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It's time to close a big tax loophole for businesses

California's property tax burden has gradually shifted to homeowners because commercial and industrial property doesn't change hands as often as homes and the sales can be easily disguised.

Michael Hiltzik

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Of all the ways in which California residents have slit their fiscal throats over the last 30 years, surely the most inexplicable is the bestowal of a gaping tax loophole on commercial and industrial property owners.

The culprit, no surprise, is that 31-year-old wolf in sheep's clothing, Proposition 13, which prohibits the reassessment of any property except at the time of a change in ownership.

A sale is a pretty straightforward transaction for a home. That's not the case for commercial or industrial property, where a sale can be disguised in an almost infinite number of ways.

"The whole system is completely unenforceable," says Lenny Goldberg, a Sacramento lobbyist who, as director of the California Tax Reform Assn., has been pressing for years to institute a "split roll" -- that is, to tax commercial and industrial property differently from residential.

The idea is to reverse what has been a shift in California's property tax burden onto homeowners from business owners under Proposition 13.

In Los Angeles County, for example, single-family residences accounted for 39.9% of the tax roll, by value, in 1975, before Proposition 13. This year their share is 55.8%. In the same period, commercial-industrial property has gone from 46.6% of the tax roll to 30.9%. These figures are from the county assessor's annual report, but a similar pattern holds statewide.

What businesses dodge, of course, the homeowner pays. It's fair to say that lots of well-off California businesses are making out like bandits at the homeowners' expense.

Goldberg calculates that Disneyland, which hasn't had a reportable change of ownership since, well, forever, is currently taxed at an average of about a nickel per square foot. For comparison, a median California home bought last year out of foreclosure, measuring 1,600 square feet and selling for about $330,000 (these are averages from the California Assn. of Realtors), would incur property tax of about $3,300 per year, or $2.06 per square foot.

On average, as the anti-tax California Taxpayers Assn. acknowledges, business property was assessed at only about 60% of its full market value as recently as 2006-07, down from a recent peak of more than 87% in 1994-95.

Bringing the percentage up to 100%, say by requiring regular reassessments of business property regardless of ownership changes, could bring the state $2 billion to $4 billion a year in new revenue, depending on who does the math.

Despite this, the split roll has been as unpopular with the voters as any other amendment of Proposition 13. The only time the proposal has made it to the ballot, as Proposition 167 in 1992, it was soundly defeated.

An effort by public employee unions to get a split-roll initiative on the ballot in 2006 didn't even make it past the signature-gathering stage.

But those were different times.

Maybe, just maybe, the voters of this financially spavined state aren't still so reluctant to close a big loophole.

Even under normal circumstances, commercial property doesn't change hands as frequently as homes do. But certainly a major cause of the category's shrinkage as a portion of the tax roll is business owners' ability to avoid reassessments -- with millions of dollars at stake, they have greater incentive to maneuver around the rules, and well-paid real estate pros to help them do so.

The cleverness of some of their maneuvers gives the lie to any claim that American business has lost its innovative edge. Over the years, critics have pointed to some truly baroque schemes.

Consider the 1997 acquisition of Mammoth Mountain ski resort by Vancouver, Canada-based Intrawest Corp. When the Mono County assessor attempted to reassess the resort, Intrawest argued that although it had acquired a majority of Mammoth's shares, it had left voting control on numerous management issues in the hands of the sellers. Therefore, it claimed, no change in ownership had occurred. That cost the county what the assessor calculated was $20 million in taxes over an eight- or nine-year period.

The resort wasn't reassessed until it was sold again -- this time in a clean 2005 deal with Starwood Capital. The new assessment was $167 million more than the old.

My favorite is the elaborate dance choreographed around the San Francisco office complex One Market Plaza.

The property was initially the subject of a 1986 deal in which the Equitable Life Assurance Co. sold an 81% interest in the property to an IBM pension plan, while formally retaining legal title.

This sale-but-not-a-sale wasn't discovered by the San Francisco assessors until 1993. Straightening out the transaction, an appeals court later remarked, required "an extensive investigation, review of thousands of pages of documents, a federal lawsuit," plus a long assessment hearing and two lawsuits in Superior Court.

Was it worthwhile? The ultimate recovery of taxes and fraud penalties in these high jinks came to $64 million, the appeals court reported.

But if Gov. Arnold Schwarzenegger really wants to wipe out waste in this state, he ought to think about

the millions of dollars squandered over 13 years in chasing down the facts.

In economic terms, rationalizing the assessments of commercial and industrial property may be the best way to broaden the state's tax base. For one thing, it's close to the “ideal of non-distorting taxes," as UC Davis economist Steven M. Sheffrin recently told a state panel that was considering changes to the state's tax structure.

By this he means that it doesn't skew business decisions on whether to build or buy a structure.

That's because most of the underassessment of business property derives from the valuation not of buildings but the land under them -- any new or acquired structure will be assessed at market value, so a split roll won't affect that aspect of the investment decision.

It would, however, help eliminate the same inconsistent taxation that afflicts the post-Proposition 13 residential market, where two neighboring properties can receive wildly divergent tax bills simply because of when they last changed hands.

San Francisco Assessor Phil Ting, a leading advocate of the split roll, reports that the Neiman-Marcus on Union Square has an assessed value of $761 per square foot, more than twice that of the Macy's next door, simply because the Neiman's property changed hands in 2006 and Macy's in 1995.

The two stores may not address exactly the same clientele, but they're not *that* different. Similar disparities exist all around the business district, Ting told me.

"Property taxes are supposed to be based on value, but these rates have nothing to do with that," he says.

Anti-tax crusaders will muster a lot of threadbare arguments against the split roll.

They'll say raising rates will burden small businesses that will see the increases in their rent bills. Goldberg proposes moderating that effect by eliminating property taxes on the first $1 million of a business' "personal property," which in practice means its equipment and machinery, tools and furniture, most of which is a pain in the neck to assess anyway.

They'll say the higher tax will be passed on to California consumers, but that's not so easy. The marketplace sets consumer prices -- one Beverly Hills hotel can't charge four times the room rate of another just because it pays four times the property tax per square foot, for example.

They'll say, finally, that higher property taxes will drive businesses out of California. Leaving aside the question of whether Disneyland can be moved to, say, Arizona, the truth is that what's really going to drive businesses and residents out of this state is a crumbling infrastructure and a tax system that doesn't work for anybody. The split roll would be a good place to start getting it to work for everybody.

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