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Date 2:16 pm, Sep 30, 2010

TO: Honorable Chair and Members of the Board of Supervisors, El Dorado County
CC: County Administrative Officer; Auditor-Controller; County Counsel
FROM: Jonathan Cristy
DATE: September 30, 2010
RE: Agenda Date: October 5, 2010
Tax Refund Claim Filed by Serrano Associates LLC

ADDITIONAL INFORMATION SUBMITTED BY SERRANO.

At the August 24 meeting, the Board requested Serrano “to annotate which collections should have been credited against which special taxes, and specify the amount Serrano claims should be refunded” and to present that information to the County by Tuesday, September 21.

On Friday, September 24, Serrano forwarded to the County a set of spreadsheets prepared by their accountant, Craig Enos. The spreadsheets respond to the Board’s second request – that Serrano specify the amount claimed. They do not respond to the Board’s first request – annotating what collections should have been credited against which special taxes. Instead, they identify year-by-year the amounts (delinquent taxes collected and investment earnings) that Serrano has argued should have been credited against Annual Costs. This appears to be a case of miscommunication.

Delinquency Rate. As I stated at the August 24 meeting, the one issue with respect to delinquent taxes that may have some merit is whether the County has correctly determined the amount of delinquent taxes each year. My understanding of the first request was for Serrano to produce any evidence that delinquent taxes collected in the same year they were levied had not been subtracted from the total of that year’s delinquencies (as occurred in June 2007). Pages 7 and 8 of the spreadsheets only show delinquent taxes paid in the next fiscal year.

Later-Collected Delinquencies. The net number shown for “Failure to Properly Calculate Reserve for Delinquencies” – \$1,420,928 – does not comport with the legal theory put forward by John Murphy that “reimbursements” (which he erroneously argues means later-collected delinquent taxes) should be credited against Annual Costs. It is not the total of subsequently collected delinquent taxes – that’s \$943,467.30. It is instead the sum of all the amounts included in Annual Costs for delinquencies over the entire period analyzed by Craig Enos (2000-01 through 2009-10) less the amount for delinquencies included in the Annual Costs for 2009-10 (\$407,301.58) and less refunds made (\$502,035).

While NBS on their annual tax levy worksheets uses the label “Reserve for Delinquencies” for the amount added to Annual Costs for last year’s delinquent amount and next year’s anticipated delinquencies, these amounts do not fund a reserve account with some fixed maximum amount. There is no excess in a reserve account that could be applied to debt service. The proposition implied by the spreadsheet is that the County should retain only what is shown

in the calculation of Annual Costs for last year's delinquencies plus an amount for anticipated current year delinquencies.

Because the County may include two years' delinquencies in Annual Costs, even if the prior year's collected delinquencies are credited against Annual Costs, that leaves the amount of one year's delinquencies as a surplus amount that is collected and swept into the Facilities Account on September 15.

Claims Period. The spreadsheets ignore the fact that Board cannot make refunds for any claim filed more than four years after payment of the tax. The total amount claimed for years before 2005-06 is \$750,054.

Investment Earnings. The spreadsheets also show numbers for interest earnings not only on the Reserve Account and the Redemption Account, for which John Murphy had argued, but also on three other accounts. The total earnings shown on those three additional accounts since 2005-06 is \$368,920

Total Claim Less Adjustments. Deducting the amounts that relate to tax years before 2005-06 (\$750,054), the amount of "excess delinquency reserve" for years starting 2005-06 (\$124,212), and the earnings claimed on the three additional accounts since 2005-06 (\$368,920) from the net claim of \$2,105,467, leaves \$862,251.

BOARD MAY MAKE REFUNDS ONLY TO CORRECT ERRORS.

Serrano filed its claim for refund under Revenue and Taxation Code section 5096 and Section 8 of the RMA. Revenue and Taxation Code section 5096 (in relevant part) provides that:

Any taxes paid before or after delinquency shall be refunded if they were ...
illegally assessed or levied.

Section 8 of the RMA (in relevant part) provides:

Any taxpayer who feels the amount of Special Tax assigned to a Parcel is in error may file a notice with the County appealing the levy of the Special Tax. ... If the County verifies that the tax should be modified or changed, a recommendation at that time will be made to the Board and, as appropriate, the Special Tax levy shall be corrected and, if applicable in any case, a refund shall be granted.

Both provisions empower the Board only to correct illegalities or errors in the application of the RMA, i.e., failures to follow the rules that result in more taxes being levied than the County was legally entitled to collect.

NOT CREDITING DELINQUENT TAX COLLECTIONS IS NOT AN ERROR.

Serrano correctly notes that the County does not credit later-collected delinquent taxes against Annual Costs. Serrano argues that these amounts are either 'reimbursements' under the definition of Annual Costs or 'applicable credits' under the definition of Debt Service. The County has, with good reason, never read the RMA that way.

Reimbursements. Fee reimbursements paid by the County to developers offset development fees that are available to pay facilities costs. The word ‘reimbursements’ appears in the definition of Annual Costs in this phrase: “less credit for applicable development fees, less any reimbursements.” Reimbursements are not an additional credit -- it does not read “less credit for any reimbursements.” Serrano argues for a strained reading of the word. The County has applied the natural reading of the word itself and the logical way of reading it in context. It was not error to have read it that way.

Applicable Credits. The definition of Debt Service in the RMA includes a deduction for “any applicable credits that may be available from any other sources available to the County to pay principal and interest.” The credit must be both ‘applicable’ and from a source that is available to pay debt service. Later-collected delinquent taxes are not obviously applicable, like capitalized interest or money in a defeasance escrow, which may only be used for debt service. Nor are they available. They get swept into the Facilities Account on September 15 each year, where they may be used for debt service only if no other money is available. It was not error to have not credited them against Annual Costs.

NOT CREDITING EARNINGS ON ACCOUNTS OTHER THAN THE RESERVE ACCOUNT IS NOT AN ERROR.

The County acknowledges that earnings on the Reserve Account must be credited against Annual Costs. The County has, with good reason, never read the RMA to require that earnings on any other accounts be credited against Annual Costs.

Serrano has argued that investment earnings on the Redemption Account are ‘applicable credits’ under the definition of Debt Service and, thereby, also deducted from Annual Costs. The spreadsheets imply that Serrano makes the same assertion with respect to three other CFD-related accounts: the Special Tax Fund, the CFD Fund, and the “Special Tax Revenues Account” (the latter being an account established by the County within the CFD Fund in addition to the two accounts (Expense and Facilities) within the CFD Fund that are established by the Indenture).

The definition of Annual Costs specifically includes the earnings on only the Reserve Account. The phrase ‘applicable credits’ in the definition of Debt Service refers to sources of funds that directly offset Debt Service, such as capitalized interest, which can only be used for Debt Service.

To be credited against Debt Service, amounts must also be available to pay that debt service. Section 3.5 of the Indenture provides that earnings on the Redemption Account be deposited into the Special Tax Fund. Section 3.1 of the Indenture provides that earnings on the Special Tax Fund and the CFD Fund shall be retained therein. Section 3.4 of the Indenture provides that all excess amounts in the Special Tax Fund be swept into the CFD Fund each September 15, where they will be deposited into either the Expense Account or the Facilities Account. Thus, the earnings accumulated during one bond year are made unavailable to pay debt service the following bond year. It was not error to have not credited them against Debt Service.