Key Context for Understanding the Commercial Property Tax Reform Proposal

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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

- Federal Funds: 15.7%
- State Funds: 31.4%
- Enterprise Revenues*: 14.8%
- Property Taxes: 19.5%
- Charges for Current Services: 8.8%
- Other**: 9.7%

* 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).