

# Split Roll Battle

## Proposition 13 Property Tax Protections Focus of Ballot Challenge in 2020

Since voters reduced California property taxes with Proposition 13 in 1978, multiple factions have attempted to roll back the reform and boost property tax collections. Government labor unions and advocacy organizations are aiming for the 2020 general election to repeal many of Proposition 13's protections and increase taxes on business properties, called a "split roll," to support their priorities. Because a split roll property tax would be so damaging to the state's small businesses and the investment climate, the initiative will be a central feature of the 2020 political debate.

### BACKGROUND ON PROPOSITION 13

Proposition 13 has been the law for more than 40 years. In 1978, property values were soaring and so were their corresponding property taxes. There was no limit to how high an assessor could increase a property's value in any given year. Between 1972 and 1977, home prices in Southern California doubled. Even if tax rates didn't change, property tax bills also doubled. Many taxpayers could not afford their ever-increasing property taxes and feared losing their homes.

Proposition 13 brought a halt to all that—limiting total taxes to 1% of the property's value, and any increases to a maximum of 2% per year. California voters passed the constitutional amendment by a nearly 2 to 1 margin, and solidified property tax reasonableness and predictability.

### PROPOSITION 13 AMENDMENTS TO STATE CONSTITUTION KEEP PROPERTY TAXES MANAGEABLE AND PREDICTABLE

Proposition 13 required that all categories of real property on the local assessment roll be assessed at the same basic tax rate and

under the same valuation standard. It did not distinguish among residential, commercial, industrial, agricultural, or any other type of property.

Additionally, it capped local property tax rates at 1% of the property's assessed value—based on the market value as of the date of the most recent change in ownership or new construction. Proposition 13 capped property tax increases at 2% per year. This means that property taxes are pegged to the property's original purchase price, plus improvements, not what the property is currently worth.

When a property is sold, it is reassessed at its new purchase price. It is then taxed at a rate of 1% of that new value, and from then on, Proposition 13's tax limits apply until it is sold again. These protections provide stability and predictability to both property owners and government coffers—protecting both from very high or very low reassessed property values each year.

Furthermore, Proposition 13 required any state tax to be approved with a two-thirds vote of both houses of the Legislature. It required approval by two-thirds of voters for any tax levied by local governments that was designated for a special purpose, like parks or roads.

### WHAT IS SPLIT ROLL?

A tax roll is the official list of all the properties to be taxed. "Split roll" means applying a different tax formula, either tax rate, reassessment frequency, or vote requirement, to commercial and industrial properties than that applied to residential properties. Proponents of a split roll would remove some of the protections of Proposition 13 from nonresidential properties in order to raise taxes.

The idea of a split roll has been rejected consistently since the passage of Proposition 13. Over the last few decades there have been numerous legislative proposals to present a split roll to the voters, but none ever reached the ballot. A split roll ballot measure in 1992 was defeated soundly.

### SPLIT ROLL BALLOT INITIATIVE

The California Schools and Local Community Funding Act of 2018—an initiative proposal for a split roll property tax—is a

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constitutional amendment that has qualified for the November 2020 ballot. On August 13, 2019, however, proponents of the initiative announced that the campaign would collect signatures for a revised version of the proposal to appear on the ballot. Even though they acknowledged the original measure was flawed, proponents refused to remove the already-qualified measure from the ballot pending qualification of the new measure. The deadline to gather signatures will be mid-April 2020.

Opposition to a split roll property tax is a fundamental concern for small business owners, commercial property owners, and industrial and manufacturing facilities, so voters can count on a well-funded opposition campaign for education about this initiative.

### KEY PROVISIONS OF INITIATIVE

- Requires all business property to be reassessed to fair market value, beginning on the 2022–2023 lien date. The Legislature may phase in this requirement over three years.
- Increases business property taxes by \$7.5 billion to \$12 billion a year, according to the Legislative Analyst.
- Requires reassessment of business property to fair market value every three years.
- Includes all business property, except for property used for residential (including rental) or agricultural production purposes. Mixed-use property is reassessed proportional to its commercial use.
- Exempts from full reassessment business property with an on-site business, and which is under a single ownership with no more than \$3 million worth of property statewide.
- Exempts from taxation up to \$500,000 of business personal property and exempts from taxation all tangible personal property of certain small businesses.
- Dedicates the proceeds of the tax increase to schools, community colleges and local governments, in proportion to what those entities currently receive in general property tax allocations. In general, schools receive about 40% of the allocation, with cities, counties and special districts splitting the rest.
- Allocates money to these entities with almost no strings attached. No money is retained for reserves and few accountability conditions are attached.
- Earmarks \$1 billion a year for the costs of implementation (for example, assessor’s offices), compliance and support of existing state and local programs.

### CONCERNS WITH SPLIT ROLL

- **Schools’ Fiscal State of Affairs Are Unaffiliated with**

**Property Taxes.** Schools could certainly use more money, especially to pay teachers trying to make ends meet in expensive coastal housing markets. But the story of school finance is not a lack of revenues; it is the growth of other state priorities. State support for the health care program for poor Californians, called Medi-Cal, has increased ten-fold since 1978. It is now by far the biggest single program in state government, annually consuming \$100 billion in state and federal funds, and serving one in three Californians.

Additionally, pension and health care costs have hit schools especially hard. In the seven years through 2020–2021, researchers estimate the cost of teacher and staff pensions for school districts will more than triple, totaling \$9 billion just to support retirement systems that are still actuarially underwater.

In the Los Angeles school district, employees (and their dependents) pay no health care premiums, have no deductibles, and have lifetime benefits. The district estimates that in two years, health and pension payments will comprise more than 37% of its general fund budget, up from 11% in 2001. In 2018, Los Angeles schools had an unfunded liability for retirees’ health benefits of \$15 billion.

Additionally, two California policy changes that predated Proposition 13 have had a far greater impact on the fiscal health of schools than property tax alterations.

First was California Supreme Court’s 1971 decision in *Serrano v. Priest*, which wrote local school boards (and voters) out of school finance decisions and placed the state Legislature firmly in control of school appropriations. The court required “equalization” of tax effort, which led to state-imposed revenue limits for schools—essentially a narrow band of per-student revenues allowed for school districts. Sacramento—not local voters—became the locus of school revenue decisions.

Second, Governor Edmund G. Brown Jr. signed legislation in 1976 granting collective bargaining rights to school employee unions. From that day on, every major spending decision by school districts required affirmative agreement by school unions. If money equals quality, then the unions must shoulder responsibility for student performance based on their spending priorities.

- **Small Businesses and Their Employees Hardest Hit.** Smaller businesses will be even more incapable of absorbing a sudden rent increase due to reassessment. Those small businesses that cannot raise prices will need to cut costs, which will include reducing employee compensation, benefits, or cutting the number of employees. Some small businesses will have to relocate or close, creating an oversupply of commercial space and higher vacancy rates, which would cause commercial property rents

and values to decline. The closing of storefronts will decrease job opportunities because of decreased economic activity.

Although the revised initiative includes a small business exemption, the split roll still would be crippling to a significant portion of businesses. The new language, for example, expands the reassessment exemption to small business owners with property valued at \$3 million or less, up from the previous \$2 million threshold.

According to California Taxpayers Association President Rob Gutierrez, the protections for small businesses aren't strong enough. Because many small businesses are renters, higher property taxes on the buildings they rent space in will result in more expensive rent for them, he said. "What that translates into is higher prices for consumers and brick-and-mortar stores," he said. "Dry cleaners, grocers, companies that cannot move, will have to find a way to pass these costs on."

• **Split Roll Will Increase Costs for Consumers.** Faced with higher property taxes, commercial property owners with typical lease terms are likely to pass the increased costs on to their tenants. For instance, a shopping center with multiple tenants would be faced with significant increased property taxes under this pending ballot initiative, and would in turn, increase rental rates. When faced with higher rent, those tenant business owners will increase the cost of their products to offset the higher rent, meaning the split roll tax will systemically increase the cost of living.

Even though a split roll tax is not aimed at consumers, the consumers are the ones who ultimately will pay for the tax through higher prices for everyday goods and services.

Residents already are struggling with a painfully high cost of living in California. This cost encompasses some of the steepest taxes in the country, including one of the highest gas, income, and sales taxes. The Legislature just passed policies that have resulted in Californians paying 48% more for electricity than the rest of the nation. Adding a split roll tax on top of these existing costs will only exacerbate the affordability issue for many Californians.

• **Split Roll Will Hurt California's Economy.** High taxes, mandates and regulations already make it difficult for California businesses to compete. An almost \$11 billion split roll tax increase will prevent businesses from hiring new employees and, potentially, from keeping existing ones. The stability and predictability brought by Proposition 13 has allowed California businesses to compete nationally despite the high cost of doing business in this state. A split roll tax will force many to close or relocate to a state that welcomes business investment.

The Legislative Analyst's Office (LAO) warned that if the split roll ballot initiative passes, it would likely increase the costs of many businesses operating in California and thus influence their decisions as to whether to invest further in the state or move elsewhere.

• **No Accountability Measures for New Revenue Are Included with the Initiative.** The ballot initiative does not include taxpayer protections, cost controls, accountability measures or transparency requirements. The proponents even removed a cap on administrative expenses—so government can waste this new tax money on administration and overhead with no limits or checks.

In addition, it is challenging for assessors to competently value properties. The initiative will change the assessor's review of property from an objective standard (price of sale) to a subjective standard (assessor's opinion of value). This will lead to arbitrary assessments, more appeals, and an increased amount of bureaucratic overhead.

• **Problem of Budget Volatility Will Be Exacerbated.** Even if properly administered, tax assessments will follow the highs and lows of California's real estate market—leading to more volatility. During recessions, this could lead to a significant reduction in revenue. For example, in 2008–2009, commercial property values declined by about 35% due to the economic recession.

**These wild value swings are what led to the passage of Proposition 13 in the first place.** 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.

• **Massive Additional Revenue Not Necessary.** California taxpayers have remitted a mountain of state and local taxes since Proposition 13's inception—more than \$240 billion this year alone. Next year, Governor Gavin Newsom anticipates a budget surplus of \$21 billion.

Since Proposition 13 passed in 1978, per capita state and local tax revenues, adjusted for inflation, have increased by 55%. That's the equivalent of \$90 billion in new spending even after adding another 17 million residents and the increased cost of living.

California has record-high revenues and an enormous surplus. Local government revenue is at an all-time high as well. When Proposition 13 was passed in 1978, local property tax assessments were \$6 billion. Local property tax levies are now projected to have grown \$19 billion over the last decade alone—from \$50 billion in 2008–2009 to \$69 billion in 2018–2019. A massive tax increase via the unraveling of Proposition 13's sound protections is not warranted.

## TAXATION

### **CALCHAMBER POSITION**

The California Chamber of Commerce strongly opposes any split roll proposal. The LAO has estimated the Legislature will have a \$7 billion surplus available to allocate in the upcoming budget process in addition to building an \$18.3 billion balance in the state's rainy-day fund by the end of 2020–2021. Clearly, there is no justification for adding another layer of taxes on Californians.

Discriminating against businesses through a split roll proposal will hurt the business community as well as employees and consumers, thereby having a negative impact on our entire economy.



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January 2020