California Budget & Policy Center

Key Context for Understanding the Commercial Property Tax Reform Proposal

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WORKSHOP: "40 YEARS IS ENOUGH: TIME TO REFORM PROPOSITION 13"

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What Would the Proposed "Schools & Communities First" Ballot Initiative Do?

- This initiative – which has not yet qualified for the ballot – would raise new property tax revenues for local services.

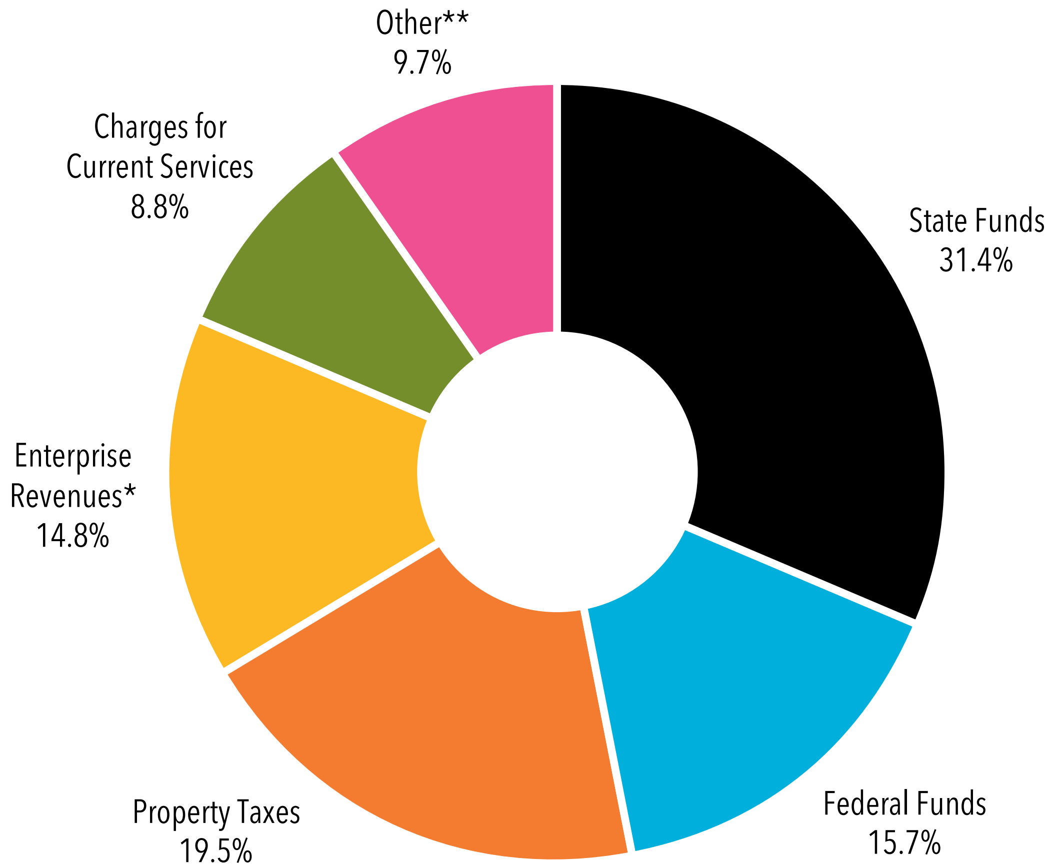
- The measure would annually tax some properties (but ***not*** residential properties) based on their *market* value, not their (generally lower) purchase price.
  - This change would affect 1) certain commercial and industrial properties **and** 2) vacant land not intended for housing or commercial agriculture.

- Most of the new property tax revenues raised by this initiative would go to local governments (cities, counties, special districts, K-12 school districts, and community college districts) based on existing formulas.

Property taxes are an important source of local revenues.

For example, property taxes comprise roughly 20% of total revenues received by counties.

Property Taxes Comprise Roughly One-Fifth of Total County Revenues, 2015-16



* Reflects revenues associated with business-type activities, such as airports and hospitals.
** Reflects a range of smaller revenue sources, including other taxes, fines, licenses, and permits.
Note: Excludes the City and County of San Francisco. Percentages do not sum to 100 due to rounding.
Source: California State Controller's Office

Local governments’ ability to boost revenues is severely constrained by state rules.

As a result, it’s difficult for local jurisdictions to raise taxes in order to enhance or expand services.

Moreover, when local tax increases *are* approved, they often are regressive, meaning they affect lower-income households more than others.

Examples of regressive taxes include the sales tax and taxes on parcels of property.

Locals Can Increase the Property Tax Rate Only to Fund Voter-Approved Debt

- Proposition 13 (1978) **limits the countywide property tax rate to 1%** of a property's assessed value. Revenues raised by this rate are allocated to jurisdictions within the county.

- Local governments can boost the property tax rate only to pay for **voter-approved debt** (generally infrastructure bonds).
  - The property tax rate *cannot* be increased to raise revenues for local services.

- Property tax rate increases for **certain school facility bonds** need approval by **55%** of local voters. Increases for **other types of infrastructure bonds** need approval by **two-thirds** of local voters.

Cities and Counties Can Raise Other Types of Taxes to Fund Local Services

- In contrast to the restrictions on the use of property taxes, cities and counties **may raise other types of taxes** to fund local services.

- These include taxes on:
  - Retail sales.
  - Short-term lodgings.
  - Utilities.
  - Businesses.
  - Property transfers.
  - Parcels of property (a fixed amount per parcel).

- However, proposals to increase these other types of taxes **must be approved by local voters**.

Cities and Counties Can Raise Other Types of Taxes to Fund Local Services (continued)

- Voter-approval requirements vary depending on whether a city or county proposes to levy a **"general" tax** or a **"special" tax**.

- General (unrestricted) taxes:
  - Must be placed on the local ballot and approved by a **simple majority of voters**.

- Special taxes:
  - Include both taxes on parcels of property and taxes dedicated to specific purposes.
  - Must be placed on the local ballot and approved by **two-thirds of voters**.

Special-Purpose Districts Have Fewer Tax Options to Support Local Services

- Special districts, K-12 school districts, and community college districts collectively are known as "special-purpose" districts.

- All special-purpose districts **can levy taxes on parcels of property** to fund local services.

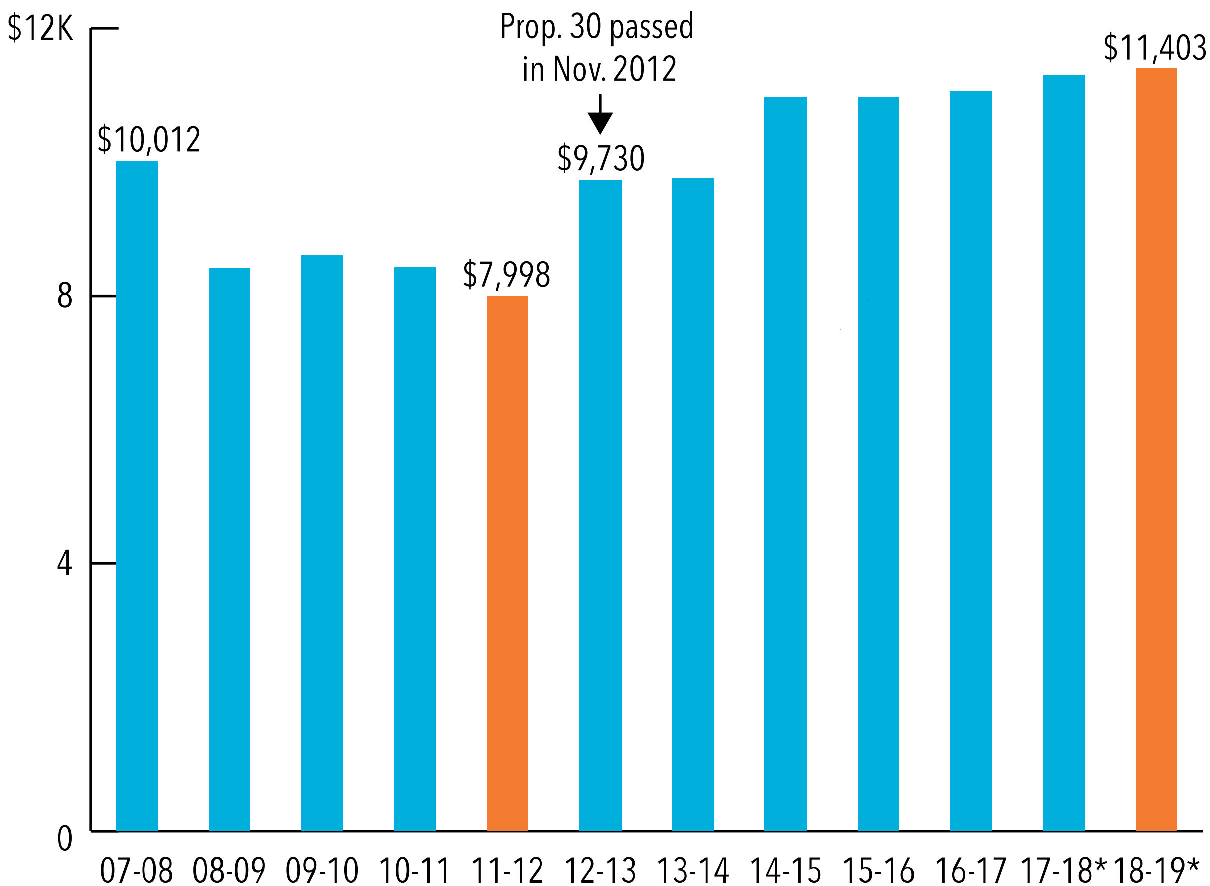
- Some *special* districts – but not K-12 or community college districts – **can also levy sales taxes**.

- These taxes **require two-thirds approval** by local voters.

California's support for K-12 education has improved in recent years, but still lags the nation on several important measures.

Due to Higher Revenues, 2018-19 Spending Per Student Would Be More Than $3,400 Above 2011-12

K-12 Proposition 98 Spending Per Pupil, Inflation-Adjusted



* 2017-18 estimated and 2018-19 proposed.
Note: Figures reflect 2018-19 dollars and exclude spending for adult education, preschool, and child care. Prop. 98 spending reflects both state General Fund and local property tax dollars.
Source: Legislative Analyst's Office

California Ranks Low on Several Measures of Support for K-12 Education

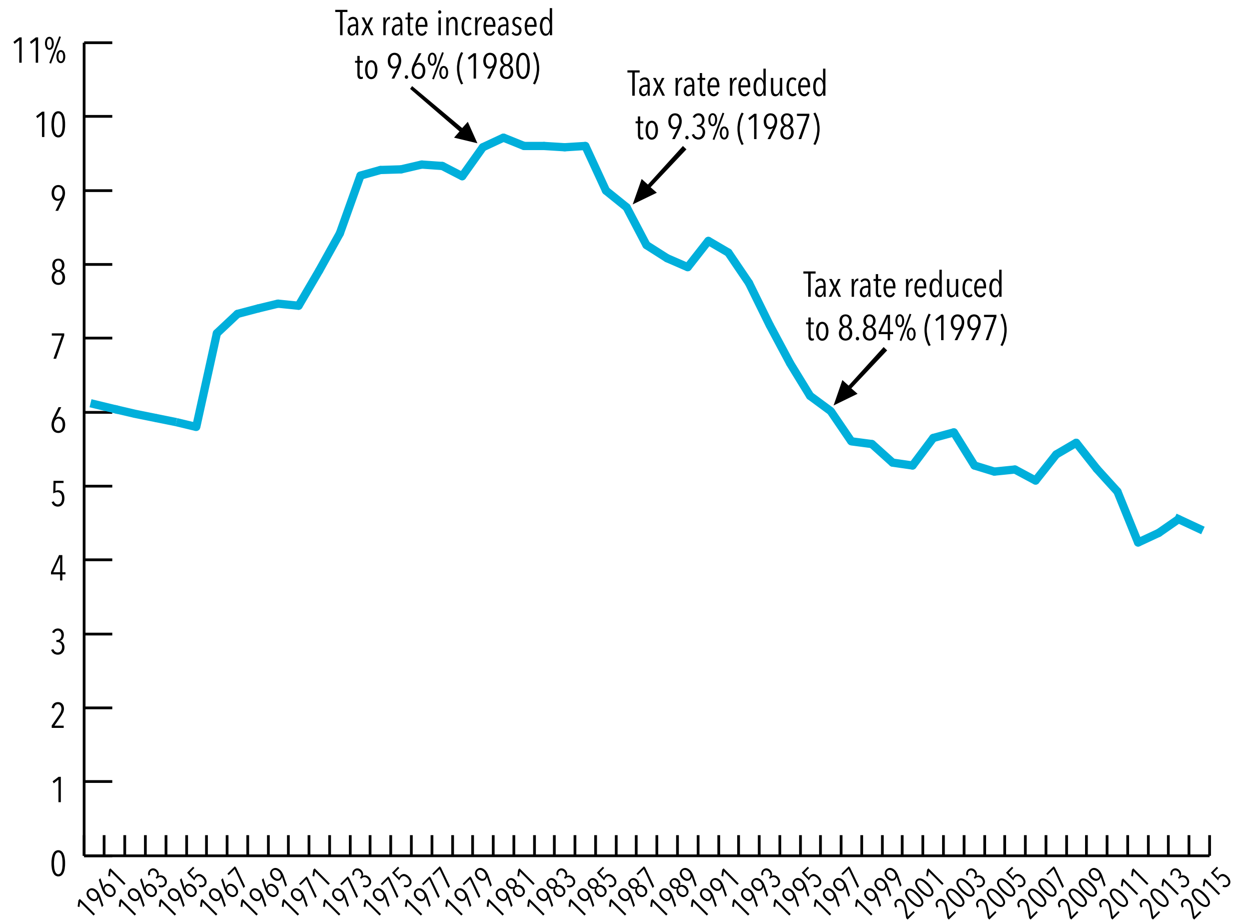
- In 2015-16, California ranked:
  - **51st nationally in the number of K-12 students per teacher** (about 22-to-1).
  - **41st in K-12 spending per student**, after adjusting for differences in the cost of living in each state.
  - **37th in K-12 spending as a share of the state economy**, as measured by personal income.

In California, the share of corporate income paid in state taxes has been falling for decades.

Corporate net income rose from $24 billion in 1981 to $203 billion in 2015. Yet, over this same period, the share of this income paid in state corporation taxes fell from nearly 10% to 4.4%.

The Share of Corporate Income Paid in State Taxes Fell By More Than Half Between 1980 and 2015

Corporate Taxes as a Percentage of Income for Corporations Reporting Net Income



Source: Franchise Tax Board

The recently enacted federal tax bill mainly benefits corporations and high-income households.

President Trump signed the tax bill in December 2017. Many of its provisions – mainly affecting taxes paid on personal income – expire after 2025.

The Tax Bill Primarily Benefits Corporations and High-Income Households

- The federal tax bill **delivers most of its benefits to the already well-off** in a number of ways. For example, the bill:
  - Permanently cuts the top corporate income tax rate from 35% to 21%.
  - Creates a 20% deduction, through 2025, for income from "pass-through" businesses. These include law firms and hedge funds.

- The **average taxpayer in the bottom 60%** will *initially* see a **relatively small tax cut**, but will later experience a **tax increase** due to the expiration of most of the bill's provisions in 2025, according to the Institute on Taxation and Economic Policy (ITEP).

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