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Overview of Current Court Challenges to Proposition 13 and Its Implementing Laws: Assessment of Similar Properties and Revenue Allocation to Local Agencies

Assembly Revenue and Taxation Committee

OVERVIEW OF CURRENT COURT CHALLENGES

TO PROPOSITION 13 AND ITS IMPLEMENTING LAWS:

ASSESSMENT OF SIMILAR PROPERTIES

AND

REVENUE ALLOCATION TO LOCAL AGENCIES

A Briefing Book

ASSEMBLY REVENUE AND TAXATION COMMITTEE

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for

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PREFACE

More than eleven years have passed since California voters approved Proposition 13 in June 1978. That once-calamitous change in the way California's local governments are financed is now fully implemented and, for many, is the only property tax system they have ever known.

Proposition 13 has given rise to several significant court decisions over the last decade, some of which remolded the shape of the initiative in important areas. However, since the California Supreme Court upheld the constitutionality of the initiative in the landmark Amador Valley decision in 1979, no lawsuits have attempted a fundamental challenge to Proposition 13.

Current Court Challenges to Proposition 13

In 1989, however, two groups of lawsuits have emerged which, if successful, could shake the foundation of Proposition 13. One set of three cases seeks to overturn the assessment provisions of Proposition 13. These provisions limit the growth in assessed value of properties while they are

held by the current owner, allowing market value reappraisals only at time of ownership change or new construction. This results in large variations in tax liability of similar properties. Three different plaintiffs are challenging this feature of Proposition 13 as a violation of equal protection guarantees. The lawsuits were prompted by a U.S. Supreme Court decision in a West Virginia property tax case handed down earlier this year.

A second set of three cases challenges Proposition 13's statutory allocation of property tax proceeds among local government agencies. Known as AB 8, this statute distributes the proceeds of the local property tax among cities, counties and districts by a complex formula. Several local government agencies are challenging this formula system, arguing that it unfairly and improperly shifts tax revenues away from some local governments to the benefit of others.

Five of the lawsuits currently are at the Superior Court level, and one is on appeal. If any of them were to be ultimately successful, they would seriously disrupt the financing of local government in California and would produce much uncertainty and confusion while the Legislature sought viable schemes to replace them.

Purpose of This Briefing Book

This briefing book is designed to provide background materials for Legislators and interested parties as part of an interim hearing of the Assembly Revenue and Taxation Committee entitled "Current Court Challenges to the Constitutionality of Proposition 13 and Its Implementing Laws." The purpose of the hearing is to inform members and the public of the existence and status of these lawsuits, and to introduce them to the arguments made by those who seek to overturn aspects of current law and those who seek to defend current law.

Chapter 1 provides background on the property assessment provisions of Proposition 13, and summarizes the three lawsuits which challenge the validity of the assessment features of Proposition 13. Chapter 2 covers the history of the property tax allocation statutes and summarizes the three lawsuits in this area. The pink pages following this Preface present questions and issues which may be helpful to discuss at the public hearing.

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CHAPTER 1

CHALLENGES TO PROPOSITION 13'S ASSESSMENT PROVISIONS

CHAPTER 1
ASSESSMENT

Introduction

As a prelude to this discussion of current court challenges to Proposition 13, it may be helpful to touch briefly on the fundamentals of property taxation in California.

The property tax is the major general revenue source for local agencies in California. It is imposed on the owners of property in proportion to the assessed value of the property and applies to all classes of property.

For purposes of taxation, property is divided into two categories: real property and personal property. Real property is land, permanently attached improvements, fixtures, and mineral rights. Personal property consists of movable property such as equipment, vessels, aircraft, and the like. Real and personal property can be either locally-assessed or state-assessed.

Article XIIIA, added to the California Constitution in 1978 by Proposition 13, revolutionized property taxation in California by changing both the tax rate and method of assessment. However, Chapter 1 exclusively examines current court challenges to Proposition 13's assessment provision and covers only locally-assessed real property.

Background: Assessment Before Proposition 13

Prior to Proposition 13, assessments for both real and personal property were based on the "fair market value" or

"full cash value" of property, i.e., the price knowledgeable and willing buyers and sellers would agree upon for such a property, given its highest and best use.

Although the assessor of each county had the constitutional mandate to annually assess all property subject to taxation by the March 1 lien date, fiscal and staffing constraints prohibited the assessor from physically reappraising all properties each year. Consequently, reappraisals would be conducted in certain geographic areas on a periodic, cyclical basis of every three to seven years. Between physical reappraisals, assessors would often apply interim value increases based on trending factors.

Except for preferentially-assessed property, (e.g., open space, agricultural land, and qualifying timberland), there was no limitation on the amount of value added to the roll when a property was reassessed to market value.

In summary, under the pre-Proposition 13 system, properties of similar market value generally received similar assessments.

Proposition 13's Assessment System

Proposition 13 drastically altered the way real property was assessed in California. It changed California's method of assessment from one based on a property's current market value to one based on so-called "acquisition value."

For purposes of transition from one system to another, Proposition 13 rolled back property values to their 1975-76

fair market value. Properties which have not sold or undergone new construction since 1975-76 are said to have a 1975-76 base year value.

Proposition 13 requires county assessors to adjust a property's base year value upward each year to reflect inflationary increases, but it caps this annual reassessment at 2%. Consequently, the only two instances in which a property can be reassessed upwards by more than 2% per year is upon a change in ownership or new construction.

When a property is sold or transferred, or any other kind of change in ownership occurs, the property is reassessed to current fair market or "acquisition" value as of the date of the transfer. Newly constructed property (which can be property built from the ground up or an addition to existing property) is also assessed at current fair market value as of the date of completion. Once a property is reassessed upward upon completion or change in ownership, it is said to have an "adjusted base year value." A property can have multiple base year values due to new construction until the whole property changes ownership, when it will be assigned a new base year value based on its total fair market value at the time of sale.

(Some forms of new construction or changes in ownership are exempt from reassessment. These include intrafamily transfers, replacement of senior citizens' residences, replacement of damaged or destroyed property, and property taken by eminent domain.)

It should be noted also that Proposition 13's assessment provisions affected only locally-assessed real property; state-assessed utilities and locally-assessed personal property are subject to the valuation rules which were in effect prior to Proposition 13. Moreover, all pre-Proposition 13 property tax exemptions (e.g., for open space, agricultural land, etc.) remain in effect.

Consequently, under Proposition 13, properties with similar fair market values can have widely disparate tax bills. It is quite common for two neighbors living in identical homes to have entirely different tax assessments. Table 1 at the end of this chapter illustrates how a home is assessed under Proposition 13.

Previous Relevant Court Cases

Amador Valley (1979). Opponents of Proposition 13 wasted little time in challenging the constitutionality of the initiative. In Amador Valley Joint Union High School District v. State Board of Equalization, attorneys for the plaintiff argued that Proposition 13:

a) Was a revision of, and not an amendment to, the Constitution and therefore could not be adopted through the initiative process;

b) Violated the single-subject and summary of purpose requirements of the Constitution;

c) Violated the federal equal protection clause;

d) Impaired the constitutional right to travel;

e) Would result in impairment of contracts; and

f) Was void for vagueness.

By a six to one vote, the California Supreme Court dismissed all challenges, including the crucial equal protection test. Writing for the majority, Justice J. Richardson opined:

> We cannot say that the acquisition value approach incorporated in article XIII A, by which a property owner's tax liability bears a reasonable relation to his costs of acquisition, is wholly arbitrary or irrational. Accordingly, the measure under scrutiny herein meets the demands of equal protection principles.

Dissenting from this position, Chief Justice Rose Bird argued that:

> The basic problem with this position is that it upholds the adoption of an assessment scheme that systematically assigns different values to property of equal worth.

Because this California Supreme Court decision was not appealed, it remains the highest judicial ruling on the constitutionality of Proposition 13.

Allegheny (1989). In January of this year the United States Supreme Court rekindled the debate over the constitutionality of Proposition 13 by ruling in a West

Virginia property tax case, Allegheny Pittsburgh Coal Company v. County Commission of Webster County, that the county's method of taxation violated the equal protection clause of the U.S. Constitution.

On its face, Webster County's method of taxation appears very similar to that of Proposition 13. The Webster County tax assessor valued real property on the basis of its recent purchase price but made only minor, periodic adjustments in the assessments of land that had not been recently sold.

The Allegheny Pittsburgh Coal Company and several other coal companies brought suit against Webster County, claiming that the assessed values of their properties were as much as 35 times higher than the assessed values of comparable neighboring properties.

The U.S. Supreme Court concluded unanimously that this practice denied the plaintiffs equal protection of the law because it "resulted in gross disparities in the assessed value of generally comparable property." Recognizing that its opinion could be construed to directly affect California's Proposition 13, Chief Justice Rehnquist, writing for the Court, noted in a footnote:

> We need not and do not decide today whether the Webster County assessment method would stand on a different footing if it were the law of a State, generally applied, instead of the

aberrational enforcement policy it appears to be.

Chief Justice Rehnquist subsequently made a direct reference to Proposition 13, leaving little doubt that the Court's opinion purposefully avoided addressing the question of the constitutionality of the California initiative. Rather, the Court's decision seemed to set the stage for a later resolution of that issue.

Nevertheless, the similarities between California's and Webster County's method of assessment have led some to conclude that if brought before the U.S. Supreme Court, Proposition 13 would be invalidated.

Assessment Cases Filed In California This Year

Seizing the Court's apparent invitation in Allegheny, taxpayers have so far filed three cases in California this year challenging Proposition 13's assessment provisions. Though the facts in each case vary, all of them challenge Proposition 13's provision which requires increased assessment of property when a change in ownership occurs. All claim that Proposition 13 violates the equal protection clause of the Constitution.

Below is a brief description of each of the three cases.

1) Northwest Financial v. State Board of Equalization and San Diego County

Northwest Financial, a Nevada firm, purchased a

home in La Jolla, California on November 30, 1987 for $730,000. Shortly thereafter, the property was reassessed up to its purchase price, representing market value.

The company filed suit on April 12, 1989, claiming that Proposition 13 is "invidiously discriminatory" and violates the equal protection clause of the U.S. Constitution. The suit argues that the property's current tax base of $730,000 is approximately four times higher than its base under the previous owner. The property's previous base was $175,839. The plaintiff is asking for a refund of property taxes.

Although the case was dismissed by the San Diego County Superior Court on September 14, plaintiffs plan to file an appeal.

2) Nordlinger v. Lynch

Stephanie Nordlinger, a Los Angeles County resident, filed suit against John J. Lynch, Los Angeles County tax assessor on September 28, 1989. Like Northwest Financial, Nordlinger is challenging the increased market value assessment of her property which took place when the change in ownership occurred.

The suit details the property tax disparity between Nordlinger's property and similarly situated properties within the same tract of homes. In some

areas of California, the suit claims, there is as much as a 15 to 1 disparity in property assessments of properties with similar fair market values.

Nordlinger is asking the Los Angeles County Superior Court to declare Proposition 13's assessment provisions and the tax assessment of her property invalid.

Arguments in the case have not been heard.

3) R. H. Macy & Co., Inc., et. al. v. Contra Costa County

R. H. Macy & Co., a Delaware Corporation, is a large retailer which owns a store in the Sun Valley Mall in Concord, a city in Contra Costa County. When R. H. Macy's predecessor underwent a corporate restructuring in 1986, it constituted a change in ownership under Proposition 13. Consequently, the county assessor reassessed its department store to fair market value.

R. H. Macy claims that this reassessment increased its property tax bill by more than 250%. Furthermore, the suit alleges that Macy's paid approximately 2.5 times more in property taxes than either J. C. Penney's or Sears which own comparable property in the same mall.

Unique in this suit is the use of a detailed, computerized statistical study which shows both the magnitude and distribution of disparity ratios caused

by changes in ownership in Contra Costa County after 1975.

One study was of properties that were on both the 1975 and 1987 rolls. According to the plaintiff's Complaint, this study revealed that 75% of commercial properties and 57% of residential properties retained their 1975 base year value on the 1987 assessment roll. As can be expected, the plaintiff and defendant differ on the interpretation of these statistics.

Plaintiff is asking the Contra Costa County Superior Court to do the following:

a. Declare Proposition 13 unconstitutional on its face and as applied;

b. Declare increased change in ownership assessments imposed on Macy's or any of its subsidiaries void;

c. Order that such assessments and taxes must be based on the 1975 base year value; and

d. Refund all taxes paid.

Arguments in the case have not been heard.

Arguments To Overturn The Assessment System

The following is a simplified summary of the arguments made by plaintiffs in the three cases to support their claims that Proposition 13's assessment provisions are invalid:

1) Proposition 13's assessment system routinely discriminates

against recent property owners in favor of long-time property owners, thus violating the equal protection clause of the California and U.S. Constitutions.

2) Proposition 13's assessment system is indistinguishable from the Webster County, West Virginia system which was recently invalidated by the U.S. Supreme Court.

3) Similar properties situated side by side have as much as a 15 to 1 disparity in assessed value under Proposition 13. Assuming the same rate of growth in assessed value over the next 10 years, by 1999 the disparity in assessed value for similarly situated properties may be as much as 100 to 1.

4) Recent property owners bear a disproportionately greater property tax burden than do long-time owners who are similarly situated. This is in violation of the equal protection clause of the California and U.S. Constitutions.

Arguments To Sustain The Assessment System

The following is a simplified summary of the arguments made by defendants in the three cases to support their claims that Proposition 13's assessment provisions are valid:

1) The equal protection clause of the California and U.S. Constitution protects people, not property. Proposition 13 treats people fairly because people who pay the same amount for similar property at the same time have similar tax bills.

2) The U.S. Supreme Court's decision in Allegheny does not affect Proposition 13 because West Virginia's Constitution, unlike California's, requires property to be taxed in proportion to its current market value. Proposition 13 taxes property in proportion to its acquisition value.

3) The Allegheny decision does not apply because Webster County, unlike California, did not provide a rational, policy basis for its taxation scheme. Proposition 13 is the result of a deliberate and articulated policy choice.

4) Disparities in the tax assessment of similarly situated properties were envisioned by both the framers and those who voted for Proposition 13. This disparity, in and of itself, does not violate the equal protection clause of the Constitution if it has a rational basis.

5) The California Supreme Court has specifically upheld Proposition 13 against an equal protection challenge.

6) The plaintiffs bear a smaller tax burden than those who purchased property after them. With the passage of time, plaintiff's share of the tax burden will grow disproportionately smaller than the most recent property owners; therefore the system equalizes over time.

Table 1

HOW A HOME IS ASSESSED UNDER PROPOSITION 13

	Calculations	
o If a home (which has not changed ownership or had new construction) has an assessed value of $50,000 in 1978 and is located in a county where the tax rate is 1.05%, its property tax bill will be $525.	$ 50,000 x .0105 $ 525.00	assess. value tax rate tax liability
o If in the following year (1979) the inflation factor is 2%, the home's assessed value will be $51,000. Its new tax bill will be $535.50.	$ 50,000 x 1.0200 $ 51,000 x .0105 $ 535.50	assess. value 2% inflation new value tax rate tax liability
o Assuming a new wing with a market value of $10,000 is added to the home in 1980 and the inflation factor is 2%, the tax liability will be $651.21.	$ 51,000 x 1.0200 $ 52,020 x .0105 $ 546.21	assess. value 2% inflation new value tax rate pre-wing tax
This figure is computed by first finding the property's new adjusted base year value of $52,020 and then computing the tax bill as if the new construction had not occurred, which is $546.21. Property tax on the new wing is computed separately and added to the tax on the old structure. The new wing's tax is $105; therefore, the total property tax bill is $651.21.	$ 10,000 x .0105 $ 105.00 $ 546.21 + 105.00 $ 651.21	value of wing tax rate tax on wing pre-wing tax tax on wing tax liability
o If the property is sold on July 1, 1983 for $175,000--which becomes its new base year value--the tax will be $1,837.50.	$175,000 x .0105 $1837.50	new value tax rate tax liability

CHAPTER 2

ALLOCATION OF PROPERTY TAX REVENUE TO LOCAL AGENCIES

CHAPTER 2
ALLOCATION

Introduction

Chapter 2 discusses pending lawsuits which challenge not Proposition 13 itself, but rather one of the most important statutes implementing Proposition 13. This group of lawsuits seeks to overturn AB 8, the major statute which determines how property tax proceeds under Proposition 13 are distributed among counties, cities, special districts, and school districts.

This litigation addresses allocation of property tax revenue arising from the countywide one percent property tax rate. Revenues raised from add-on tax rates levied to pay for voter-approved indebtedness are not at issue in these cases.

Background: Allocation of Property Tax Revenues Before Proposition 13

Until the 1978-79 fiscal year--that is, before Proposition 13 took effect--cities, counties, special districts and school districts in California all were authorized to levy their own tax rates. The governing board of each local agency would adopt a tax rate by ordinance annually.

These rates were expressed as so many cents per $100 of assessed value of property. Tax rates in a hypothetical community in the late 1970's might have been $0.75 levied by the county, $0.80 levied by the city, $1.10 levied by the school district, and $0.50 levied by special districts serving

the area. Therefore, the total tax rate applying to properties within the boundaries of these four agencies would have been the sum of their rates, $3.15 per $100 of assessed valuation (here expressed in terms of the current 100% assessment ratio rather than the previous 25% assessment ratio.)

Prior to Proposition 13, the county tax collector sent a tax bill to each property in the county, billing the property owner for the tax arising from the sum total of all the property tax rates levied by the local agencies serving the property. These tax proceeds were then divided and returned by the county auditor to each of the local agencies in the county, in proportion to the tax rates each agency levied.

Therefore, before Proposition 13 each local agency had the authority to determine how much property tax revenue it would collect each year. It exercised this authority by applying a tax rate to the assessed value of properties within its boundaries. The tax rate each property owner paid was the sum total of all the rates levied by the several local agencies serving his property. The revenue arising from each agency's tax rate was tracked and allocated directly to that agency for expenditure.

What Proposition 13 Provided

One of the key provisions of Proposition 13 was the placement of a cap on the total property tax rate that could apply to property in California. Whereas prior to Proposition

13 the combined tax rate paid to all local agencies by California property owners averaged about three percent of assessed value, Proposition 13 limited the countywide tax rate to one percent of assessed value.

For practical purposes, Proposition 13 also did away with the authority of local agencies to set and levy their own tax rates. Rather, the initiative established a single countywide tax rate of one percent and required the Legislature to put in place a mechanism for allocating the proceeds of this countywide rate to the various agencies within each county.

This is the language adopted by the voters in Section 1(a) of Article XIIIA of the Constitution:

> The maximum amount of any ad valorem tax on real property shall not exceed one percent (1%) of the full cash value of such property. The one percent (1%) to be collected by the counties and apportioned according to law to the districts within the counties.

How Proposition 13 Was Implemented By AB 8 of 1979

In the aftermath of Proposition 13, the Legislature first enacted a one-year, short-term implementation program referred to as SB 154, which applied to the 1978-79 fiscal year. The following year it enacted AB 8, which was a comprehensive, long-term implementation of the initiative. Both these pieces of legislation were complex and covered many aspects of

Proposition 13's implementation. The paragraphs below describe in simplified terms the provisions of AB 8 which address allocation of the proceeds of the countywide one percent property tax rate.

The Policy Underlying AB 8. The dilemma the Legislature faced was to divide up the proceeds of a much smaller property tax "pie" to all local agencies in each county. The goal was to do this in a way which shared the reduction among them equitably and would, over the long-term, respond flexibly and fairly to growth and development within each county.

The path the Legislature chose in implementing Proposition 13 was to make a one-time distribution of property tax revenues in 1979-80, which became a "base" for all future years, and then to provide a procedure for allocating future increases in property tax revenues arising from growth and development (called "increment").

How AB 8 Works. Under AB 8, the amount each local agency receives in property tax revenues each year is a combination of the calculation of its "base" revenues and its "increment."

This is how the two components of the allocation system work:

Base. The 1979-80 "base" amount of property tax revenue which each agency receives was originally determined in two steps.

First, property tax revenues from Proposition 13's first year (1978-79) under SB 154 were divided among local

agencies. Because Proposition 13 reduced the countywide tax rate from an average of just under three percent to one percent and reduced property assessments, property tax revenues were about $5 billion less statewide than they had been in the prior year. This smaller "pie" was allocated to local agencies in proportion to the average share of county property tax revenues each received in the three years preceding Proposition 13.

Second, additional amounts of property taxes were added to the allocations for each city, county and special district based on block grants made to those agencies in the first-year (1978-79) emergency implementation of Proposition 13 by SB 154. (These additional amounts of property tax revenue were available to allocate to cities, counties and special districts because property tax funding of schools was substantially reduced and replaced by state General Fund financing of local school districts, with minimum school revenue guarantees.)

The combination of these two amounts became the 1979-80 "base" amount of property tax revenues to which every local agency was entitled. In this way, the entire amount of the new smaller pot of property tax revenues under Proposition 13 was allocated among local agencies. Each year, local agencies are guaranteed to receive this "base" amount of revenue, plus growth (as described below).

Increment. The second part of the AB 8 system determines how property tax revenues arising from growth and development after 1978-79 are to be allocated to local agencies. These new revenues from growth are called "increment." Specifically, increment is growth in property tax payments resulting from the following features of Proposition 13's assessment system: 1) the annual two percent increase in assessment, 2) the increases due to new construction, and 3) the increases due to changes in ownership.

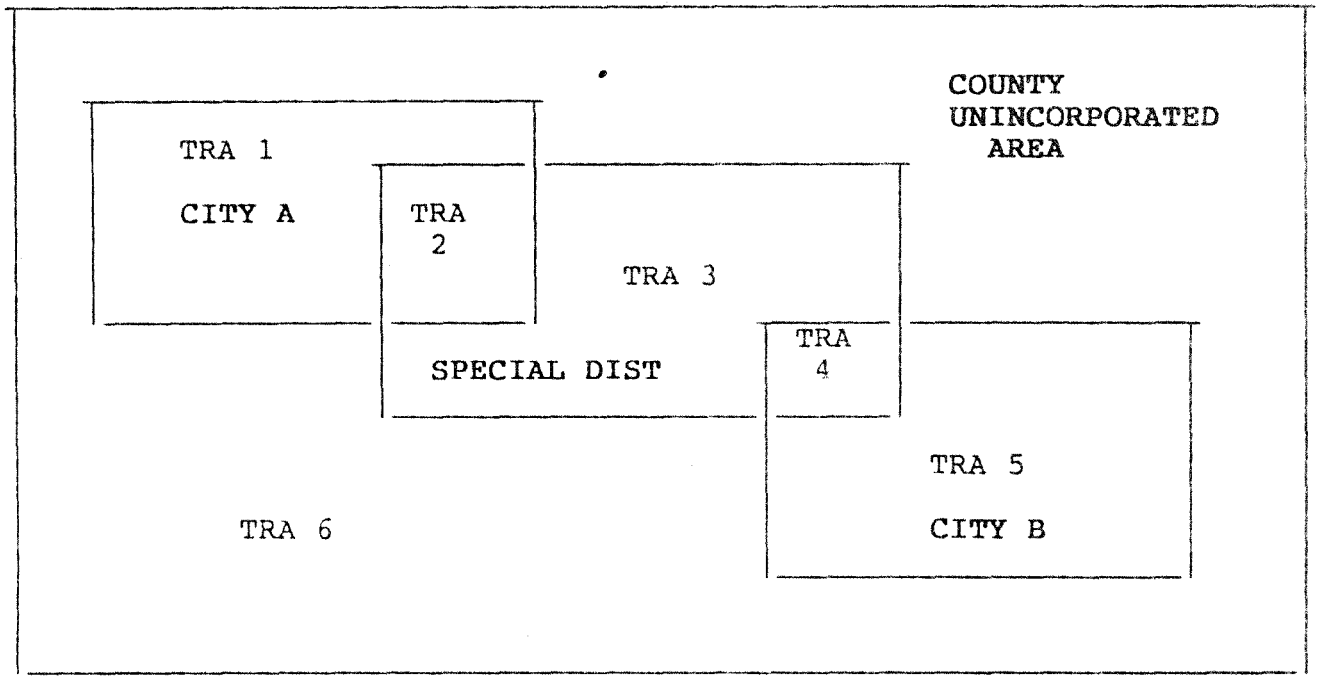
AB 8 provides that "increment" is to be distributed to local agencies on a situs basis, that is, based on the geographic location of the properties whose value had grown.

Because this is a situs-based system, county assessors and auditors must keep track of properties within very small geographic cells. These are called Tax Rate Areas (TRAs). A TRA is an area in which all parcels are served by the exact same mix of local agencies.

Chart 1 below contains a simplified schematic example of how a county would be divided into TRAs. In the example in Chart 1, TRA #1 is served by the County and City A; TRA #2 is served by the County, City A, and the Special District; TRA #3 is served by the County and the Special District; TRA #6 is served by the County only; and so on.

Chart 1

EXAMPLE OF HOW A COUNTY IS DIVIDED INTO TAX RATE AREAS (TRAs)



AB 8 provides that when property values increase within a particular TRA, only the local agencies serving that TRA will receive the additional property tax revenues. AB 8 also provides how the additional revenues are to be allocated among those agencies: the increment is allocated within TRAs by formula in proportion to each agency's average share of property tax revenues in the TRA in the three years preceding Proposition 13. This is the same formula approach as was used for allocation of the "base" portion of the property tax.

Therefore, incremental revenues are allocated by a two-step process, first to geographic areas based on the

location of the growth, and then among the local agencies which serve the area by formula based on historical share of the property tax.

AB 8 Recap

In sum, then, AB 8 put into place a complex system of allocating property tax revenues by formula. The formula is a hybrid which allocates revenues to local agencies each year partially in relation to their pre-Proposition 13 local fiscal position and partially in relation to the location and value of growth since 1978-79. The pre-Proposition 13 fiscal position of a local agency affects its current share of property tax revenues in both the "base" and "increment" portions of the AB 8 allocation system. Unlike the pre-Proposition 13 system, the AB 8 formulas can produce shifting of revenues among local agencies within a county.

The Case of No-Property-Tax Cities

A category of local government agencies affected in a rather extreme way by AB 8 is the so-called "no-property-tax cities" (and their cousins, "low-property-tax cities"). These are cities which levied no city property tax (or a very low tax rate, in the case of the "lows") prior to the enactment of Proposition 13.

Because AB 8 formulas provide that allocations of property tax revenues depend on pre-Proposition 13 levies,

no-property-tax cities now receive no allocations of revenue from the one percent rate. Even though residents of these cities pay the same one percent tax rate as residents of other areas of the county, their city governments do not receive a share of those tax payments. A similar but less extreme situation occurs with low-property-tax cities, which receive small allocations of revenues. This result was consistent with the original goals of AB 8, because AB 8 was designed to share the post-Proposition 13 property tax revenues among local governments which levied property taxes immediately before Proposition 13.

In 1987 and 1988, the Legislature enacted legislation which modified AB 8 by requiring counties to shift portions of their property tax allocations to certain low- and no-property-tax cities. These shifts are to occur over a 7-year phase-in period, and are beginning to be made in 1989-90.

Current Court Challenges to The Allocation System

Three lawsuits have been filed to date challenging the property tax allocation system enacted by AB 8. Each case has been filed by a local government agency, and the defendants are either other local agencies or the state, or both.

Although individual taxpayers are named as plaintiffs in one of these suits, these basically are disputes between local government agencies over division of local revenues.

The cases vary according to characteristics of the local agencies filing the actions, and the legal arguments brought to bear are somewhat different. However, all three have the common feature of challenging the constitutional validity of the way current law allocates property tax revenues from the countywide one percent rate among cities, counties, special districts, and school districts.

The cases are as follows:

1) County of San Diego v. Controller of the State of California

In this lawsuit, San Diego County alleges that AB 8 requires an unfairly large proportion of property tax collections in San Diego County to be allocated to schools. This allows the state to provide a relatively smaller subsidy to San Diego County schools than it provides in other counties, San Diego County argues, while denying the county government of property tax revenues to which it is entitled.

2) City of Rancho Mirage v. County of Riverside

The City of Rancho Mirage is a no-property-tax city. In this lawsuit, the city argues that because the AB 8 allocation formula is based on the amount of property taxes levied by a local agency prior to Proposition 13, no-property-tax cities like Rancho Mirage are unfairly penalized by being denied any allocation of the property tax today, even though

their citizens pay the same tax rate as citizens living elsewhere in the county. In addition, the city argues that this feature of AB 8 denies the city's citizens the opportunity to take advantage of the tax relief provisions of Article XIIIB, the appropriations limit.

3) City of Rancho Cucamonga, et. al. v. Counties of San Bernardino and Los Angeles, et. al.

This suit is filed by the Cities of Rancho Cucamonga, Temple City, Compton, El Segundo, and Carson against the Counties of Los Angeles and San Bernardino and the Cities of Los Angeles and Redlands.

The plaintiff cities in the case are either no-property-tax or low-property-tax cities. They are members of the Contract Cities Association, which is sponsoring this lawsuit.

Like the Rancho Mirage case, this lawsuit argues that the AB 8 system unfairly shifts property taxes away from historically "frugal" cities and benefits historically "spendthrift" cities within any given county. This results in harm to taxpayers, the plaintiffs argue, because their tax dollars are being exported to finance services to citizens of other communities.

Status of the Lawsuits

All three cases are currently at the Superior Court level, and none have been argued. Some of the parties have suggested consolidating the three cases into one.

Summary of Arguments to Overturn The Allocation System

The following is a simplified summary of the points made by plaintiffs in the three cases, arguing that the AB 8 system is invalid:

1) AB 8 is unfair, because it allocates property tax proceeds without regard for who paid them, allowing property tax proceeds to cross jurisdictional lines within a county.
2) It violates the "tax situs" requirements of the California Constitution, because taxpayers are not getting the benefit of services from their tax dollars. In some cases, citizens are "paying twice" for services, since the city must levy other taxes or fees to replace property tax revenue it is not receiving.
3) AB 8 is discriminatory and violates the equal protection clauses of the California and United States Constitutions because: (a) historically low-tax cities are hurt vis-a-vis historically high-tax cities, and (b) cities incorporated after Proposition 13 are allowed to share in the property tax while low-tax cities existing before Proposition 13 are not.

4) The "home rule" provisions of the California Constitution are violated. These give charter cities the right to control their own municipal and fiscal affairs. AB 8 violates this by preventing cities from levying their own property tax rates.

5) AB 8 violates the "uniformity" provision of the state Constitution, which requires uniform taxation for owners of like property. This occurs because a higher county-government tax rate is imputed to property owners in cities where lower revenues are allocated to city government. This results in property owners in different areas of the county paying different county-government tax rates even though they receive the same county services.

6) The results of the AB 8 system have harmed the plaintiff cities' abilities to provide essential public services and solve pressing municipal problems.

7) Even if the provisions of AB 8 were initially justified by the emergency resulting from adoption of Proposition 13, that emergency no longer exists and conditions have changed markedly in the decade since that time. By contrast, the inequities wrought by AB 8 will get worse over time.

8) Cities which have had property tax revenues shifted away from them are denied the opportunity to give tax relief to their residents under Article XIIIB of the California Constitution (the appropriations limit). This provides

for the return to taxpayers of revenues that exceed the governmental agency's annual appropriations limit.

Summary of Arguments to Sustain Allocation System

It is difficult to provide a complete summary of arguments defendants will use to defend the validity of AB 8, because defendants' answers filed in the courts to date have primarily denied the charges made by plaintiffs and set forth procedural objections.

Some of the general responses made by defendants include: sufficient facts have not been presented to constitute a cause of action; the action is barred by statutes of limitation; defendants were acting in accordance with state law in implementing the allocation system; the complaints contain defects and misjoinders of parties; and others.

Based on conversations with representatives of the defendants, it is expected that some of the more specific responses they will make in defending the validity of AB 8 will include:

1) AB 8 does not violate the "home rule" provisions of the Constitution. When the California Supreme Court upheld the constitutionality of Proposition 13 in the Amador Valley case in 1979 (see Chapter 1), SB 154 had already been enacted. SB 154 formed the basis for AB 8. The Supreme Court took the SB 154 revenue allocation scheme into account and did not invalidate it.

2) AB 8 does not violate the equal protection clauses of the United States or California Constitutions. In matters of taxation, the courts allow the Legislature great leeway so long as there is a rational basis for differences in tax burdens. In the case of AB 8, the Legislature distributed a drastically-reduced property tax "pie" among the local government entities which had levied property taxes prior to Proposition 13. Further, under AB 8, revenue growth from new development is distributed on a situs basis. This is a rational basis for the current allocation system.

3) There are no violations of "tax situs" principles, because property tax revenues produced from properties within a county remain with that county. AB 8 does not permit transfer of property tax revenues across county boundaries. The "tax situs" principles apply within county boundaries, not within sub-county boundaries.

4) While plaintiffs point out the transfers of property tax revenues away from them, they fail to acknowledge that reverse transfers also occur. That is, plaintiffs benefit from aspects of the AB 8 formulas which shift property tax revenues from other cities to the plaintiff cities.

5) Plaintiffs fail to take into account other complicated features of local government financing which bear on the fairness of the AB 8 allocation system. Examples include: (a) statutes which permit some cities, but not others, to

levy property taxes to pay for pension systems, (b) different levels of property taxes diverted to community redevelopment agencies in different cities, and (c) the fact that in some counties contract cities are not charged general overhead costs for county services, which are paid for from general county funds, contributed to by all county taxpayers.