

SPLIT ROLL PROPERTY TAX

POLICY BRIEF | FEBRUARY 2013

KEY FACTS

- **Property Tax Burden Has Not Shifted to Homeowners.** Proposition 13 has not shifted the property tax burden to homeowners. Board of Equalization data shows that Proposition 13 assessments have grown faster on business and non-homeowner-occupied property.
- **Businesses Pay Largest Share Under Proposition 13.** Data from the Board of Equalization shows that businesses and non-homeowner-occupied property owners pay the largest share of the property tax under Proposition 13.
- **Impact on Residential Properties.** Most split roll proposals that address change in ownership or control of a legal entity typically are viewed in context of commercial properties. However, such a proposal could affect the assessment of residential rental property if owned by a legal entity.
- **Increases Revenue Volatility.** A split roll would increase the volatility in property tax revenue, since tax revenue would mirror fluctuating property values from year to year.

The idea of a split roll property tax has been fully vetted and consistently rejected since the passage of Proposition 13 in 1978. While some believe that a split roll would bring in additional revenue, it would stifle the state's economic growth in the long term. From what is known about the economic impacts of split roll, it remains an ill-advised idea.

What Is a Split Roll?

California's system of property taxation under Proposition 13 uses an acquisition-value standard: county assessors determine a property's value when it goes through a change in ownership or undergoes new construction, and tax is assessed at 1 percent of this value, plus a rate for voter-approved indebtedness. Thereafter, the taxable, or assessed, value of property may increase annually by the lesser of the rate of inflation or 2 percent.

Under a split roll, not all properties on the assessment roll are treated equally. For example, a split roll may require businesses to pay property taxes at a rate higher than the rate imposed on homeowners. There is no split roll in California for locally assessed real property: property taxes are imposed without distinguishing property used as a principal residence, or an apartment building rented to tenants, or property used for commercial or industrial purposes. All locally assessed Proposition 13 property is subject to the same rules regarding the maximum assessed value and maximum tax rates.

Voters approved the acquisition-value system that requires assessors to assess property when there is a change in ownership or new construction. Voters have rejected all split roll proposals, including one in 1978 when Proposition 13 was approved. Since voters approved Proposition 13 as a constitutional



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amendment, any changes to Proposition 13 require a vote of the people.

Any Shift in Tax Burden?

Contrary to what supporters of split roll claim, Proposition 13 does not shift the property tax burden to homeowners. The assessed value of non-homeowner property subject to Proposition 13 has grown an average of 7.5 percent per year, while homeowners' property tax has grown an average of 7.2 percent. Thus, the Proposition 13 property taxes paid by non-homeowners have outpaced homeowners' property tax burden. In fact, Proposition 13 has prevented a property tax shift to homeowners.

What Is the Economic Impact on California?

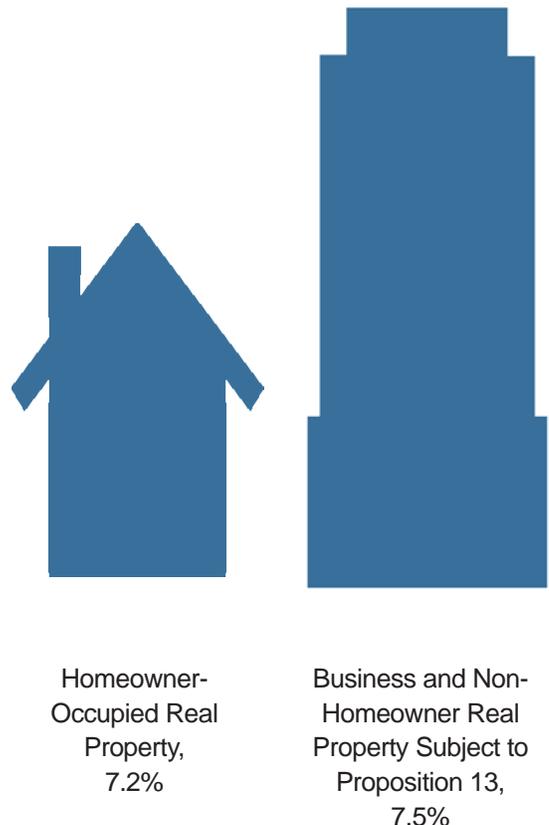
During the past three decades, there have been numerous split roll proposals to replace California's current single- or unified-roll tax system for locally assessed real property. The current system has had a positive economic effect, and while the details of split roll proposals differ, they have a common feature: if a split roll system is enacted, a large share of California property no longer would be protected by the limitations on property tax assessments established by voters when they approved Proposition 13, creating a significant economic threat to California.

Bad for the Economy and Consumers. The Legislative Analyst's Office found that a split roll would increase costs to businesses due to higher property taxes, which could result in higher product prices, reduction in employees' salaries, and a reduction in overall economic activity. Higher prices on products and services would make California businesses less competitive in national and global markets.

Some Dwelling Units Will Be Negatively Impacted by a Split Roll. Proponents argue that a split roll would generate more revenue without directly taxing a large bloc of voters who own houses. This is based on the principle, "Don't tax you, don't tax thee, tax that fellow behind the tree." Unfortunately for split roll proponents, no matter how a split roll is drafted, there will be some or many dwelling units on the wrong side of the split. All split roll proposals to date suffer from

AVERAGE ANNUAL GROWTH OF ASSESSED VALUES OF PROPERTY SUBJECT TO PROPOSITION 13

From 1979-80 to 2011-12, the average annual growth of assessed value for business and non-homeowner real property subject to Proposition 13 has outpaced the growth of homeowner-occupied property.



Source: Board of Equalization.

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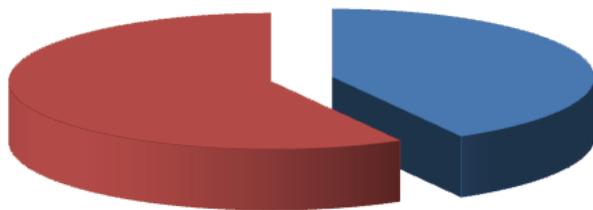
this infirmity. Voters should be aware that a split roll tax may increase tax burdens on their dwelling units.

Hurts Many Businesses. A split roll would adversely impact businesses, particularly small businesses, because their lease costs would increase with higher property taxes. Lease payments on commercial buildings, shopping centers and business parks would increase to reflect increased property taxes, as most commercial leases allow for such increases. Smaller businesses would be less able to absorb a sudden rent increase due to reassessment, and many would have to reduce their number of employees or close down completely.

Hurts Retirees. Retirees whose pension funds invest in California businesses and business properties would see the value of their funds reduced, as these businesses become less competitive and less profitable. For example, as of October 2012, the California Public Employees' Retirement System (CalPERS) had \$5.3 billion invested in California real assets, including real estate and other property holdings. Since the effects of the higher property taxes brought about by a split roll would be capitalized, the market price of these real estate holdings would decrease. The market value of CalPERS' California equity holdings also would go down if the issuing corporations and other legal entities were not able

TAX BURDEN FOR PROPERTIES UNDER PROPOSITION 13

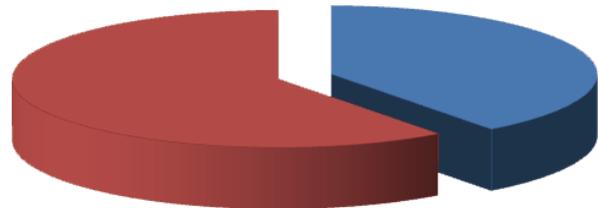
1979-80 ASSESSMENT PERIOD



Business and Non-Homeowner Property Subject to Proposition 13, 58.17%

Homeowner-Occupied Property, 41.83%

2011-12 ASSESSMENT PERIOD



Business and Non-Homeowner Property Subject to Proposition 13, 60.23%

Homeowner-Occupied Property, 39.77%

Data from the Board of Equalization shows that the property tax burden has not shifted to homeowners. In fact, a small shift toward business and non-homeowner property subject to Proposition 13 has occurred. Homeowner-occupied properties are residential properties serving as a principal place of residence, where owners claim the homeowners' exemption. Business and non-homeowner property includes commercial and industrial property, and other investor-owned property subject to Proposition 13.

Source: Board of Equalization.

to pass along the increased tax burden to renters, employees and consumers

Is a Split Roll the Solution to the California's Fiscal Problems?

As California's fiscal woes have worsened, there has been renewed discussion about establishing a split roll system, often in the name of "closing a corporate loophole" and funding vital local services, including schools.

California ranks substantially higher in aggregate tax burden than the Western states with which we compete for jobs and investments. Raising taxes is not the solution to the state's fiscal problems.

Leads to Unfair and Subjective Tax Policy. Prior to Proposition 13, assessors used the theory of "highest and best use," which meant that property value was estimated by considering the "highest and best use" of the property, rather than the actual use. This forced many property owners to sell their property. A return to market-value assessments would bring back this undesirable assessment method, which was partly responsible for the property tax revolt that led to enactment of Proposition 13. It also was a key element in the assessors' scandals in the 1960s. Moreover, a return to assessments based on market value would shift taxes from an objective standard (sales price) to a subjective one (assessors' opinion of value), leading to arbitrary assessments and more appeals.

Increases Revenue Volatility. A split roll based on the market value of real property would increase volatility in property tax revenue, as revenue would be directly impacted by the fluctuation of property values from year to year. Proposition 13 stabilized the flow of property tax revenue by locking in acquisition values, and allowing these values to increase slowly from year to year. If taxes on locally assessed real property were based on market values, local government would not be able to absorb the enormity of the losses during downturns – for example, locally assessed real property values fell \$86 billion during the 2009-10 fiscal year, and \$76 billion during the 2010-11 fiscal year. One of the unheralded benefits of Proposition 13 is that it

serves as a circuit breaker to large fluctuations in market values, either upward or downward.

Administrative Obstacles. A split roll based on sales of stock is administratively unworkable. Stock of a publicly traded company changes hands numerous times each hour, day, month and year. How would such a company determine the cumulative effect of changes in stock ownership? Assessors would have to revalue property each time a change occurred, resulting in hundreds, if not thousands, of reappraisals each year for a single company. And with each reappraisal, a supplemental roll tax bill would have to be issued. Taxpayers would have the right to appeal the value of the property after each reappraisal, further overburdening the assessment appeals system.

Affects Any Type of Real Property Owned by a Legal Entity. Split roll proposals that address ownership in a legal entity typically are viewed in the context of commercial properties, but any type of real property owned by a legal entity could be subject to a new change-in-ownership definition. Such a proposal could affect the assessment of single-family homes, multi-family properties (such as apartments, duplexes and mobile home parks), agricultural property, family farms, and small businesses whenever such properties are owned by a legal entity.

About CalTax

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