process.

**FINDING 2—
Reimbursement of
Property Tax
Administrative Costs**

During testing of the county's reimbursement of property tax administrative cost process, we found that the county incorrectly included excess ERAF when computing the property tax administrative fee factors for FY 2013-14 through FY 2016-17, which resulted in the misallocation of property tax administrative costs to all affected entities in the county. We did not quantify the monetary impact due to the various components involved in the calculation.

The inclusion of the excess ERAF amount was due to a differing interpretation of the statutes.

RTC section 95.3 provides the legal requirements for reimbursement of property tax administrative costs. Allowable administrative costs are described in RTC sections 96.1 and 100 and Health and Safety Code section 33670.

The County Assessor, the County Tax Collector, the Assessment Appeals Board, and the Auditor-Controller all incur administrative costs associated with the apportionment and allocation of property tax revenues. Applicable statutes enable the county to be reimbursed by local agencies for the aforementioned costs.

Recommendation

We recommend that the county:

- Update and implement policies and procedures to exclude excess ERAF amounts from the computation of property tax administrative factors; and
- Recalculate the property tax administrative costs for FY 2012-13 through FY 2015-16 for the reallocation of the FY 2013-14 through FY 2016-17 administrative costs and make monetary adjustments, if the amounts are significant.

County's Response

We respectfully disagree with the above recommendations and have attached for your consideration our analysis which supports our position to include Excess ERAF in the property tax administrative factors (see Attachment B).

SCO Comment

Our finding and recommendation remain unchanged.

RTC sections 97.2 and 97.3 made a one-time base year modification to RTC section 96.1 for FY 1992-93 and FY 1993-94 only, not every fiscal year thereafter.

**FINDING 3—
Vehicle License Fee
Adjustments**

During testing of the VLF adjustment process, we found that the county incorrectly included unsecured aircraft assessed values twice in its computation for FY 2013-14 through FY 2016-17. In addition, we found that the county also carried forward the incorrect FY 2015-16 VLF adjustment when computing the FY 2016-17 VLF adjustment. These errors resulted in an under-allocation of ERAF revenue to the following sampled jurisdictions:

<u>Sampled Taxing Jurisdiction ¹</u>	<u>Approximate Amount Due From the ERAF</u>
City of Atherton	\$ (73)
City of Belmont	(6)
City of Daly City	(5,262)
City of San Carlos	(11,339)
San Mateo County	<u>(252,249)</u>
	<u>\$ (268,929)</u>

¹ These errors may also affect other incorporated cities in the county; however, we did not measure the fiscal impact.

These errors are due to an oversight on the part of the county when compiling information for the calculation.

RTC section 97.70 provides the legal requirements for VLF adjustments.

The VLF permanently provided additional property tax revenues to cities and counties in lieu of the discretionary VLF revenues that these agencies previously received.

Recommendation

We recommend that the county:

- Update and implement policies and procedures to properly identify unsecured aircraft assessed values in the computation of the VLF adjustment calculation; and
- Recalculate the VLF adjustment for FY 2013-14 through FY 2016-17 and make monetary adjustments, if the amounts are significant.

County’s Response

Agree. The recommendations [related] to VLF will be implemented in FY 2019-20.

**Attachment—
County’s Response to Draft Audit Report**



COUNTY OF SAN MATEO
OFFICE OF THE CONTROLLER

Juan Raigoza
Controller

Shirley Tourel
Assistant Controller

555 County Center, 4th Floor
Redwood City, CA 94063
650-363-4777
<http://controller.smcgov.org>

December 6, 2019

Lisa Kurokawa, Chief
Compliance Audits Bureau
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250

Dear Lisa:

On June 28, 2019, the State Controller's Office ("SCO") issued the DRAFT San Mateo County Audit Report "Apportionment and Allocation of Property Tax Revenues" that included three findings and three recommendations to the San Mateo County Controller ("County Controller"). Of those three findings, we agree with Finding #3 and disagree with Findings #1 and #2.

On September 27, 2019, we provided the SCO a letter detailing the County Controller's response to the SCO's draft audit report. The September 27, 2019 letter included two attachments, labeled A and B. Attachment A was a statement submitted jointly by the counties of Los Angeles, San Mateo, and San Joaquin ("Counties") addressing the audit finding issued by the SCO directing Counties to exclude unsecured aircraft assessed values from the computation of the annual tax increment. Attachment B was the County Controller's detailed response to the SCO's recommendation to recalculate the allocation of property tax administration costs. The County Controller's September 27, 2019 letter and attachments are enclosed with this cover letter.

Also attached are the SCO's November 18, 2019 email responding to the Counties' joint statement (see Attachment A of the September 27, 2019 letter), and the Counties' second joint statement, dated December 4, 2019, responding to the SCO's November 18, 2019 email.

We look forward to receiving your response to the Counties' December 4, 2019 joint statement and the aforementioned Attachment B, related to the County's allocation of property tax administration costs.

Sincerely,

Juan Raigoza
Controller

Cc: Jim L. Spano, CPA, Chief, Division of Audits, State Controller's Office
Scott Freesmeier, Audit Manager, Division of Audits, State Controller's Office



COUNTY OF SAN MATEO
OFFICE OF THE CONTROLLER

Juan Raigoza
Controller

Shirley Tourel
Assistant Controller

555 County Center, 4th Floor
Redwood City, CA 94063
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September 27, 2019

Lisa Kurokawa, Chief
Compliance Audits Bureau
State Controller's Office
Division of Audits
P.O. Box 942850
Sacramento, CA 94250

Dear Lisa:

On June 28, 2019, the State Controller's Office issued the DRAFT San Mateo County Audit Report "Apportionment and Allocation of Property Tax Revenues" that included three findings and three recommendations to the San Mateo County Controller (the "County Controller"). This letter provides the County Controller's Office's response to the recommendations made in your letter.

Finding 1 – Computation and Distribution of Property Tax Revenue

Recommendation

We recommend that the county:

- Update and implement policies and procedures to exclude unsecured aircraft assessed values from its computation of the ATI; and
- Recalculate the ATI computation for FY 2013-14 through FY 2016-17 and make monetary adjustments, if significant.

Response

We respectfully disagree with the above recommendation and have attached for your consideration our analysis which supports our position to continue to include unsecured aircraft assessed values when calculating AB 8 factors (see Attachment A).

Finding 2 – Reimbursement of Property Tax Administrative Costs

Recommendation

We recommend that the county:

- Update and implement policies and procedures to exclude excess ERAF amounts from the computation of property tax administrative factors; and
- Recalculate the allocation of property tax administrative costs for FY 2012-13 through FY 2016-17 and make monetary adjustments, if significant.

Response

We respectfully disagree with the above recommendations and have attached for your consideration our analysis which supports our position to include Excess ERAF in the property tax administrative factors (see Attachment B).

Finding 3 – Vehicle License Fee Adjustments

Recommendation

We recommend that the county:

- Update and implement policies and procedures to properly identify unsecured aircraft assessed values in the computation of the VLF adjustment calculation; and
- Recalculate the VLF adjustment for FY 2013-14 through FY 2016-17 and make monetary adjustments, if significant.

Response

Agree. The recommendations to VLF will be implemented in FY 2019-20.

We ask that you review our attached analyses and reconsider your recommendations for Findings 1 and 2. Please contact Shirley Tourel, Assistant Controller, via e-mail at stourel@smcgov.org or at phone number (650) 599-1149 if you have any questions. Thank you.

Sincerely,



Juan Raigoza
Controller

cc: Jim L. Spano, CPA, Chief, Division of Audits, State Controller's Office
Scott Freesmeier, Audit Manager, Division of Audits, State Controller's Office

Attachment A



ARLENE BARRERA
ACTING AUDITOR-CONTROLLER
LOS ANGELES COUNTY



JUAN RAIGOZA
CONTROLLER
SAN MATEO COUNTY



JEROME C. WILVERDING
AUDITOR-CONTROLLER
SAN JOAQUIN COUNTY

September 4, 2019

Lisa Kurokawa
Chief, Compliance Audits Bureau
State Controller's Office, Division of Audits
P.O. Box 942850
Sacramento, CA 94250

RE: Exclusion of Noncommercial Aircraft Assessed Value Growth From Property Tax Allocation Factors

Dear Ms. Kurokawa:

This statement is submitted jointly by the counties of Los Angeles, San Mateo, and San Joaquin (Counties) to address an audit finding issued by the State Controller's Office (SCO) that directs the Counties to exclude noncommercial aircraft assessed value growth (Aircraft Growth) from the calculation of property tax allocation factors (referred to as the "AB 8 allocation factors"). Hereafter, all future references to "aircraft" means "non-commercial aircraft."

The Counties object to the audit finding for the following of reasons:

1. There is no express provision in Revenue & Taxation Code (the "R&T Code") to exclude noncommercial aircraft when calculating the AB 8 factors. To the contrary, the plain language of the R&T Code (in defining the "last equalized roll") *requires* the inclusion of Aircraft Growth in calculating AB 8 factors. In fact, the base year property tax allocations initially established in Fiscal Year (FY) 1979-80 included the revenues of noncommercial aircraft;
2. The statutes governing the "allocation" process (which require the inclusion of Aircraft Growth in the calculation of AB 8 factors) as set forth in R&T Code Sections 96 *et seq.* are separate and distinct from the statutes governing the "apportionment" or "distribution" of noncommercial aircraft tax revenue set forth in R&T Code Sections 5451-5456. Because there is no ambiguity in the language of the relevant allocation statutes, there is no need to look to the legislative history of R&T Code Sections 5451-5456 for guidance. Moreover, even if one were to consider the legislative history of those sections, it would only be informative as to the Legislature's intent regarding the distribution of tax revenue as opposed to the calculation of AB 8 factors;

3. Excluding Aircraft Growth from the calculation of AB 8 factors in the absence of clear statutory authority leads to a number of unintended and problematic consequences with respect to the myriad of other calculations that the Counties' auditor-controllers must undertake each year;
4. To the extent that there are perceived inequities between the allocation process and distribution process for Aircraft Growth which need to be addressed, the only remedy is for the Legislature to amend the applicable statutes.

Each of these grounds is discussed in greater detail below.

1. **There is no express provision in the R&T Code allowing auditor-controllers to exclude noncommercial aircraft when calculating AB 8 factors, and, in fact, Aircraft Growth must be included in such calculations.**

One of the audit finding's fundamental problems is that it fails to differentiate between those provisions of the R&T Code which concern the "apportionment" (*i.e.*, distribution) of taxes levied on noncommercial aircraft and those provisions which concern the "allocation" of assessed aircraft values in calculating AB 8 factors and determining the "last equalized roll."¹

As the SCO has acknowledged, R&T Code Sections 5451-5456 provide for the apportionment of the unsecured countywide property tax levied on aircraft and require such taxes to be distributed according to one of two schemes (*i.e.*, either "1/3 city, 1/3 county, 1/3 school districts" or a "1/2 county, 1/2 school districts"). Notably, Sections 5451-5456² fall within Division 1 ("Property Taxation"), Part 10 ("Aircraft Assessment and Taxation"), Chapter 6 ("Distribution") of the Revenue & Taxation Code. Indeed, R&T Code Section 5451, the first section of Chapter 6, expressly provides that "[t]he revenue derived from any tax levied pursuant to this part shall be distributed as prescribed in this chapter." (emphasis supplied).

Significantly, while Sections 5451-5456 clearly call for the distribution of taxes levied on aircraft pursuant to a non-AB 8 scheme, there are no parallel sections to adjust the way that local auditor-controllers are to incorporate the assessed value of such aircraft into the R&T Code's allocation calculations (*i.e.*, R&T Code Section 96 *et seq.*) which, it should be noted, are set forth within Division 1 ("Property Taxation"), Part 0.5 ("Implementation of Article XIII A of the California Constitution"), Chapter 6 ("Allocation of Property Tax Revenue"), Article 2 ("Basic Revenue Allocations") of the Revenue & Taxation Code.

¹ Cal. Rev. & Tax. Code § 2050 further provides that any reference to the "last equalized county assessment roll" or other similar references to the current assessment roll or latest assessment roll shall be taken to reference the "last equalized roll" as defined in Part 3, Chapter 3.

² Unless otherwise indicated, all subsequent statutory references are to the Revenue and Taxation Code.

Indeed, the various interrelated sections of the R&T Code actually *require* the inclusion of the assessed value of noncommercial aircraft in the auditor-controller's AB 8 calculations. Section 2052 provides that the "last equalized roll" is determined each year by adding the following:

The "local roll" (which is defined in Section 109 as "those parts of the secured and unsecured roll containing property which it is the county assessor's duty to assess") "as delivered to the auditor" which delivery must be prior to July 1st pursuant to Section 617;

including any changes made by the county board during the month of July,

+

together with the "board roll" (which, pursuant to Section 756, must be delivered by the BOE to the local auditor-controller on or before July 31st) and

+

the estimate (from the state) with any changes transmitted pursuant to Section 755 (which concerns total unitary value and operating nonunitary value of state-assessed property and which must be transmitted by July 15th).

Section 2052 further provides that the components listed above, taken together, "shall become the last equalized roll on August 20, and such rolls together shall continue to be the last equalized roll." (Cal. Rev. & Tax. Code § 2052).

Section 96.1 of the Revenue and Taxation Code establishes the method for auditor-controllers to calculate the AB 8 allocation factors. Specifically, Section 96.1 provides that the AB 8 allocation factors include two components: (1) the property tax allocated to that local government in the prior fiscal year (the "base"), plus (2) a share of the growth (positive or negative) in tax revenue attributable to the growth in assessed value in that local government's jurisdiction ("Annual Tax Increment").

Section 96.5 provides how auditor-controllers must calculate Annual Tax Increment: as a general matter, the auditor-controller must determine the total property tax revenue in the current year based on the equalized assessment roll (*i.e.*, the "last equalized roll" for the current year pursuant to R&T Code § 2050), then subtract the total property tax revenue allocated in the prior year under Section 96.1. Thus, calculating Annual Tax Increment—and by extension, the AB 8 allocation factors—requires use of the equalized assessment roll.

Put another way, as personal property subject to taxation at general property tax rates (*see* Rev. & Tax. Code §§ 5362, 5391), noncommercial aircraft are included in the local roll component of the last equalized roll. *See* Cal. Rev. & Tax. Code §§ 109, 2052; Cal. Code Regs., tit. 18, § 252. The last equalized roll, in turn, is used to calculate Annual Tax Increment, and Annual Tax Increment is a component of the AB 8 allocation factors. Accordingly, Aircraft Growth must be included in the AB 8 allocation factors.³

³ Additionally, pursuant to Sections 106 and 109, noncommercial aircraft are part of the "unsecured roll" which is part of "the entire assessment roll."

Inclusion of noncommercial aircraft values in the property tax allocations system is not new and goes back to implementation of Proposition 13. Section 96 and Government Code Section 26912 which together established the base year property tax allocation in the 1979-80 fiscal year, required auditor-controllers to allocate to each local government an amount of property tax revenue based on the average of the taxes received by each local government in the three fiscal years prior to FY 1978-79. This three-year average of tax revenues included revenue from taxes on noncommercial aircraft. Noncommercial aircraft revenues were included in the base year allocation, and Sections 96.1 and 96.5 carry that practice forward each year thereafter. Nothing in Section 96 or Government Code Section 26912 for the base year, Section 96.1 or Section 96.5 for subsequent allocations, nor any other law passed by the Legislature since Proposition 13, allow for the exclusion of the Aircraft Growth from the AB 8 allocation factors.

2. Because the allocation statutes are clear, there is no need to look to the legislative history of AB 1994. Moreover, AB 1994's legislative history is only informative as to the Legislature's intent regarding the *distribution* of aircraft tax revenue as opposed to the *allocation* of Aircraft Growth in connection with the calculation of AB 8 factors.

The SCO premised its finding on legislative actions leading up to passage of Assembly Bill 1994 (Lockyer, 1980). Specifically, the SCO points to the Legislative history indicating that AB 1994 initially included, then removed, a provision repealing the sections of the Revenue and Taxation Code governing distribution of aircraft property tax revenue (Sections 5451-5456) as well as an amendment to Section 5392 which would have provided that aircraft property tax revenue be distributed in the same manner as all other personal property. We understand the SCO interprets these actions as demonstrating an intent by the Legislature to remove Aircraft Growth from the AB 8 allocation factors.

The Counties disagree with this premise on two grounds: First, general principles of statutory interpretation only look to legislative history when existing law is subject to two or more reasonable interpretations. However, the California Supreme Court stated, “[i]f there is no ambiguity in the language [of a statute], we presume the Legislature meant what it said, and the plain meaning of the statute governs.” (*Hunt v. Superior Court* (1999) 21 Cal.4th 984, 1000.) Here, the law governing what is included in the AB 8 allocation factors is clear:

- Annual Tax Increment is a component of the AB 8 Allocation Factors (Section 96.1);
- Annual Tax Increment is derived from the equalized assessment roll (Section 96.5);
- “Roll” means the entire assessment roll, including the local roll (Section 109);
- The local roll includes all personal property subject to taxation at general property tax rates. (Cal. Code Regs., tit. 18, § 252.)
- Noncommercial aircraft are personal property on the unsecured roll subject to taxation at general property tax rates. (Sections 5362 & 5391.)

These provisions of law indicate the Legislature's intent to include Aircraft Growth in the AB 8 allocation factors. There is no reasonable alternative interpretation of these laws that suggest the

Legislature intended otherwise. There is no justification to second-guess the Legislative intent displayed by the laws listed above by examining the Legislative history of AB 1994.

Moreover, even if AB 1994's legislative history were to be considered, it would not demonstrate an intent to exclude Aircraft Growth from the AB 8 *allocation* process. This is because, as noted above, Sections 5451 through 5456 only describe how aircraft tax revenue is *distributed*—these sections do not address AB 8 allocation factors. Similarly, the proposed amendments to Section 5392 would simply have modified *distribution* of tax revenues, as opposed to *allocation* of Aircraft Growth. Had the Legislature intended to exclude aircraft from the calculation of AB 8 factors, it knew how to do so. For example, Section 96 makes the allocation of property tax revenue “subject to the allocation and payment of funds as provided for in subdivision (b) of Section 33670 of the Health and Safety Code...”). With this, the Legislature excluded tax revenues generated in redevelopment project areas because those revenues were subject to both *allocation and payment* according to other provisions of law. However, the Legislature did not do the same to exclude aircraft from the AB 8 allocation factors. This left Aircraft Growth part of the AB 8 allocation factors for purposes of allocating general property tax revenues, but preserved Sections 5451 through 5456 for purposes of distributing aircraft tax revenues. The only intent that can be derived from the Legislative history of AB 1994 is an intent to preserve *distribution* of aircraft tax revenue through the manner prescribed in Section 5451 *et seq.*, which was accomplished by not repealing those sections. But the Legislature history reveals no such intent to change the AB 8 allocation computation.

Additionally, compelling Counties to modify the computation of the AB 8 allocation factors based on the SCO's interpretation of Legislative history, rather than the clear text of the law, is a violation of the rulemaking requirements applicable to the SCO, as set forth in California's Administrative Procedure Act. (Gov. Code 11340.5.) If the SCO believes Aircraft Growth should be excluded from the AB 8 calculation, the SCO should implement that belief through the tools available to that Office: either by adopting regulations to that effect, pursuant to Section 96.1(c)(1); or recommending changes to the Legislature pursuant to Government Code Section 12468.

3. Excluding Aircraft Growth from the calculation of AB 8 factors in the absence of clear statutory authority leads to a number of unintended and problematic consequences.

The SCO's proposed audit finding states the Counties "incorrectly included unsecured aircraft assessed values in its computation of the annual tax increment." This implies the Counties must exclude noncommercial aircraft from the "last equalized roll", which leads to a number of unintended and problematic consequences. This is because, in addition to the calculation of AB 8 factors, the "last equalized roll" is utilized to calculate each taxing entity's debt limit for the purpose of issuing bonds as well as "for all other purposes . . ." Cal. Rev. & Tax Code § 2052(b) (emphasis supplied). For example, pursuant to Cal. Health & Safety Code § 34182(c)(1), the last equalized roll is utilized to calculate each former redevelopment agency's tax increment. (H&S § 34182(c)(1)) ("The county auditor-controller shall calculate the property tax revenues using current assessed values on the last equalized roll on August 20, pursuant to Section 2052 of the Revenue and Taxation Code . . ."). Additionally, the last equalized roll is utilized to calculate

Vehicle License Fee amounts (Sections 97.70(c)(1)(B)(i)(II)(ib), 97.70(c)(1)(C)(ii)(II), and 97.70(c)(2)(B)(ii)(II)).⁴

As a result, to the extent that local auditor-controllers will be required to exclude noncommercial aircraft from the last equalized roll for AB 8 calculation purposes, such Aircraft Growth must also be excluded from the last equalized roll in determining each taxing entity's bonding capacity and a myriad of other calculations.

4. To the extent that there are perceived inequities between the allocation process and distribution process for Aircraft Growth, the only remedy is for the Legislature to amend the applicable statutes.

While the inclusion of Aircraft Growth in AB 8 calculations may seem inconsistent, this conclusion alone does not justify deviation from the plain language of the R&T Code. There must be an express statutory provision authorizing such exclusion. Prior to the passage of the so-called "TEA City" legislation, for example, it may have appeared inequitable that no-tax or low-tax cities would not receive their proportional share of the 1% general property tax. Until the provisions of the R&T Code were amended, however, local auditor-controllers were not permitted to simply adjust AB 8 factors to account for this perceived inequity.

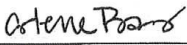
It is noteworthy that when the Legislature has wanted the "last equalized roll" to exclude certain amounts or adjustments, it has specifically provided for them. Indeed, Section 2052 expressly requires that exclusions from the last equalized roll be set forth elsewhere in the R&T Code. *See* Cal. Rev. & Tax. Code 2052 (providing that the local roll and the additions set forth therein "*shall continue to be the last equalized roll, except as otherwise provided in this chapter . . .*") (emphasis supplied). For example, Section 2053 provides that if an assessment appeals board makes any change in the local roll, then those changes (along with the State's transmissions regarding State-assessed properties) "shall become the last equalized roll on the date the auditor receives notice of the action of the board, *except for the purpose of computing any debt limit referred to in Section 2052.*" (emphasis supplied).

⁴ Section 2052 provides that "last equalized roll" is utilized by local auditor-controllers "(a) for the purpose of computing any debt limit for the issuance of bonds of any public entity that is based on a percentage of assessed valuation as shown on the last equalized assessment roll and (b) *for all other purposes*, until the assessment roll for the following year becomes the last equalized roll in accordance with the provisions of this section." (Rev. & Tax. Code § 2052) (emphasis supplied). As such, the exclusion of aircraft assessed values – as proposed by the SCO – would have consequences beyond AB 8 calculations.

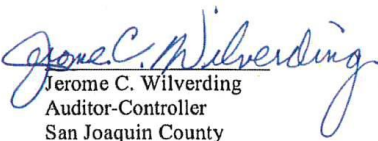
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September 4, 2019
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Attachment A

In light of the foregoing, the Counties respectfully request the SCO withdraw its proposed recommendation concerning Aircraft Growth.


Arlene Barrera
Acting Auditor-Controller
Los Angeles County


Juan Raigoza
Controller
San Mateo County


Jerome C. Wilverding
Auditor-Controller
San Joaquin County

3340535.2

PTAF Pro-Rata Share Calculation

In its June 28th draft audit report and October 30th e-mail, the State Controller's Office (SCO) opined that "the county's practice of adjusting the R&T Code Sections 96.1 and 96.2 amount by the Excess ERAF provision of R&T Code Sections 97.2 and 97.3 when calculating for PTAF factors is incorrect because *R&T Code Sections 97.2 and 97.3 only modified R&T Code Section 96.1 in FY 1992-93 and 1993-94, not every fiscal year thereafter.* (emphasis supplied). Based on this analysis, the SCO issued an audit finding directing the County of San Mateo (the "County") to calculate its PTAF pro-rata share, for every fiscal year after FY 1993-94, "by determining the property tax revenue pursuant to 96.1 and 96.2 (AB8), as modified by R&T Code Sections 98 ("TEA"), and 100 (unitary and operating non-unitary" (and not by Sections 97.2 and 97.3).

The County objects to the audit finding on the grounds that the plain language of Revenue & Taxation ("R&T" Code Sections 97.2 and 97.3 expressly requires the ongoing adjustment of PTAF calculations after FY 1993-94. Specifically, Section 95.3¹, which sets forth the method for calculating taxing entities' pro-rata shares of the PTAF incorporates Section 96.1. Section 96.1, in turn, incorporates all of the calculations provided in "Article 3" which include the ERAF (and "Excess ERAF") provisions in Sections 97.2 and 97.3. This analysis is set forth in greater detail below.

1. **R&T 95.3, the section concerning PTAF calculations, requires counties to calculate the PTAF factors by dividing the sum of the amounts calculated under R&T 96.1 for each jurisdiction, ERAF, and RDA by the total amount calculated countywide.**

Specifically, Section 95.3(a) provides:

Notwithstanding any other provision of law, for the 1990-91 fiscal year and each fiscal year thereafter, the auditor shall divide the sum of the amounts calculated with respect to each jurisdiction, Educational Revenue Augmentation Fund (ERAF), or community redevelopment agency pursuant to Sections 96.1 and 100, or their predecessor sections, and Section 33670 of the Health and Safety Code, by the countywide total of those calculated amounts.

Cal. Rev. & Tax. Code § 95.3(a).

2. **R&T 96.1, in turn, incorporates Article 3 (commencing with Section 97) and Article 4 (commencing with Section 98) of Division 1, (Property Taxation), Part 0.5 (Implementation of Article XIII A of the California Constitution), Chapter 6 (Allocation of Property Tax Revenue) of the Revenue & Taxation Code into its calculations.**

Section 96.1(a) provides:

¹ Unless otherwise noted, all references to "sections" shall refer to the Cal. Revenue & Taxation Code.

Except as otherwise provided in Article 3 (commencing with Section 97), and in Article 4 (commencing with Section 98), *for the 1980-81 fiscal year and each fiscal year thereafter*, property tax revenues shall be apportioned to each jurisdiction pursuant to this section and Section 96.2 by the county auditor, subject to allocation and payment of funds as provided for in subdivision (b) of Section 33670 of the Health and Safety Code and subparagraph (D) of paragraph (3) of subdivision (g) of Section 53395.8 of the Government Code, to each jurisdiction in the following manner:

Cal. Rev. & Tax. Code § 96.1 (emphasis supplied).

Thus, for the same reason that local auditor-controllers have adjusted their PTAF calculations for TEA pursuant to Article 4 for “each fiscal year thereafter,” those same calculations have been adjusted for ERAF (and Excess ERAF) pursuant to Article 3. In particular, Sections 97.2(d)(4) and 97.3(d)(4) make clear that the provisions requiring the return of Excess ERAF to counties, cities, and special districts continue from year to year and were not limited to the 1992-93 and 1993-94 fiscal years. *See generally* Cal. Rev. & Tax. Code sections 97.2(d)(4)(A) and 97.3(d)(4)(A).

3. **Any suggestion that the provisions of Sections 97.2 and 97.3 (including the provisions regarding Excess ERAF) were effective only for FYs 1992-93 and 1993-94, and not thereafter, is contrary to both the plain language of those statutes in addition to well-settled interpretation by the courts.**

Since FY 2000-01, Article 3 has required auditor-controllers to allocate any remaining ERAF revenues (i.e., “Excess ERAF”) among the county, cities, and special districts in proportion to amounts of ad valorem property tax revenues otherwise required to be shifted from those local agencies in the county ERAF for the relevant fiscal years pursuant to R&T 97.2(d)(4)(B)(i)(III) and 97.3(d)(4)(B)(i)(III).

The plain language of Sections 97.2 and 97.3 demonstrate that those provisions were not limited to FYs 1992-93 and 1993-94. Sections 97.2(d)(4)(B)(i)(I) and 97.3(d)(4)(B)(i)(I), for example, apply to “the 1995-96 fiscal year *and each fiscal year thereafter*” Cal. Rev. & Tax. Code section 97.2(d)(4)(B)(i)(I) (emphasis supplied). Other subsections apply to “*the 2007-08 fiscal year and each fiscal year thereafter*” or “*the 2000-01 fiscal year or any fiscal year thereafter.*” Cal. Rev. & Tax. Code sections 97.2(d)(4)(B)(i)(II) and (III); 97.3(d)(4)(B)(i)(II) and (III) (emphasis supplied). Finally, certain other subsections, such as Section 97.3(d)(4)(B)(iii), are applicable after FY 1993-94, even if only for one year, stating, for example, that they apply to the “1996-97 fiscal year only” or the 1999-2000 fiscal year only.”

In *Alhambra*, for example, the Supreme Court noted:

The enactment of the ERAF's *permanently modified the A.B. 8 allocation system* by reducing the property tax base for each city and county by the amounts specified by the implementing statutes for ERAF I and ERAF II. (§§ 97.1, subds. (a)(1)-(2), 97.2, subds. (a)(1), (b)(1) & (c)(1), 97.3, subds. (a)-(c).) The permanent base shifts required by ERAF

I and ERAF II *became self-perpetuating for future fiscal years through the A.B. 8 process* with each ERAF effectively becoming another entity receiving its share of local property tax revenues through the annual A.B. 8 allocation system. (citing *City of Scotts Valley v. County of Santa Cruz*, 201 Cal.App.4th 1, 15-17)

Alhambra v. County of Los Angeles, 55 Cal. 4th (emphasis supplied).

Notably, the California Supreme Court has recognized that if the principal AB 8 property tax revenue allocation statute (section 96.1) incorporates Article 3 allocation adjustments, then the property tax administration fee statute's reliance on those section 96.1 allocations suggests that the property tax administration fee should be calculated *after* the adjustments required Article 3. *City of Alhambra v. County of Los Angeles*, 55 Cal. 4th 707, 723 (2012). In *Alhambra*, for example, the California Supreme Court found that the only reason that Article 3 adjustments for VLF and Triple Flip should not be made was that, unlike here, the specific "statutory provisions of the Triple Flip and VLF Swap suggest a contrary, revenue-neutral intent to maintain the status quo of A.B. 8 allocations." *Id.*

Indeed, the suggestion that sections 97.2 and 97.3 were only effective for FYs 1992-93 and 1993-94, would essentially mean that counties were no longer required to shift any monies in to ERAFs at all. Such an interpretation is also illogical insofar as various subsections of sections 97.2 and 97.3 also recognize the fact that those sections have continued to be effective long after 1994. *See, e.g.*, Cal. Rev. & Tax. Code §§ 97.2 (d)(4)(B)(i)(II).

For the reasons stated above, the SCO's assertion that R&T Code Sections 97.2 and 97.3 only applied to FYs 1992-93 and 1993-94 is incorrect and is contrary to the plain language of the R&T Code. The R&T Code sections concerning Excess ERAF apply not just to the aforementioned fiscal years, but to all fiscal years thereafter. As such, the County's PTAF calculations should not be changed.



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LOS ANGELES COUNTY



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JEROME C WILVERDING
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December 4, 2019

Lisa Kurokawa
Chief, Compliance Audits Bureau
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P.O. Box 942850
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RE: Follow-up Response to Exclusion of Noncommercial Aircraft Assessed Value Growth From Property Tax Allocation Factors

Dear Ms. Kurokawa:

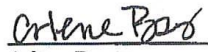
On September 4, 2019, the counties of Los Angeles, San Mateo, and San Joaquin ("Counties") submitted a joint statement disputing the State Controller's Office ("SCO") draft audit finding that directs the Counties to exclude noncommercial aircraft assessed value growth ("Aircraft Growth") from the calculation of property tax allocation factors ("AB 8 allocation factors"). The Counties' statement set out four specific concerns challenging the legal basis for the disputed audit finding, including: (1) there is no express provision of law that excludes Aircraft Growth from the AB 8 allocation factors; (2) the statutes governing calculation of the allocation factors are different from the statutes governing property tax distribution; (3) excluding aircraft growth will have unintended and problematic consequences; and (4) the proper method to correct any perceived discrepancies between the statutes governing allocation and distribution is through the legislative process. These concerns were supported with nearly seven pages of detailed legal analysis, including references to the specific statutes requiring the inclusion of Aircraft Growth in the calculation of AB 8 allocation factors.

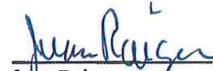
The SCO responded on November 18, 2019, with two conclusory sentences that merely reiterated the SCO's position that Aircraft Growth should not be included in the AB 8 allocation factors. While the response indicates that SCO's legal counsel has several legal reasons justifying this conclusion, the SCO declined to disclose their counsel's analysis and instead only shared "three" of the reasons: "the aircraft assessed values runs counter to the legislative purpose of the AB 8 process, the longstanding BOE interpretation, and the view of the California Association of County Auditors (PTX Managers Manual)." Notably absent was any legal analysis explaining how the statutes governing the AB 8 allocation factor calculation support the SCO's conclusion, let alone citation to statutes actually directing the exclusion of Aircraft Growth from the calculation of AB 8 allocation factors.

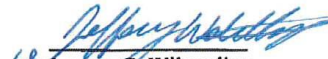
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County auditor-controllers have a legal duty to administer the property tax system according to the law as it reads in the Revenue and Taxation Code. Throughout the Sections governing the basic revenue allocations (Sections 96 through 96.81), the Legislature uses the term "shall" to mandate how property tax allocations are to be calculated. This requires the Counties to administer the property tax system according to the calculations and formulas set forth in those statutes.

Without legal justification rooted in specific statutory provisions, the SCO's proposed audit finding effectively asks the Counties to disregard the law. The Counties need more than conclusory statements from the SCO to change their AB 8 allocation factor calculation to a different one that, in the Counties' view, violates the law. The Counties therefore request the SCO either provide a detailed legal analysis for the Counties' consideration, or remove this proposed audit finding from the pending audit report.


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FOR Jerome C. Wilverding
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