



California Schools and Local Funding Act 2020

November 2020

SDCTA Position:

OPPOSE

Rationale for Position:

SDCTA should oppose this measure to implement a split roll property tax system as it could lead to an eventual reduction of California's level of economic activity. An amendment of the state constitution that introduces a split-roll property tax may have potential negative effects on California's economy.

Title: California Proposition 15, Tax on Commercial and Industrial Properties for Education and Local Government Funding Initiative (2020)

Jurisdiction: State of California

Type: Constitutional Amendment

Vote: Simple Majority of votes

Status: On the November 3, 2020 General Election Ballot

Issue: Property Tax

Description: The California Schools and Local Community Funding Act of 2018—an initiative proposal for a split roll property tax—is a constitutional amendment that has qualified for the November 2020 ballot.

The economic impact of periodic revaluations of commercial property depends on the extent to which such taxes may be passed onto consumers. Primarily, SDCTA should refer to the study completed in 2014 regarding Split Roll. Key points about the negative effects of burdening commercial properties with increased tax rates are well documented in the study. There were seven key findings in the 2014 study, which still hold true today:

Finding #1 - The data, both statewide and in San Diego, does not support the claim of Split-Roll advocates - that there has been an unintended shift of the tax burden to residential taxpayers. Prop 13 has not shifted a substantial tax burden onto homeowners. The share of the tax burden paid by homeowners and other property taxpayers has varied by under three percent of total Prop 13 assessed values since 1982, the period for which all data sources are available and consistent assessment practices were followed.

Finding #2 – Adopting a “Split-Roll” property assessment system that raises assessed values to match market values would result in a tax increase estimated at \$173.5 million in San Diego alone. In recent years, assessed value of commercial/industrial properties were estimated by the California Board of Equalization to be at 85.7 percent of market value. SDCTA applied the average tax rate to the increased assessed value to estimate the additional property taxes that would be paid by San Diego County Taxpayers.¹

Finding #3 –The tax increase is ongoing disinvestment from the regional economy. A tax increase on non-residential properties acts as a tax increase on businesses. Many businesses own the property they operate out of and nearly all commercial/industrial renters have leases that require the renter to pay all property tax increases. Following a tax increase, businesses are faced with a modified cost structure that they must respond to.

Background:

California’s system of property taxation under section 2 of Article XIII A in the California State Constitution (Proposition 13) values residential and commercial property at its full cash value² with annual increases limited to the inflation rate, as measured by the state’s Consumer Price Index (CPI), or 2%, whichever is less, until the property changes ownership.³ At the time of ownership change, the value of the property for property tax purposes is reassessed based on current market value.

¹ Numbers from SDCTA 2014 Split Roll Study

² The county assessors 1975-96 valuation, or if property obtained thereafter the valuation’s base year is its year of acquired ownership.

³ Official California Legislative Information, *California Constitution Article 13 Taxation*, http://www.leginfo.ca.gov/.const/.article_13.

Prior to Proposition 13's passage, the property tax was an ad valorem system. There was favoritism and corruption in property taxation that led to assessment inequalities. Assessments prior to Proposition 13 assessed properties at values ranging anywhere from 2% to 100%. In addition, property tax values in some occasions varied significantly in a short time period (i.e. few years).

Since the passage of Proposition 13 in 1978, there has been concern that because commercial property changes ownership less frequently than residential property, there is now an unintended shift of the tax burden to residential taxpayers. The split roll initiatives propose changing the frequency by which non-residential properties are reassessed. Therefore, there have been several proposals to amend the constitution's acquisition value system of property taxation into a split-roll process that periodically appraises commercial and industrial properties at their current market values. Non-residential property in a split rate property tax system is estimated to bring in a significant amount of tax revenue. Unless property is sold, increases in the assessed value are limited to a 2% annual inflation factor. Otherwise, when properties are sold, they are reassessed at 1% of the sales price.

Proposal-2020 Split Roll Ballot Initiative:

The California Schools and Local Community Funding Act of 2018—a proposal for a split roll property tax—is a constitutional amendment that now has qualified for the November 2020 ballot. If approved by the voters, this initiative would amend Prop. 13 and increase taxes by reassessing business property every three years to the market price. The initiative purports to alleviate the burden this tax increase would place on small businesses by exempting business owners with property holdings of less than \$2 million in California.

The Legislative Analyst's Office (LAO) estimates that the measure will raise between \$6.5 billion to \$10.5 billion per year. These funds would go first to the county assessors to cover their administrative costs—with no limits placed on such costs—and to the state General Fund to backfill income tax losses coming from higher property tax deductions. Of the amount left over, 60% of the new revenue would go to cities, counties and special districts, and 40% would go to schools and community colleges with little or no requirements on how the money would be spent.⁴

General Economic Analysis:

In economic theory, firms make decisions at the margin. This means that firms compare expected benefit of each additional investment opportunity to each additional expected cost. In the short run, a split-roll property tax system would increase the tax burden on commercial, industrial, and non-owner occupied residential property. In the long run, this increase would affect property owners in such ways that have fiscal significance:

⁴ <https://lao.ca.gov/BallotAnalysis/Initiative/2017-055>

- Increases in property tax will make land and capital cost more expensive for businesses in California.
- The property owner's/firm's financial circumstances will be worse off post property tax increases if it is not able to offset higher property taxes to renters, consumers, and or employees.

The adoption of a split-roll property tax would increase the usage cost of land and capital by businesses, therefore, weaken their financial conditions. Businesses seek to maximize their profits.⁵ Since firms evaluate the relative burden of state and county taxes when deciding about the business' location, this is an aspect that may influence business decisions.⁶ A split roll property tax would increase a firm's cost and not increase expected benefits and investment opportunities, keeping all things constant.⁷ Firms would then have less profits to reinvest, increase operations, or take out as profits.

The conditions of markets also determine if investments are to be made. Tax policies adopted by a state alone are not known to typically cause a firm to relocate or locate to an area where the resources are not sufficient (i.e. skilled labor, transport, etc).⁸ A state's tax burden on a firm may affect its total costs, therefore, if a company operates in a high tax state then the firm must reduce costs or raise prices to maximize its after tax profits.

The long run fiscal impact on jobs, wages and investment in California will be determined by the reaction of firms and owners to the above factors. According to economic theory, if there is an increase in rents, tenants would have less disposable income to spend on other goods and services.⁹ The fiscal impact would be felt beyond commercial property owners and its renters. If there was a decrease in the amount of business investment in California, then there would be an increase in unemployment and in consumer prices including a decrease in wages and in the use of land and capital. If the state adopted a split roll property tax system the state would potentially encounter the following fiscal impacts: higher rents paid, reduced business investment, higher unemployment rate, reduced wages, and increased consumer prices.

Under the adoption of a split roll local, small, and less well capitalized businesses would need to offset potential increases in rent or tax liabilities, and if unable to do so, they will potentially go out of business. The adoption of a split roll regime that separates non single-family residential properties from Proposition 13's property taxation fiscal impact is potentially harmful to California's business and economic climate.

⁵ The percentage difference between assessed value and market value

⁶ Firms seek to maximize profits after taxes and expenses such as wages

⁷ If a split-roll property tax was to be introduced and projected to decrease after-tax income then there would be no economic incentive to begin or continue production in California, ceteris paribus.

⁸ Sometimes location is more important than tax burdens on the investments of a firm.

⁹ Tenants would incur higher rents paid therefore having less disposable income. As a result, ceteris paribus, consumption would decrease and firms who provide goods and services to these renters would in return be negatively affected.

In terms of annual revaluation under the split roll property tax system, the state government would need to consider the fiscal impact of how the adoption of this property tax would cost in the short run. The split roll tax adoption would affect the ability to close assessment roll on time and in accordance with California state law if there is not enough Assessors in California. The state government must examine how much more the process of reassessment of all properties would cost and how long it would take. Otherwise, the State needs to set guidelines of what is considered as “non-residential property” and in particular properties that are used for multi-purposes. Therefore, there is an issue of deciding exactly what category certain properties fall under. For example, there is a complication of what category “agricultural property” and “work-live property” be classified or considered as. The question the State would need to answer is under what guidelines such properties would be considered commercial properties. This is important because if the property is considered residential, then it still falls under the protections of Proposition 13. Otherwise, the property is subject to the split roll tax which entails frequent reappraisals and higher tax rates.

Proposition 13 limits the amount of tax revenue to a value less than the average inflation rate. This value has the potentially to increase only when there is considerable development of new real-estate, or if property is resold in an appreciating market. Since a large portion of property tax revenue goes towards funding for education in the state of California, an increase in property taxes would help raise the funds allocated to public state schools.

A common discussed fiscal impact of Proposition 13 is that the taxation system it implements shifts a tax burden from commercial to residential properties. Since Proposition 13’s passage, there have been several allegations that such a shift exists. According to an analysis published by David R. Doerr¹⁰ of California Taxpayers Association in 2008 using data from the Board of Equalization, it concludes that Proposition 13 has prevented a further tax burden shift to residential property owners.

Proponent Arguments:

Proponents of a split roll property tax system argue that in order to remove market distortions and tax inequities in California, businesses’ property values should be reassessed on a regular basis. Proponents insist that commercial properties enjoy an unfair subsidy whereas homeowners do not. If Proposition 13 were amended as a split roll property tax system, then additional tax revenue may be acquired from undervalued commercial and industrial sector landholdings. Therefore, split roll property tax proponents maintain that homeowners encounter a burden as the property tax has shifted over to residents and local governments. In addition, proponents argue that since the split roll taxation system is a tax on holdings, the burden cannot be shifted in to the market. As a result, the additional revenue gained in a split roll tax is likely to be borne by the owners of the property¹¹.

¹⁰ Chief Tax Consultant, California Taxpayers Association. Doerr served 24 years as Chief Consultant for the Assembly Revenue and Taxation Committee. Doerr is an expert on California's Revenue and Taxation Code. Doerr is the founding editor of Cal-Taxletter. In addition, he is the author of *California's Tax Machine: A History of Taxing and Spending in the Golden State* (2000).

¹¹ Proponents maintain that the profile of commercial real estate owners are higher income taxpayers

Proponents insist that Proposition 13 creates an inefficient real estate market because there are disincentives to sell property to avoid a higher assessment¹². Lastly, proponents argue that there the assessments are unequal because it is based on the purchase date; therefore, properties may have different appraisals even if they are in the same community.

Opponent Arguments:

Opponents of a split roll property tax system argue that the state of California's most reliable tax for the government is under Proposition 13. Opponents maintain that during recessions the property taxes were not as affected as income taxes. Opponents counter argument to the proponent's argument of a shift in tax burden is that in order to take the burden off homeowners, if there is a raise in commercial property taxes, then there needs to be a property tax cut to homeowners. Opponents insist that what Proposition 13 has currently set in place has provided stability predictability for property owners. Opponents of a split roll property taxation system maintain that an amendment of a split roll property tax would create unintended consequences that would affect not only Californian businesses and consumers but the state's overall economic climate.

¹² This is under the assumption that there is appreciation from the base year.