Property Tax Rate Dispute Merits California Supreme Court Review

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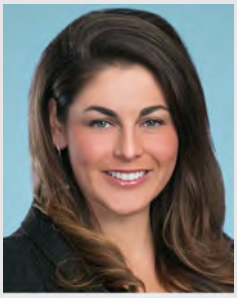
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In this installment of SeeSALT Digest, the authors examine the California Court of Appeal's recent decision in *AT&T Mobility* regarding centrally assessed property and assert that the California Supreme Court should review the case to clarify apparent discrepancies between it and a 1985 supreme court opinion.

For years, some California counties have been imposing disproportionately higher property tax rates on centrally assessed property despite the state constitutional mandate that this property be assessed like locally assessed property. In a challenge brought by centrally assessed utilities, the California Court of Appeal conceded that the higher property tax rates disproportionally burden utility company property but concluded that this disparity does not violate the California Constitution.

In *County of Santa Clara v. Superior Court of Santa Clara County (AT&T Mobility LLC Real Parties in Interest)*, the California Court of Appeal, Sixth Appellate District, held that the mandate in Article XIII, section 19, of the California Constitution that centrally assessed utilities[1] be subject to property taxation "to the same extent and in the same manner as other property" does not require imposition of the

[1]We have used the term "centrally assessed utilities" to identify privately owned public service companies subject to assessment by the California State Board of Equalization under Article XIII, section 19. Section 19 defines the companies and properties authorized to be assessed by the BOE as follows: "The Board shall annually assess (1) pipelines, flumes, canals, ditches, and aqueducts lying within 2 or more counties and (2) property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity."

Cal. Rev. and Tax. Code section 100.9 provides that many centrally assessed electrical generation facilities, not owned by a regulated utility, are not subject to higher debt-service tax rates. Instead, these facilities are taxed on a situs basis in the tax rate area of the property's specific location, just like locally assessed taxpayers. Those properties remain unaffected by the appeals court opinion.

same tax rates as those imposed on locally assessed taxpayers.[2] As a result, the court upheld the validity of Cal. Rev. and Tax. Code section 100, which imposes higher debt-service component tax rates on centrally assessed utilities than the debt-service component tax rates imposed on other taxpayers.[3]

The court's opinion was surprising. Not only did it overturn the trial court's rejection of the county's demurrer, but it dismissed the taxpayers' case without leave to amend, holding that the taxpayers failed to state a valid cause of action.[4] Most practitioners anticipated the court would rule the centrally assessed utilities had at least stated a cause of action regarding whether section 100's seemingly discriminatory tax rates violated the constitutional mandate that centrally assessed utilities be subject to property tax "to the same extent and in the same manner" as non-centrally assessed properties. Indeed, the California Supreme Court's 1985 opinion in *ITT World Communications* concluded that Article XIII, section 19, requires centrally assessed utilities to receive the same property tax rates as non-centrally assessed property.[5] But, the court of appeal dismissed this finding as dicta, ruling instead that the constitution does not require rate parity.[6]

Background

Before 1935, utilities were not subject to property taxation and instead were subject to state-imposed gross receipts taxes. That changed in 1935 with the adoption of the predecessor of Article XIII, section 19 (formerly Article XIII, section 14) and the associated implementing legislation extending California property taxes to utilities. These provisions stated that the assessed values of utilities would be determined on a statewide basis by the California State Board of Equalization.[7] The BOE then allocated the unitary value of each company across the individual tax rate areas in the counties where the utility property was located, with each county then applying the appropriate tax rate to the BOE-allocated values. Utilities thus paid corresponding property tax at the same rate as all other real property in the same tax rate area.[8] As noted, this new regime was governed by section 19, requiring that centrally assessed utility "property shall be subject to taxation to the same extent and in the same manner as other property."[9]

In 1978 California voters adopted Proposition 13 (Article XIII A of the California Constitution). Article XIII A, section 2 specified that the assessed values on real property determined by county assessors would be limited to the assessed values on the 1975-1976 tax roll, increased to reflect the fair market value as of any subsequent change in ownership, and increased for the value of any subsequently completed new construction, but with all other increases to assessed value limited to 2 percent annually.[10] The *ITT* court concluded that the Proposition 13 assessed value limitations did not apply to centrally assessed utilities.[11] The court concluded that Article XIII, section 19, required only that centrally assessed utilities be afforded the same property tax rates as non-centrally assessed property, and did not require that these utilities receive the benefits of Proposition 13's limits on assessed values. The court wrote:

> By requiring that public utility property be "subject to taxation to the same extent and in the same manner as other property," article XIII, section 19, does not impose a requirement of equal valuation between public utility and

[2] *County of Santa Clara v. Superior Court of Santa Clara County (AT&T Mobility LLC Real Parties in Interest)*, No. H049161, 2023 WL 118623, at *12 (Cal. Ct. App. Jan. 6, 2023).

[3] *Id.*

[4] *Id.*

[5] *ITT World Communications Inc. v. City and County of San Francisco*, 37 Cal. 3d 860, 870 (1985).

[6] *AT&T Mobility*, No. H049161, 2023 WL 118623, at *12.

[7] Cal. Const. Art. XIII, section 19.

[8] *Id.*

[9] *Id.*

[10] Article XIII A, section 1(a), also placed a 1 percent limit on the annual property tax rate, with section 1(b) allowing the 1 percent limit to be increased for funding debt service on specific voter-approved public indebtedness.

[11] *ITT*, 37 Cal. 3d at 870.

> other property, but simply specifies that public utility property, after it has been placed on the local rolls, *be levied on at the same rate as locally assessed property*, instead of being subject to a special gross receipts "in lieu" tax. In other words, this comparability requirement was not intended to apply to the valuation of public utility property, but only to its taxation after assessment.[12]

To reduce the administrative burden for the BOE and for taxpayers, the Legislature adopted Cal. Rev. and Tax. Code section 98.9 (the predecessor to section 100) in 1987.[13] It specified that each county shall have a single countywide property tax rate applied to the BOE-determined countywide assessed values for centrally assessed utilities.[14] Its current version, section 100, specifies that this countywide property tax rate is to be the sum of the standard 1 percent statewide property tax rate (without debt service (section 100(b)(1))), increased by a countywide debt service component tax rate to be determined, year-by-year, in accordance with section 100(b)(2).[15] Section 100(b)(2) specifies that this debt-service tax rate for centrally assessed utilities would be the sum of the countywide debt-service tax rate for the prior year (section 100(b)(2)(A)) adjusted for the percentage change in the total dollars required for county debt servicing between the prior two years (section 100(b)(2)(B)).[16]

Section 100(b)(2)'s approach of adjusting the year-by-year countywide debt-service rate by the percentage change in the total dollars of countywide debt-service costs over the prior two years ignores that the countywide locally assessed secured property roll is usually increasing year by year, allowing the countywide debt-service costs to be spread across a greater denominator of assessed value each year.[17] The mechanics of section 100 result in disproportionately higher debt-service component tax rates on centrally assessed utilities by first failing to account for the dilution of the debt-service tax rates caused by the normal year-over-year growth of total assessed values in each county, and then compounding this by continuously adding these disproportionate increases to the already inflated debt-service tax rate from the prior year. Indeed, the section 100 debt-service property tax rates for centrally assessed utilities in many counties are now many multiples higher than the debt-service property tax rates applied to non-centrally assessed properties.[18] This disparity served as the foundation of the centrally assessed utilities' assertion that the section 100 formula can yield unconstitutional results.[19]

Notably, the bulk of the burden caused by section 100's higher debt-service property tax rates falls directly on California customers (the ratepayers) who receive services from cost-of-service regulated utilities. This is because these rate-regulated utilities are allowed to recover expenses like property tax through utility rates. Thus, the court's opinion effectively condones section 100's shift of these disproportionately high property tax charges to customers of rate-regulated utilities rather than having all public debt-service charges evenly allocated across both the locally assessed and centrally assessed property.

[12] *Id.* (emphasis added).

[13] Cal. A.B. 454 (1987), Cal. Stats. ch. 921, section 1.

[14] *Id.*

[15] Cal. Rev. & Tax. Code section 100.

[16] *Id.* Structurally, section 100 established a "base year rate" based on the effective countywide average tax rate that the utilities had been paying in the final year of situs-based taxation, and then tried to annually index the growth of that tax rate only as much as debt service burden grew countywide.

[17] The formula was succinctly described recently by the Ninth Circuit in *BNSF Railway Co. v. County of Alameda*, 7 F.4th 874, 881-882 (9th Cir. 2021):

> Like section 93, section 100's first component is effectively a 1 percent general tax levy. *Id.* section 100(b)(1). Section 100's second component is also a debt service component, but it is calculated differently from section 93's. Section 100's debt service component is calculated as the previous year's unitary debt service rate, *see id.* Section 100(b)(2)(A), multiplied by the percentage change between the two preceding fiscal years in the county's ad valorem debt service levy (not rate) for the secured roll. *Id.* Section 100(b)(2)(B). The formula for the second component means that the unitary rate is based on the change in absolute dollars of the county's debt service rate, not changes in the percentage that taxpayers are paying. According to BNSF, it is this component that accounts for the divergence between the section 100 and section 93 rates. Specifically, if the tax rate applied to the secured roll increases, but the property values also rise, the section 93 rate will not rise. But the section 100 rate will increase because it is based on the increase in actual dollars of debt service tax paid.

[18] *See id.* at 882.

[19] *AT&T Mobility*, No. H049161, 2023 WL 118623, at *1.

The Basis for the Court's Decision to Uphold Section 100

In their lawsuit, the centrally assessed utilities argued that section 100 violates Article XIII, section 19's requirement that their property "be subject to taxation to the same extent and in the same manner as other property" because the mechanics of section 100 result in centrally assessed utilities paying higher debt-service component tax rates than locally assessed taxpayers.[20] The court disagreed, ruling against the taxpayers for three primary reasons.

First, the court reasoned that the "to the same extent and in the same manner as other property" language in Article XIII, section 19 does not explicitly require parity in the property tax rate applied to centrally assessed property and non-centrally assessed property.[21] The court found that it only "describes the extent to which the property shall be subject to taxation, rather than the extent to which it shall be taxed."[22] The court compared this with the next sentence in section 19, which states: "No other tax or license charge may be imposed on these companies which differs from that imposed on mercantile, manufacturing, and other business corporations."

Here, the court concluded that section 19's prohibition against the imposition of "any *other* tax that differs from that imposed on other [non-centrally assessed utility] taxpayers" prevents rate discrimination for these *other* taxes but does not prohibit rate discrimination for property tax.[23]

Second, the court found it significant that the pre-1974 version of Article XIII, section 19 (Article XIII, section 14) had included provisions preventing higher excise tax rates or income tax rates on utilities, but did not include any prohibition against higher property tax rates.[24] When this language was replaced in 1974 with the current version of section 19, the language prohibiting higher excise and income tax rates was dropped. Notwithstanding this change, the court pointed to legislative history that stated this change was not substantive.[25] As a result, the court concluded that the ongoing provisions of section 19, which require more general consistency for the property taxes, should be constrained by these deleted pre-1974 provisions, which included more specific prohibitions against rate discrimination for excise and income taxes.[26]

Finally, the court noted that the overriding purpose for the 1935 adoption of what is now Article XIII, section 19, was to authorize, not to limit, property tax on utility properties that cross county lines.[27] The court reasoned that this 1935 change in the California Constitution was focused on providing that utility property would thereafter be fully "subject to property tax" *in the same manner and to the same extent as other property*.[28] The court found that nothing required the post-1935 property taxation of centrally assessed utilities to reflect the same property tax rate applied to locally assessed property.[29] It was this reasoning that led the court to dismiss as dicta the California Supreme Court's finding in *ITT* that section 19 requires centrally assessed utilities to receive the same property tax rate as non-centrally assessed properties.[30]

As a result, the court sustained the county's demurrer to dismiss the case without leave to amend.[31] Notwithstanding Article XIII, section 19's mandate "that [centrally assessed] property

[20] *Id.*

[21] In *BNSF*, the Ninth Circuit held that section 100's disproportionately high debt-service component property tax rates were illegal. The court concluded that section 100's disproportionately higher tax rates violated federal law that prohibits the application of discriminatory property tax rates against railroads. 49 U.S.C. section 11501(b)(3). The California counties tried to defend the constitutionality of section 100 as applied to railroads by noting section 100's higher tax rates apply equally to the railroads as other centrally assessed utilities. The court rejected this argument and ruled that section 100 was illegal as applied to railroads because it resulted in imposition of higher tax rates on railroads than on all other California taxpayers.

The Sixth Appellate District's *AT&T Mobility* opinion does not address *BNSF* or its contrary opinion. These inconsistent decisions leave centrally assessed utilities subject to section 100's higher tax rates while shielding other centrally assessed taxpayers like railroads from these rates.

[22] *AT&T Mobility*, No. H049161, 2023 WL 118623, at *9.

[23] *Id.* at *8.

[24] *Id.* at *10.

[25] *Id.* at *9.

[26] *Id.* at *10.

[27] *Id.*

[28] *Id.* at *11.

[29] *Id.* at *12.

[30] *Id.*

[31] *Id.*

shall be subject to taxation to the same extent and in the same manner as other property," the court held that the Legislature was able to impose disproportionately higher property tax rates on centrally assessed utilities through section 100.[32]

Conclusion

Centrally assessed utility taxpayers were more than reasonable to conclude that Article XIII, section 19's mandate that centrally assessed "property shall be subject to taxation to the same extent and in the same manner as other property" requires consistency in something as fundamental as the tax rate. Moreover, the court's conclusion that section 19 requires consistency only in the determination of the assessed value of centrally assessed utility property, not consistency in property tax rates, is entirely inconsistent with the California Supreme Court's *ITT* opinion. After all, *ITT* states that section 19 requires that centrally assessed property be subject to the same property tax rates as other property. Moreover, the *ITT* court did not reach this conclusion in a vacuum. That position was urged by both the BOE and 48 counties in briefs submitted in the case.[33]

It is particularly unsatisfying for the court to summarily dismiss *ITT*'s conclusion that Article XIII, section 19, provides rate protection as inconsequential dicta, as this suggests that section 19 may have no meaning at all. According to the court, section 19 no longer provides centrally assessed utilities with the property tax rate protections afforded other taxpayers, and, according to the *ITT* opinion section 19 fails to require that centrally assessed utilities receive the Proposition 13 assessed valuation protections afforded other taxpayers.

Even more troubling is the court's strained analysis of the language and history of Article XIII, section 19, upholding the discriminatory tax rates of section 100 (including its reliance on constitutional provisions repealed almost 50 years ago) that was used to overturn the trial court's rejection of the county's demurrer. At a bare minimum, the case should have proceeded to the trial court for a determination on the merits, rather than a holding that the taxpayer's view of section 19 failed to raise a legitimate grievance meriting judicial review.

The court's opinion should be reviewed by the California Supreme Court so that centrally assessed utility taxpayers and assessing authorities are given guidance on the meaning of Article XIII, section 19. As it stands, the court's opinion leaves everyone uncertain as to section 19's ongoing protections. It needs to be clarified whether section 19 continues to provide property tax rate protections as directed by *ITT*, which would require the court of appeal's opinion to be overturned. Conversely, if section 19 is to be judicially narrowed, with section 100's disproportionately high debt-service tax rates upheld, it should be the California Supreme Court that takes action to constrict *ITT*, not the court of appeal.[34] ■

[32] *Id.*

[33] *See, e.g.*, Brief of Respondent State Board of Equalization, p. 5, *ITT World Communications Inc. v. City and County of San Francisco*, 151 Cal. App. 3d 1 (1984) (1 Civil No. A017703). In the BOE's brief, it urged the court to find that Article XIII, section 19, provides property tax rate protection but not the benefit of Proposition 13's limitations and protections on assessed values (Article III A, section 2).

[34] The California Supreme Court's guidance is also needed to reconcile the court of appeal's opinion with its 1985 holding in *ITT*. Contrary to *ITT*, the court of appeal's opinion seems to hold that Article XIII, section 19 requires that state-assessed properties be assessed under the same valuation standards as locally assessed property. If this is left unreviewed, it would suggest that section 19 might provide centrally assessed utilities the same Proposition 13 valuation protections provided locally assessed properties, which would have far greater impact on state and local revenues than the consistency in debt-service rates. Indeed, property tax revenues are not at risk at all in this case because any reductions in the section 100 disproportionately high property tax rates for debt service will be recovered through slight adjustments in the debt-service rates for locally assessed property under Cal. Rev. and Tax. Code section 93.