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Raising Revenue for Schools and Local Communities, Changing California's Inequitable Taxing of Commercial Properties, and Understanding Proposition 15

Local tax revenue reflects a community's shared effort to support vital public services that all Californians need to thrive in our cities and counties. This ranges from education for students in K-12 schools and community colleges to access to housing, health care, public parks, and libraries. These vital public services are supported by tax revenues from commercial and industrial properties – many of which are still taxed based on purchase prices that are more than four decades old. California voters will be asked in fall 2020 to vote on a measure known as Proposition 15, an amendment to the state Constitution that would change how commercial and industrial properties are taxed and provide more revenue for schools and local communities to support services Californians rely upon.

How Would Prop. 15 Change the Property Tax System to Raise Revenue for Schools, Community Colleges, and Local Communities?

Prop. 15 would increase property tax revenue by requiring local governments to tax commercial and industrial properties based on their market value (the price the property could be sold for) rather than their purchase price. This change would be phased in over several years, beginning in 2022-23, following a process established by the Legislature. After this phase-in period, commercial and industrial property would be subject to regular reassessment (updating the taxable value to market value). The Legislature would determine the frequency of reassessment, but it would happen at least every three years.¹ If at least 50% of a property (determined by square footage) is occupied by small businesses, the property would not be assessed until 2025-26 at the earliest.²

Prop. 15 would not affect the assessment of residential property (including owner-occupied homes

and residential rental property) or property used for commercial agricultural production, both of which would continue to be assessed according to the rules put in place by Proposition 13 in 1978.³ Additionally, properties worth \$3 million or less would be exempt from the shift to market value taxation, except for those that have any direct or indirect owner that holds more than \$3 million in commercial and/or industrial property statewide.⁴ The measure would also create new exemptions for business personal property (such as equipment, furnishings and supplies): small businesses would be able to exempt all of their business personal property from taxation, and other business taxpayers would be able to exempt the first \$500,000 in business personal property.⁵

How Much Revenue Would Prop. 15 Raise for Schools and Local Communities?

The Legislative Analyst's Office estimates that Prop. 15 would raise between \$8 billion and \$12.5 billion in statewide property tax revenues for schools and local

communities in most years from the shift to property assessment based on market value. Because Prop. 15's new exemptions for business personal property would reduce property taxes, the measure would net an estimated \$7.5 billion to \$12 billion in property tax revenues statewide. Counties would collect Prop. 15 revenues and be reimbursed for administrative costs to implement the measure.⁶ Prop. 15 would also reimburse the state for reductions in corporate and personal income tax revenues that would result from larger deductions due to higher property tax liabilities. After reimbursing counties and the state, the remaining revenues – an estimated \$6.5 billion to \$11.5 billion – would be allocated to K-12 schools and community colleges, counties, cities, and local special districts.⁷

How Would Prop. 15's Revenues Be Distributed to Schools and Local Communities?

Revenues raised by Prop. 15 in each county for public services provided by K-12 school districts, community college districts, cities, counties and special districts would be allocated:⁸

- Among cities, counties, and special districts based on the share of countywide property taxes that these local governments received as of January 1, 2020; and
- To a new statewide fund for K-12 school and community college districts – the Local School and Community College Property Tax Fund (“K-14 Education Fund”). The share of Prop. 15 revenues allocated to the K-14 Education Fund would be

equal to the share of countywide property taxes that K-12 school and community college districts received as of January 1, 2020.

All cities, counties, special districts, and K-12 school and community college districts would be required to publicly report the amount of Prop. 15 revenues that they receive annually and how those dollars were spent.

The dollars Prop. 15 distributes from the K-14 Education Fund could only supplement, and not replace, the minimum funding for K-12 schools and community colleges currently required by the state Constitution.⁹ Moreover, dollars deposited into the K-14 Education Fund could only be used to support K-12 schools and community colleges and could not be loaned to any state or local fund. Dollars in the K-14 Education Fund would be distributed as follows:¹⁰

- 89% to K-12 school districts, charter schools, and county offices of education based on the share of funding that each of these school entities received from the state's Local Control Funding Formula as of July 1, 2019.¹¹
- 11% to community college districts based on the share of funding that each district received from the state's distribution formulas as of January 1, 2020.

After decades of tax breaks for California's commercial and industrial properties, voters have an opportunity with Prop. 15 to correct a fundamental inequity in the state's tax system and send billions of dollars annually to their schools and local communities for services that benefit all Californians and their families.

Jonathan Kaplan and Kayla Kitson prepared this *Issue Brief*. The Budget Center was established in 1995 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The Budget Center engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the Budget Center is provided by foundation grants, subscriptions, and individual contributions. Please visit the Budget Center's website at calbudgetcenter.org.

ENDNOTES

- ¹ Prior to setting in law the processes for reassessing properties, the Legislature would be required to convene a task force to develop recommendations on the equitable implementation of the measure. The task force would include a county assessor or designee, a Board of Equalization member or designee, a proponent of Prop. 15 or designee, a taxpayer representative, and a member of the Legislature or designee.
- ² While 2025-26 is the first year that these properties could be reassessed, the Legislature would be allowed to delay the initial reassessment to any year after 2025-26. A “small business” is defined for the purpose of this measure as an independently owned business that owns real property – such as land and buildings – in California and that has fewer than 50 full-time-equivalent employees.
- ³ For mixed-use properties that include both residential and commercial or industrial uses, only the portion that is used for commercial or industrial purposes would be subject to reassessment to market value. For mixed-use properties where at least 75% of the property is used for residential purposes, the Legislature could exclude the commercial share from reassessment. Additionally, the Legislature would be required to provide by law that “limited commercial uses” of residential property, such as home offices, home-based businesses, and short-term rentals, are classified as residential and not subject to reassessment.
- ⁴ The \$3 million threshold would be based on the market value of properties, and would be adjusted every two years for inflation, beginning January 1, 2025. The inflation adjustment would be determined by the State Board of Equalization.
- ⁵ For the purposes of the business personal property tax exemption, “small business” has the same definition as for the delay in reassessment for properties primarily occupied by small businesses. Additionally, the measure would include businesses’ fixtures in the exemption. However, aircraft and vessels would not be exempt from the business personal property tax.
- ⁶ Prop. 15 would require the Legislature to establish a method for determining the additional revenue generated in each county. The measure would require the Legislature to appropriate state General Fund dollars to pay for start-up costs associated with implementing the measure and to provide for the state General Fund to be reimbursed for these start-up costs once sufficient funds are available to pay for ongoing implementation. The measure would allow start-up costs to be paid from funds allocated to support K-12 school and community college districts.
- ⁷ Prior to allocating dollars to K-12 school and community college districts, cities, counties, and special districts, the state General Fund would be reimbursed for the amount it would be required to provide to K-12 school and community college districts that could result from reductions in property taxes due to Prop. 15’s business personal property exemption. The requirement for the state to backfill reductions in property taxes for K-12 schools and community colleges occurs in most years under the state’s current constitutional funding guarantee for K-14 education.
- ⁸ Unless otherwise specified, “K-12 school districts” in this *Issue Brief* includes charter schools and county offices of education.
- ⁹ Prop. 15 revenues would not be part of the calculations used to determine the state’s minimum annual funding requirement for K-12 schools and community colleges – also known as the Proposition 98 guarantee.
- ¹⁰ Under Prop. 15, K-12 school and community college districts that receive property tax revenue in excess of the state’s distribution formulas – “excess tax districts” – would have their share of the K-14 Education Fund reduced by the amount of that excess revenue. Prop. 15 would provide a minimum distribution of \$100 per student for any excess tax district whose share of the K-14 Education Fund is less than the excess property tax revenue that district receives above the state’s distribution formulas. The amount of this minimum distribution would be adjusted annually by the same percentage that the K-14 Education Fund grew or declined from the previous year and would be allocated based on each K-12 school district’s average daily attendance and each community college district’s full time equivalent student enrollment.
- ¹¹ The Local Control Funding Formula is California’s main K-12 education funding formula, which provides school districts, charter schools, and county offices of education a base grant per student, adjusted to reflect the number of students at various grade levels, as well as additional grants for the costs of educating English learners, students from low-income families, and foster youth.