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FILE # ML-43016-03

March 6, 2003

I.D. # 43016

The Honorable Greg Abbott  
Attorney General of Texas  
Attn: Opinion Committee  
Supreme Court Building  
P.O. Box 12548  
Austin, Texas 78711-2548

RECEIVED  
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OPINION COMMITTEE

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MAR 10 2003  
OPEN RECORDS DIVISION

Re: Interpretation of Tax Code Sections 11.26 and 23.23 regarding the valuation of repairs made to a property owner's homestead necessitated by flood, wind, fire or other damage. C.A. File No. 03RPD0019

Dear General Abbott:

Pursuant to section 402.043 of the Government Code, we respectfully request an opinion on the interpretation of Tax Code Sections 11.26 and 23.23 regarding the valuation of repairs made to a property owner's homestead necessitated by flood, wind, fire or other damage. This request is made on behalf of the Harris County Appraisal District. A Memorandum Brief is attached.

Sincerely,

MIKE STAFFORD  
County Attorney

By John M. Renfrow  
JOHN M. RENFROW  
Assistant County Attorney

Approved:

John R. Barnhill  
JOHN R. BARNHILL  
First Assistant County Attorney

Attachment

## MEMORANDUM BRIEF

### INTRODUCTION:

The question presented concerns the valuation for ad valorem tax purposes of repairs made primarily to flood and fire-damaged homesteads. Damages to improvements on these properties range from minor to total destruction. The magnitude of the problem in Harris County was exacerbated by tropical storm Allison in June 2001, during which approximately 40,000 homes were damaged. Many of the same homes were flooded again in 2002. This opinion request arises in the context of TEX. TAX CODE ANN. §§ 23.23 and 11.26 (Vernon 2002). Unless otherwise noted, all subsequent section references are to sections of the Tax Code. Sections 23.23(a), (b) and (e) state as follows:

- (a) The appraised value of a residence homestead for a tax year may not exceed the lesser of:
  - (1) the market value of the property; or
  - (2) the sum of:
    - (A) 10 percent of the appraised value of the property for the last year in which the property was appraised for taxation times the number of years since the property was last appraised;
    - (B) the appraised value of the property for the last year in which the property was appraised; and
    - (C) the market value of all new improvements to the property.
- (b) When appraising a residence homestead, the chief appraiser shall:
  - (1) appraise the property at its market value; and
  - (2) include in the appraisal records both the market value of the property and the amount computed under Subsection (a)(2).

\* \* \*

- (e) In this section, “new improvement” means an improvement to a residence homestead that is made after the appraisal of the property for the preceding year and that increases the market value of the property. The term does not include ordinary maintenance of an existing structure or the grounds or another feature of the property.

The Tax Code defines market value as the price a knowledgeable buyer is willing to pay a knowledgeable seller for property which is for sale on the open market for a reasonable time, assuming that both parties seek to maximize their gains and that neither party is in a position to take advantage of the other. §1.04(7). The term “appraised value,” however, may mean something other than “market value.” Appraised values are determined as provided in Chapter 23. *See* §1.04(8). As such, all references to “appraised value” in this Memorandum Brief refer to the amount calculated under the provision of Section 23.23(a)(2) and may also be referred to as “capped value.”

Section 11.26 provides that school districts may not increase ad valorem taxes imposed on “the residence homestead of an individual 65 years or older above the amount . . .” imposed

in the first or second year of qualification (whichever is lower). § 11.26(a). Section 11.26(b) states as follows:

If an individual makes improvements to the individual's residence homestead, other than improvements required to comply with governmental requirements or repairs, the school district may increase the tax on the homestead in the first year the value of the homestead is increased on the appraisal roll because of the enhancement of value by the improvements. The amount of the tax increase is determined by applying the current tax rate to the difference in the assessed value of the homestead with the improvements and the assessed value it would have had without the improvements. A limitation imposed by this section then applies to the increased amount of tax until more improvements, if any, are made.

#### FACTUAL SCENARIOS:

The difficulty in applying Sections 23.23 and 11.26 arises in a number of different circumstances. For ease in identification and discussion, they are listed below as Scenarios One through Four. For each scenario, it should be assumed that the properties were appraised in 2000, 2001, 2002, and 2003. Accordingly, the ten percent cap would be applicable in each of the last three years. It is also assumed that for the years 2001, 2002, and 2003, the market value of the properties was neither appreciating nor depreciating.

**Scenario One:** The property had a market value for 2001 of \$100,000. It qualified for the ten percent homestead cap, which resulted in its appraised value for 2001 being \$70,000. The home suffered \$15,000 in damage from tropical storm Allison. The damage was not repaired as of January 1, 2002. The appraisal district determined that the market value of the property was \$85,000 for 2002. The appraised value calculated according to Section 23.23 would be the lesser of \$85,000 or \$70,000 plus ten percent (\$77,000). Thus, the 2002 appraised value would be \$77,000, a ten percent increase even though the district had reduced the market value. As of January 1, 2003, the damage was fully repaired and the district estimates that the repairs add \$15,000 to the value of the home. The 2003 market value will be \$100,000, back to its pre-flood value. Should the \$15,000 in repairs be added to the cap amount in calculating the home's appraised value for 2003? If so, the home's appraised value would jump from \$77,000 in 2002 to \$99,700 (\$77,000 + \$7,700 + \$15,000) in 2003; if not, the home's appraised value would only increase to \$84,700 (\$77,000 + \$7,700). Had there been no damage to the home, the home's appraised value would have been \$84,700 for 2003.

**Scenario Two:** Assume that the home in this scenario was identical to the home in Scenario One, but was completely destroyed by the storm in June 2001. Its 2001 market value was \$100,000, of which \$20,000 was attributable to the land and \$80,000 to the improvement. As in Scenario One, the capped appraised value for 2001 was \$70,000. On January 1, 2002, repairs had not been made. The appraisal district determined the market value of the property to be \$20,000. Section 23.23 requires the capped value for 2002 to be the lesser of the \$20,000 market value or the prior year's appraised value plus ten percent, which is \$77,000. Since the market value is lower, \$20,000 became the appraised value for 2002. As of January 1, 2003, a completely new home had been built on the property. The appraisal district estimates that the market value of the new improvement is \$80,000 and that the market value of the land is \$20,000. The total market value is \$100,000 for 2003. Should the \$80,000 in repairs be added to the cap amount in calculating the home's appraised value? If so, the 2003 appraised value

would be the lesser of \$100,000 or the prior year's appraised value of \$20,000 plus ten percent (\$2,000) plus \$80,000, which equals \$102,000. If the repairs are not added to the cap, the 2003 appraised value would be the lesser of \$100,000 or \$20,000 plus ten percent, which equals \$22,000. Had no damage occurred to the home, the 2003 appraised value would have been \$84,700 as in Scenario One. Does repairing the damage inevitably cause the homeowner's appraised value to increase more than it would have had no damage occurred?

**Scenario Three:** Assume that in Scenarios One and Two that the property owner also qualified for the over-65 "ceiling" on school taxes provided by Section 11.26. Each owner's school tax levy was fixed at \$500 prior to 2001. For 2002, there would be no change in the maximum levy amount, even though the tax for that year might be lower. Unlike the ten percent homestead cap, reductions in value do not change a frozen school tax levy. The question again concerns how 2003 will be handled. Section 11.26 does provide for increasing the frozen levy if the owner makes "improvements" other than repairs or improvements necessary to comply with government requirements. It seems clear for Scenario One that the \$15,000 in value added by the repairs would not be considered "improvements" for the purpose of Section 11.26. However, is there a different result in Scenario Two where a completely new structure replaces the existing structure?

**Scenario Four:** The first three scenarios assume that the repairs simply bring the property back to its pre-flood state. In reality, the repairs will often bring the property to a better than pre-flood state as worn or outdated components are replaced with new, up-to-date components. For example, a flood-damaged kitchen might have new cabinets, counter tops, flooring, and appliances installed. This type of remodeling often enhances the value of the property over its pre-flood value. Similarly, if the property owner builds a new structure on an elevated foundation, its value may be significantly greater than that of the pre-flood property. The enhancement in value, however, is incidental to the repair; the homeowner is simply intending to restore his home to a functional state. Should the value added as a result of replacing worn or outdated components with new be treated as "improvements" for the purposes of calculating either the Section 23.23 cap or the Section 11.26 frozen levy? Moreover, if the owner makes significant other enhancements, such as adding an extra bath or increasing the size of the home, should value added by these enhancements be treated differently?

#### DISCUSSION:

The facts presented in Scenarios One through Four cite the flooding caused by tropical storm Allison as the source of damage for illustration purposes only. The legal consequences for ad valorem tax purposes under Sections 23.23 and 11.26 would be the same for damages caused by fire, earthquake, wind, hail, ground shifts, termites, environmental contamination, or any other similar event.

There appears to be no case law interpreting the words "new improvements," "improvements," "repairs," or "ordinary maintenance" as used in the applicable sections of the Tax Code. Although Section 23.23 purports to define "new improvements," the definition is not precise, particularly in the context of a totally destroyed homestead. The section provides that a "new improvement" is "an improvement . . . that increases the market value," but "does not include ordinary maintenance . . ." §23.23(e).

Section 11.26 uses similar, but not the same terminology. It states that a school district may increase the tax on a homestead when improvements are made to the extent that the improvements enhance the assessed value. Rather than excluding "ordinary maintenance" as does Section 23.23(e), Section 11.26(b) excludes "repairs" and "improvements required to comply with governmental requirements . . . ." Section 23.23(e) does not mention improvements required by the government.

The Code Construction Act provides that words in a code are to be given their ordinary meaning unless specifically defined. TEX. GOV'T. CODE ANN. §311.011 (Vernon 1998). *Webster's Third New International Dictionary* (1993) [hereinafter "*Webster's*"] defines "repair" as "to restore by replacing a part or putting together what is torn or broken." Similarly, *Webster's* defines "maintain" as "to keep in a state of repair, efficiency, or validity: preserve from failure or decline." To "improve," on the other hand, is defined as "to enhance in value or quality." *Id.* These definitions suggest that for the purposes of Section 11.26, only the value attributable to repairs and governmental requirements that enhance the quality of the property above its pre-flood condition should be added to the tax ceiling. Otherwise, the tax ceiling should not be changed. Incidental enhancement in value due simply to the repairs necessary to bring the property into good repair or to comply with building codes or other regulations should not be added. These definitions also suggest that the words "ordinary maintenance" as used in Section 23.23(e) and the word "repairs" as used in Section 11.26(b) should be read to have the same meaning. This conclusion is based on *Webster's* definition of "maintain" to mean "keep in a state of *repair*." (emphasis added)

This interpretation of "ordinary maintenance" as used in Section 23.23 is consistent with the legislative history of the statute. Senate Bill 841, the enabling legislation for the ten percent cap, was introduced in the 75<sup>th</sup> Regular Session of the Texas Legislature and signed by the governor on June 19, 1997. The requisite constitutional amendment was approved by voters on November 4, 1997 and became effective on January 1, 1998. The purpose of the constitutional amendment was to limit "appraisal tax creep," which occurs when the appraised value of homes rapidly appreciates. Section 23.23 accomplishes this goal by leveling out "property tax payments to make them more affordable. The higher value would still be taxed but would be spread out in a reasonable manner to avoid huge increases in any single year." House Research Organization, *Constitutional Amendments*, September 5, 1997, at 7. Theoretically the appraised value will eventually catch up to the market value. If the owner of the repaired residence subsequently sells the house, the capped value automatically expires on January 1 following the sale. §23.23(c).

In addition to the foregoing, it is the appraisal district's position that both sections of the Tax Code should be interpreted in a way that neither unduly penalizes nor unduly rewards property owners for repairing damage to their homes caused by events beyond their control. Applying this approach, together with the legal analysis discussed above, to the four scenarios produces a consistent, equitable outcome in each instance.

#### RESOLUTION OF SCENARIOS:

**Scenario One:** In this case a home with a market value of \$100,000 and an appraised value of \$70,000 suffered \$15,000 in flood damage in 2001. The damages were not repaired until sometime after January 1, 2002. Application of the cap resulted in an appraised value for 2002 of \$77,000. During 2002, \$15,000 in repairs were made. The issue is whether the \$15,000

in repairs should be added to the capped value for 2003. These repairs should be treated as ordinary maintenance under Section 23.23(e), thus causing them to be excluded. For 2003, the market value would have returned to \$100,000 and the appraised value would be the same as if no damage had occurred, \$84,700 (\$77,000 + \$7,700), not \$99,700 (\$77,000 + \$7,700 + \$15,000).

**Scenario Two:** The facts are the same as Scenario One, except that the home was completely destroyed by the flood. In 2001 the improvements had a market value of \$80,000 and the land was valued at \$20,000. No repairs had been made as of January 1, 2002. Therefore, the appraised value for 2002 was \$20,000, the lesser of the market value (\$20,000) or the prior year appraised value plus ten percent (\$70,000 + \$7,700). As of January 1, 2003, the home had been rebuilt as closely as possible to the original design, thus bringing the market value of the property back to \$100,000. The new improvement contained no additional living area or other enhancements. There are three possible resolutions of this scenario. First, Section 23.23 could be interpreted to produce a capped appraised value of \$22,000 (\$20,000 + \$2,000). The second choice would be to treat the repairs as non-excludable new improvements resulting in a value of \$102,000 (\$22,000 + \$80,000). Since the market value of \$100,000 is lower, the new appraised value would be \$100,000. Both approaches are inconsistent with the clear purpose of Section 23.23, which was meant to limit "appraisal tax creep." The third, and better, approach would be to appraise the property the same as in Scenario One, \$84,700. This approach puts owners in the same position they would have been in but for the flood. It neither penalizes nor unduly rewards homeowners.

**Scenario Three:** This scenario assumes the same facts as in Scenarios One and Two, but raises issues concerning application of the Section 11.26 over-65 homestead "ceiling" on school taxes. Section 11.26(b) contains clear guidance for both sets of facts. The homeowners have simply repaired the damage to their property. School taxes should remain frozen under both scenarios.

#### **Scenario Four:**

This scenario first raises the issue of whether the value added as a result of replacing pre-flood worn and outdated components of the home with new, up-to-date components should be treated as "improvements" for the purposes of calculating either the Section 23.23 cap or the Section 11.26 frozen levy. Under both provisions, it appears that the repair of partial damage which does not include additional square footage or features such as an additional bathroom or fireplace would not constitute "improvements." Although Section 23.23 does not include the exception for improvements mandated by the government as found in Section 11.26, it would be consistent with the legislative history of Section 23.23 to allow the exception. The issue typically arises when a building permit is sought to repair partial damages caused by flooding, fire, or termites. In older homes the existing plumbing and electrical wiring may not meet current building code requirements. If the city requires the homeowner to replace these components throughout the structure as a prerequisite to issuance of the building permit to repair damage, such enhancements to the structure should not be treated as "improvements" under Section 23.23.

A similar situation occurs with property located within a flood zone. If the home is totally destroyed, a building permit will not be issued to construct a replacement unless the foundation is raised above the flood level. Such construction can add substantially to the cost of

rebuilding, as well as significantly increase the market value of the property. Because the "improvement" is necessary to comply with a requirement of the government, additional value attributable to the raised foundation should be treated as excluded under Sections 23.23 and 11.26. However, if the property owner replaces a 2,100 square foot, single story, three-bedroom, two-bath house with a raised-foundation, 4,200 square foot, two-story, five-bedroom, four-bath house, the value of all improvements which exceed replacement of the original structure should be considered "improvements" for purposes of establishing appraised value under both sections.

#### SUMMARY:

The terms "new improvements" and "improvements" as used in Sections 23.23 and 11.26 of the Tax Code, respectively, have the same meaning when determining the effect of repairing or making improvements required by a governmental authority to a homestead when the repairs or improvements result from damage caused by fire, flood, wind, earthquake, termites, environmental contamination, or other similar events beyond the control of the homeowner. In such instances, these improvements do not increase the appraised value under Section 23.23 or increase frozen school taxes under Section 11.26, to the extent that the damaged home is restored to its pre-damaged state. Incidental enhancements in value attributable to replacing old components with new components are not "improvements" within the meaning of Sections 23.23 and 11.26. However, if the homeowner substantially changes the characteristics of the pre-damaged property by increasing the size of the improvement or by adding new features such as extra bathrooms or fireplaces, the value of these changes will increase the appraised value and the amount of school taxes owed on the home.