

The California Supreme Court Says the Only Way to Challenge a Special Assessment of Property Tax is by Exhausting Administrative Remedies

by Robert S. Horwitz

In 2008, California enacted the Property Assessed Clean Energy (“PACE”) Act that allows local governments to provide homeowners with financing for energy efficient home improvements. PACE allows local governments to fund their PACE programs by issuing bonds. The special assessment is assessed and collected “in the same manner and at the same time” as local taxes and secured by a priority tax lien that runs with the land. In exchange for the financing, the homeowner must agree to a voluntary special assessment added to their property taxes and secured by a lien on their real property.

Most local governments contracted with private companies to administer their local PACE program. The private companies normally arrange for the sale of the municipal bonds, handle loan applications, make the loans, and arrange for the PACE assessments to be made and the liens to be filed. The special assessment appears as a separate line item on the homeowner’s property tax bill. The property tax is paid to the local government, which remits most of the special assessment to the administrator who, in turn, makes the required payments on the municipal bonds.

Morgan v. Ygrene Energy Fund, Inc., 18 Cal.5th 1061 (2025), involves two consolidated class actions. The named plaintiffs were representatives of a class of senior citizens who had entered into PACE contracts with the defendants, private companies that administered their local PACE program. The complaints alleged that the defendants failed to comply with various consumer protection statutes and other legal requirements applicable to commercial lenders. The complaints sought various remedies including

- a. An order requiring the defendants to return PACE assessments paid by the plaintiffs;
- b. An injunction to prohibit the defendants from initiating any collection of delinquent PACE assessments; and
- c. An order that the injunction remain in place until the defendants got the PACE assessments removed from the class members’ property taxes.

The superior court granted demurrers to the complaints on the ground that the plaintiffs failed to exhaust administrative remedies by first paying the special assessments and then filing refund claims. The court of appeals affirmed the superior court's decision, and the California Supreme Court granted review.

The issue before the Supreme Court was 'whether plaintiffs were required to follow the statutory procedures for challenging taxes — meaning that they should have started not by filing suit in court, but by paying the PACE assessments and then seeking administrative tax relief from local authorities.' The Supreme Court answered yes as to claims that challenge, directly or indirectly, the tax. As to other claims that were not tax related, the Supreme Court held that the plaintiffs should be allowed to amend and plead claims that weren't tax related. It therefore affirmed in part and reversed and remanded in part.

The Court Frames the Issue

The parties agreed the issue was "whether plaintiffs were required to exhaust their administrative remedies before filing suit." The exhaustion requirement "stems from a more general requirement to challenge the legality of a tax by exclusive means of the procedures set forth in the Revenue and Taxation Code." According to the Court, the case before it was more broadly about the exclusivity of the rules the Legislature had prescribed for challenging taxes.

California's Procedures for Challenging a Property Tax Assessment

Under the California Constitution, no suit may be maintained against the State to enjoin collection of any tax; the only way to challenge a tax was to pay the tax and interest and then seek a refund in the manner prescribed by the Legislature. Rev. & Tax. Code § 4807 made this "pay first, litigate later" rule applicable to local governments.¹

To challenge a local property tax assessment, a property owner must file an application to reduce the amount of an assessment within a short period of time. If the application is not granted, the property tax bill is issued with the assessed amount. The property owner must pay the assessment and file an administrative refund claim within four years of the date the tax is paid. It is only if the county board

¹Interestingly, the California Attorney General and the California Board of Equalization filed amicus briefs in support of the plaintiffs.

of supervisors or the city council refuses to order a refund that a property owner can file a suit in superior court challenging the tax in the context of a refund suit. According to the Court, the governing statutes make clear that challenges to a PACE assessment are subject to the same rules as challenges to other forms of property taxes.

The Court Addresses Plaintiffs' Arguments

Plaintiffs made several arguments as to why they were not required to exhaust administrative remedies before filing suit. Their first argument was that the exhaustion rules do not apply because they were only suing private, not public, entities. The Court rebutted by stating a litigant cannot circumvent statutory procedures for challenging a tax by leaving the government out of the suit. The Court pointed to *Loeffler v Target Corp.*, 58 Cal. 4th 1081 (2014), where the plaintiff sued Target over the collection of sales tax on sales of hot coffee. The Court held that the plaintiff could not avoid the limitations of the Rev. & Tax. Code for disputing a tax and made clear that the presence of a private party as defendant is not dispositive of whether the litigants must follow statutory tax relief provisions.

The relief sought by plaintiffs, to cancel property tax obligations, must be directed to local authorities in the first instance. The relief sought amounts to the refund of the assessments and the prohibition of future collections of delinquent assessments unless the assessments are removed. It is thus subject to the Rev. & Tax. Code's exclusive procedures.

The bottom line was that plaintiffs' consumer protection causes of action unavoidably seek to invalidate the underlying obligation to pay PACE assessments, thus running into the bar on granting such relief outside of the statutory provisions for granting tax relief.

Plaintiffs also argued that the procedures shouldn't apply because the local government is merely acting as a pass-through for the private administrators of the PACE loans. The Court noted that PACE assessments were, in the first instance, remitted to the local governments along with other parts of the property tax bill. They could be comingled with other county funds and used for short-term governmental operations before remittance to the PACE administrators. Granting the relief requested would also make it more difficult to sell the bonds that fund the PACE program. Additionally, when it enacted the PACE program the Legislature made it clear that PACE assessments were to be treated as other property taxes.

The Procedures to Be Followed in Challenging PACE Assessments

The Court then turned to the required procedures for challenges to PACE special assessments. To the extent the plaintiffs wished to challenge only the PACE assessments on the grounds set out in the complaints, there was no need to apply for an assessment reduction. This is because the assessment reduction procedure focuses on the value of the property for *ad valorem* taxation. PACE assessments are not based on the value of the property and no statute provides for their inclusion in the local assessment rolls.

By statute, taxes include “assessments collected at the same time and in the same manner as county taxes.” Based on the Rev. & Tax. Code and prior case law, to challenge the PACE assessment, the plaintiffs needed to pay the amounts due and file claims for refund that set out in the complaint. The Court rejected plaintiffs’ argument that their claims were outside the competence of local tax authorities and thus futile. The Court stated that the local authorities launched the local PACE programs, authorized PACE loans and contracted with the PACE administrators.

Finally, the Court noted that to the extent plaintiffs are not challenging, directly or indirectly, the tax, they are not required to comply with the statutory tax relief procedures.

The Court therefore affirmed in part and reversed in part and remanded to the court of appeals with directions to permit the plaintiffs to argue that they should be permitted to pursue remedies that do not challenge the special assessments without first having to exhaust administrative tax remedies.

Conclusion

The case highlights the importance of following refund procedures if a taxpayer wants to challenge any California tax. Although all California taxes have refund procedures, each tax has its own administrative procedures for challenging the tax administratively. Close attention must be paid to the specific procedures under the Revenue & Taxation Code for challenging property, income, sales and use and other taxes. For payroll taxes, employers and their advisors must pay close attention to the provisions of the Unemployment Insurance Code and the regulations thereunder. To make their way through the complexities of California’s tax laws, a taxpayer should seek the assistance of an attorney experienced in dealing with California’s tax agencies.

From the Court's discussion of the type of refund claim needed to challenge the PACE special assessments, a refund claim to challenge a California tax must contain the legal and factual grounds upon which the taxpayer bases the claim for refund.

An exception to the "pay first, litigate later" rule is challenging proposed income tax deficiencies based on a determination that the taxpayer is a resident of California. In residency cases, a taxpayer can protest the notice of proposed assessment, then appeal to the Office of Tax Appeals (OTA) and, if unsuccessful before the OTA, petition a superior court in a county where the Attorney General has an office without first paying the deficiency and interest.

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