Civil No. B218347
[Superior Court Case No. BS 116375*]*

In The Court of Appeal, State of California

SECOND APPELLATE DISTRICT

DIVISION THREE

City of Alhambra, et al.
Plaintiffs and Appellants

vs.

County of Los Angeles, et al.
Defendants and Respondents.

Appeal from the Superior Court of the State of California
for the County of Los Angeles

Honorable James Chalfant, Judge Presiding
[By C.C.P. § 638 Reference to the Hon. Dzintra Janavs (Ret.)]

APPELLANTS' REPLY BRIEF

Michael G. Colantuono (SBN 143551)
Holly O. Whatley (SBN 160259)
COLANTUONO & LEVIN, PC
300 S. Grand Ave., 27th Floor
Los Angeles, California 90071-3137
Telephone: (213) 542-5700
Facsimile: (213) 542-5710

Attorneys for Appellants
City of Alhambra, *et al.*

I. Introduction

This case involves dense provisions of the Revenue & Taxation Code arising from the Legislature's gymnastic efforts to avoid the 40% set-aside of State General Fund Revenues for K-12 and community college education effected by Prop. 98.[1] The VLF Swap and Triple Flip were designed to manipulate allocations of property taxes, sales taxes and vehicle license fees ("VLF") in a manner that is revenue-neutral as to cities and counties, using the Legislature's control of the property tax system conferred by Proposition 13. They have the effect of decreasing the State's General Fund, but augmenting its non-General Fund revenues by reallocating sales taxes and vehicle license fees from cities and counties to the State and replacing those revenues with property taxes previously allocated to schools via the education revenue augmentation fund ("ERAF"), a previous manipulation of the property tax system with a similar (although non-revenue neutral) purpose. Thus, the State may fund education with funds that never reach the State's General Fund and are never subject to Prop. 98's 40 % set-aside for education.

In light of this legislative intent, it is more than a little ironic that the County sees these budget devices as an opportunity to accomplish a multi-million-dollar set-aside of its own – requiring cities to disproportionately support budgets for the County's Assessor, Tax Collector, and Sheriff's sales whenever the Legislature wields its Constitutional authority to allocate property taxes. Yet that is exactly what the County asks this Court to allow.

However, to seek to persuade this Court that the State's adjustment of the State's own financial obligations somehow empowered the County to increase its

[1] The County acknowledges this motivation of the Triple Flip and VLF Swap. (Respondents' Brief at p. 2, fn. 3.)

annual PTAF revenue by more than $10 million, the County relies, of necessity, on a needlessly complex and Byzantine interpretation of the relevant statutes. The Petitioner Cities' ("Cities") statutory interpretation, by contrast, is simple; Revenue & Taxation Code § 97.75[2] means what it says: that counties may recover their actual cost to implement the Triple Flip and VLF Swap and not tens of millions of dollars more. In evaluating the two competing interpretations of § 97.75 presented here, it is useful to apply a principle widely recognized in science—Occam's Razor—which states that the simplest of competing explanations of a problem tends to be the best.[3] Under this analysis, the Cities' position must prevail. It is more straightforward, requires fewer assumptions and hews more closely to the language of § 97.75 than does the County's, and, thus, supports this Court reversing the trial court's judgment.

California's tax laws are hardly a model of transparency and simplicity, but this Court need not further burden the Legislature's power to manage the State's finances with yet another set-aside for the benefit of a well-positioned constituency by adopting the artful construction of these statutes urged by the County.

II. The Cities Do Not Argue For PTAF Immunity for the Triple Flip and VLF Swap Based On Those Funds Flowing Through ERAF as the County Claims

As it did below, the County misrepresents the Cities' argument. The Cities

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[2] Unless otherwise noted, all statutory references are to California's Revenue & Taxation Code.

[3]The Encyclopedia Britannica's discussion of Occam's Razor appears at http://www.britannica.com/EBchecked/topic/424706/Ockhams-razor (viewed March 4, 2010).

have *never* argued that the Triple Flip and VLF Swap in-lieu payments are immune from the property tax administration fee ("PTAF") because they pass through an ERAF account. Rather, the Cities have consistently argued that § 97.75 immunizes the in-lieu payments, regardless of the account from which the funds flow. As the County admits, these *in-lieu* payments are derived from funds that previously flowed to ERAF, and § 97.75 preserves the *status quo* as to the PTAF burden if construed as the Cities construe it, and as the Legislature intended.

If the immunity rule were otherwise, a county could expand its PTAF take from property tax revenues the Legislature allocated to cities simply by "laundering" the in-lieu funds through an account of a county assessor's choosing. Section 97.75 evidences no intent to allow the immunity of the in-lieu funds to turn on the account from which the funds flow, and the Cities do not contend, and have never contended, otherwise.

That the in-lieu payments originate from property tax revenues does **not** mean they are property taxes subject to PTAF, contrary to the County's claim. The in-lieu funds replace non-property tax revenue – sales taxes and VLF. Thus, it does not follow that they should be treated as property tax share when calculating PTAF. In fact, the opposite is true.

The VLF swap is calculated separately and in addition to the basic property tax allocation known as the AB 8 formulation, after the post-Prop. 13 legislation that established the basis of our current system for apportioning property taxes.[4]

[4] Prior to Prop. 13, there was no need for state legislation to apportion property taxes. Each taxing agency received all the proceeds of the tax it imposed. Prop. 13 capped all such taxes at 1% of assessed valuation (with certain exceptions not relevant here) and transferred to the Legislature power to distribute the proceeds of that one percent tax. *County of Los Angeles v. Sasaki* (1994) 23 Cal.App.4th 1442.

Likewise, the Triple Flip is not calculated using the formulas used to allocate the bulk of property tax revenues among cities and counties. Rather, it is measured by retail sales activity in a jurisdiction, not the assessed valuation of property there.

Simply put, the in-lieu payments are not property taxes subject to PTAF because the Legislature declared it so. To allow the County to treat the payments otherwise is to accomplish a multi-million dollar transfer of responsibility to fund the property-tax system despite the following:

(i) The Legislative intent that the Triple Flip and VLF Swap be revenue-neutral to cities and counties [the County readily admits "the Triple Flip and VLF Swap were not intended to increase or decrease revenues flowing to local government." (Respondents' Brief, p. 23.)];

(ii) the absence of legislative intent to alter the County's burden to fund its Assessor, Auditor and Sheriff; and,

(iii) the intent stated in the final sentence of § 95.3(e) authorizing PTAF in general: "The Legislature finds and declares that this section … is not a reallocation of property tax revenue shares or a transfer of any financial or program responsibility." This language distinguishes the Triple Flip and VLF Swap which plainly were intended to "reallocat[e] … property tax revenue shares."

Therefore it makes sense that the PTAF implications of those in-lieu payment streams would be dealt with – as they are – by the specific language of § 97.75 rather than the earlier, more general, provision of § 95.3.

III. The County Conveniently Ignores § 97.75's Critical Modifier of "Services"

The County argues that "services" can mean either of two things—either all of the services provided to fund the County Assessor, Auditor and Sheriff's costs to operate the property tax system or only the incremental services necessary to reallocate funds from ERAF to cities in lieu of sales taxes and VLF revenues. However, there is no need to construct complex, historical arguments to define the word "services" as used in § 97.75. The statute itself defines the term.

Section 97.75 defines "services" for which the County might be reimbursed as "services performed by the county under Sections 97.68 and 97.70." Neither of those two sections involves the collection, assessment or enforcement of property taxes or any cost other than the $35,000 per year which the County admits is its entire cost to implement the Triple Flip and the VLF Swap. (See, Rev. & Tax. Code §§ 97.68 and 97.70.) "Services" thus means the incremental services required by §§ 97.68 and 97.70 and not the broader services necessary to operate a property tax system – a system that existed prior to and independently of the adoption of those code sections

The County mistakenly argues that even if § 97.75's use of the word "services" means "incremental services" under §§ 97.68 and 97.70, it may still charge Cities millions annually in PTAF even though its incremental cost to provide those services is a mere $35,000. This argument is based on the flawed logic that if "services" means incremental services, then the issue of recovery with respect to the VLF Swap and Triple Flip *in-lieu* revenues of "traditional PTAF would be addressed by other statutes. . ." (Respondents' Brief, p. 5).

Such an argument begs the question, and is circular at best. As the County admits, the purpose of the VLF Swap and Triple Flip was to balance the *State's* budget through various funding shifts. The Legislature did not contemplate a

multi-million-dollar, permanent funding shift between cities and counties. Nor did it contemplate allowing counties to stake a claim on property taxes of other local governments comparable to the Prop. 98 set-aside that motivated all these fiscal maneuvers in the first place. In this context, the County's self-serving administration of the property tax system bespeaks both irony and chutzpah.

Moreover, the County seeks to persuade this Court to ignore § 97.75's plain limitation by describing the authority for PTAF as "long-standing" and "traditional." However, there is no dispute that counties were legally required to fund the Assessor, Auditor and Sheriff's property tax functions from at least the 1960s (Respondents' Brief, pp. 8-9) and were first authorized to recover **some** of the cost of those functions in 1994 (Respondents' Brief, pp. 12, 31), and have **never** had authority to recover all of it – schools and ERAFs remain exempt under the language of § 95.3, and counties – the largest recipient of property taxes – pay the largest share of PTAF. The County admits the Legislature exempted schools and ERAF to protect the State's own budget (Respondents' Brief, p. 33), yet would have this Court construe the Revenue & Taxation Code to empower all counties to impose a set-aside for *their* benefit on legislative efforts to make revenue-neutral swaps of revenues flowing to cities and counties for the *State's* benefit. The Court need not be misled by these tactics.

The Cities agree that all the relevant Revenue & Taxation Code sections could be written more plainly. However, § 97.75 is no more defective than the other provisions of that Code in issue here. These facts aid its reading:

(i) It is the only statute specific to the Triple Flip and the VLF Swap;

(ii) it was adopted contemporaneously with the Triple Flip and VLF Swap and well after § 95.3's general grant of authority for PTAF;

(iii) it states that it is "notwithstanding any other provisions of law," which necessarily includes the earlier-enacted § 95.3;

(iv) the Legislature intended to make the Triple Flip and VLF Swap revenue-neutral as to cities and counties, as the County readily admits;

(v) the Legislature desired to avoid fiscal set-asides (like Prop. 98 and the County's construction of § 97.75) that strain its ability to direct revenue streams;

(vi) Counties bore PTAF responsibility for ERAF funds prior to the essential depletion of that fund by the Triple Flip and VLF;

(vii) the County's action unilaterally shifts PTAF in that same measure to Cities; and,

(viii) the County cites no evidence of legislative intent to end counties' responsibility for that measure of PTAF.

Indeed, the County's desire to ignore the phrase "notwithstanding any other provision of law" with which § 97.75 commences is so profound it allows itself to argue that § 97.75 states no "rule of exclusion" from the County's power to impose PTAF (Respondents' Brief, p. 19). To state the argument demonstrates its absurdity.

Section 97.75 is also more easily read if its subject is understood to be the power of counties to recover the cost of administering the Triple Flip and the VLF Swap. In light of that purpose, its meaning is plain – counties get nothing in FY 2004-05 and FY 2005-06 (which the County understood to be the case, charging nothing) and counties get only the "actual cost" "for the services performed by the county under Sections 97.68 and 97.70." There is no dispute here that most of the multi-million dollar annual cost the County unilaterally transferred from itself to the Cities is for services not described in those sections. Thus, the Cities and the County agree (Respondents' Brief at pp. 19-20) that the Legislature intended this provision to govern more than the $35,000 the County incurred to implement the Triple Flip and VLF Swap – it is a prohibition on the

"reduc[tion] of a city's allocation of ad valorem property tax revenue" (§ 97.75) – the very reduction for which the Cities seek a remedy here. Accordingly, reversal is warranted.

IV. The County Ignores the Differences Between the First and Second Sentences of § 97.75

The first sentence of § 97.75 prohibits a county in FY 2004-05 and FY 2005-06 to "impose a fee, charge or other levy on a city, []or [to] reduce a city's allocation of ad valorem property tax revenue." The second sentence empowers a county in FY 2006-07 and future years to "impose a fee, charge or other levy on a city for these services" that "shall not exceed the actual cost of providing these services." The second sentence makes no reference to reduced property tax allocations to cities. Thus, reducing cities' property tax allocations is prohibited in FY 2004-05 and FY 2005-06 by the first sentence of § 97.75 and not within the grant of authority provided for FY 2006-07 and future years under the rule of "*expressio unius est exclusio alterius*." (See, e.g., *National R.R. Passenger Corp. v. Nat'l Ass'n of R.R. Passengers* (1974) 414 U.S. 453, 458 (to say one thing is to exclude another); *Bonner v. County of San Diego* (2006) 139 Cal.App.4th 1336, 1347-48 (same).)

However, the County has done precisely what § 97.75 forbids – it has unilaterally transferred to itself property tax revenues from Cities to create what it perceives to be a "fairer" allocation of the burden to fund the County Assessor, Auditor and Sheriff's property tax responsibilities. Even § 95.3 did not intend this result; that section states it was "not a reallocation of property tax revenue shares or a transfer of any financial or program responsibility." Thus, the County's reliance on § 95.3 to bootstrap its argument to take $10 million annually in excess PTAF in the teeth of § 97.75's limits fails based on the text of the very statute on

which it relies.

V. The County Auditors' SB 1096 Guidelines Are Irrelevant to Interpretation of Section 97.75

The County repeatedly points to the Guidelines using their full and grand title to suggest that these voluntarily guidelines developed by private association of primarily elected officials given no status in law somehow provides legal support for their interpretation of § 97.75. That many County Auditors assert their right to withhold city property taxes to augment funding for their offices does not confer that right.

One can easily avoid being mislead by this claim by noting that the Guidelines:

- Do not have the force of law, as the County admits (Stip. Fact No. 15, [JA[5] 48-49, Vol. 1, Tab 5]); and,
- Revenue and Taxation Code § 96.1 (c) provides that if either the State Controller or the State Department of Finance adopts the Auditors' Guidelines regulations, they are deemed correct unless clarified by legislation or court decision. To date, however, no regulations have been adopted by either the State Controller or the Department Finance, and the Guidelines on which the County relies remain the private view of Auditors, whose own funding is at stake here.

Moreover, the Guidelines are at odds with the State Controller's interpretation of § 97.75 (See Exh. B to Whatley Decl. [JA 512-517, Vol. III, Tab. 12].) The Controller is authorized to convert a Guidelines provision to an

[5] All references to "JA" refer to the Joint Appendix filed by the parties.

authoritative regulation and has no dog in this fight. Accordingly, its views are both more persuasive and more authoritative than the Auditors'.

Although the trial court overruled the Cities' objection to the Guidelines as irrelevant (3 JA 540), it explicitly recognized that the Guidelines are not "binding on [the trial court] in terms of deciding the questions under the statute of whether or not the statute means what you say or what they say. I don't think it's binding on me at all." (Reporter's Transcript, 10:25-11:2.) "I don't view the guidelines as being binding on me in which way I go by any means." (Reporter's Transcript, 12:2-3.) Their relevance was solely as to why the County calculated PTAF using the challenged method. They are evidence of what the County did and it's reasoning in doing so, but not evidence of its authority to expropriate the Cities' property tax revenues.

Moreover, the only reference to § 97.75 in the Guidelines is buried in the footnotes on Schedules K-1 and K-2 – dozens of pages into a dense document. (1 JA 42-43.) No accompanying text alerted a reader to the significant, multi-million-dollar annual transfer of funds the County Auditors Associations wished to make for the benefit of counties at the expense of cities. Such a passing and cryptic reference, quietly drafted by county auditors with a stake in the matter, and presented in the most understated way, is essentially unhelpful to this Court's interpretation of the Legislature's intent in adopting § 97.75.

VI. The County Misconstrues the Facts Regarding the League of California Cities' Alleged Support of the County's PTAF Calculation

The trial court sustained the Cities' objection to material the County submitted in support of its claim the League somehow signed off on the challenged method. (3 JA 539.) The League plainly did not draft the Guidelines, has no statutory role in interpreting property tax statutes and is without power to

bind its members or to authoritatively construe legislation. Moreover, the League's alleged participation in the formulation of the Auditors' Guidelines is irrelevant, as the trial court declared in sustaining Petitioners' objection to the offered material: "I don't think that these guidelines [mean] that the League of Cities or anyone else can waive the Cities' rights to have the statute interpreted, if they disagree with that position." (Reporter's Transcript, 17:25-18:3.)

Further, a multi-million dollar transfer of responsibility to fund the County Assessor, Auditor and Sheriff communicated only by two footnotes to spreadsheets buried in the guidelines of a voluntary association of county officials is hardly notice to cities, the League of California Cities (a legal entity distinct from its members), or to State officials. It was not until PTAF bills soared in the 2006-07 fiscal year that the Assessors' sleight of hand was revealed.

VII. Alleged Increases in VLF In-Lieu Payments Are Irrelevant

The County asks this Court to ignore § 97.75's mandate because the VLF Swap has allegedly netted cities and counties more in revenue than they lost because of the rising real estate market. In other words, the County asks the Court to ignore § 97.75 because Cities were not really harmed.

Notably, though the County claims the Cities have benefitted from the VLF Swap, it is the County itself that is the largest single beneficiary as it receives VLF Swap funds on the same terms as do Cities. (See, Rev. & Tax. Code § 97.70(b)(1).) Thus any alleged "benefit" to Cities is enjoyed in greater amounts by the County. But such alleged benefit cannot authorize or excuse the County's unlawful calculation of PTAF. The Court may not rewrite § 97.75 to offset a perceived inequity created by another statute (§ 97.70.).

Moreover, by including in its PTAF calculation the purported "boon" to the cities and counties from the VLF Swap, the County actually receives a double windfall, for it receives both the authorized VLF Swap from schools (which the Legislature backfilled to schools) and the unauthorized PTAF from cities, for which no backfill is provided to anyone.

Additionally, the County admits that the VLF increases are associated with a rising real estate market. (Respondents' Brief, pp. 23-24.) As recent economic events demonstrate, what goes up can come down. Accordingly, the falling real estate market can be expected to dramatically reduce property taxes paid in lieu of VLF. Temporary fluctuations in the relative value of VLFs and the property taxes paid in lieu of them shed little light on the meaning of § 97.75. Moreover, to the extent the VLF Swap overcompensated cities during the real estate boom of the first decade of this century, it overcompensated counties in equal measure. The point is therefore a rhetorical distraction which this Court may set aside.

VIII. Conclusion

Section 97.75, enacted long after § 95.3's general grant of PTAF authority, specifically addresses the County's authority to charge Cities for services related to the VLF Swap and Triple Flip mandated by §§ 97.68 and 97.70. The more recent and specific statute controls by its own terms and by the general rules of statutory construction. Accordingly, the County may not continue to withhold millions in property taxes from Petitioners in violation of § 97.75.

To uphold the trial court decision here is to empower County Auditors to establish a set-aside for the benefit of their own offices at the expense of the Legislature's power to allocate property tax revenues. This Court need not add one more ironic complexity to a state fiscal system fairly groaning with them. It may, rather, implement § 97.75 as the Legislature wrote it. Accordingly, the

Cities respectfully requests the Court reverse the lower court's ruling and direct it to issue the mandamus relief for which they petitioned.

DATED: March 5, 2010

Respectfully submitted,

COLANTUONO & LEVIN, PC

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HOLLY O. WHATLEY
Attorneys for Appellants
City of Alhambra, et al.

CERTIFICATE OF COMPLIANCE

Counsel of Record hereby certifies that pursuant to Rule 8.204(c) of the California Rules of Court, this brief contains 3,468 words, which is less than the limit mandated by the rule. Counsel relies on the word count of the Word 2007 computer program used to prepare this brief.

DATED: March 5, 2010

Respectfully submitted,

COLANTUONO & LEVIN, PC

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HOLLY O. WHATLEY
Attorneys for Appellants
City of Alhambra, et al.

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