Split Roll Property Tax

Initiative Targets Business, But Ultimately Harms Economy

Perennial demands by government labor unions and advocacy organizations for greater public spending for their priorities inevitably leads to calls for general tax increases, despite California's record budget surplus. At the forefront of these efforts is a proposal known as the "split roll" property tax, which would repeal many of the protections of Proposition 13 as they apply to business property.

Recently, the split roll proposal qualified as a ballot initiative to be voted on in November 2020. Although split roll is described by its proponents as "tax reform," it really is just a targeted tax increase on business—potentially to the tune of more than $10 billion per year. Since the goal of government unions and progressive advocacy groups is a large tax increase, their strategy is to target increased taxes on businesses as more politically viable than general tax hikes on California residents. Of course, increased business taxes ultimately are passed on either to consumers as higher prices, to employees as less compensation, or to the general community as less business activity, and so are—under any circumstance—harmful to California's economy.

BACKGROUND ON PROPOSITION 13

Proposition 13 was passed by 65% of California voters in 1978. At that time, property values were soaring and so were the corresponding property taxes. There was no limit to how high an assessor could increase a property's value in any year. Many taxpayers could not afford their ever-increasing property taxes and feared losing their homes. Californians were angered by government's inability or unwillingness to solve this problem and channeled their frustration into overwhelming support for Prop. 13 at the ballot box.

Prop. 13 Amendments to State Constitution Keep Property Taxes Manageable and Predictable

• It 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.

• 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.

• It 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, Prop 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.

Prop. 13 Also Created Additional Protections for Taxpayers

• Required any state tax to be approved with two-thirds of both houses of the Legislature.

• 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 split roll would remove some of the protections of Prop. 13 from nonresidential properties in order to raise taxes on them.

The idea of split roll has been rejected consistently since the passage of Prop. 13. Over the last few decades there have been numerous proposals for split roll, but none became law. One such proposal made it onto the ballot in 1992, but was defeated soundly.

2020 Split Roll Ballot Initiative

The California Schools and Local Community Funding Act of 2018—a proposal for a split roll property tax—is a constitutional amendment that now has qualified for the November 2020 ballot. If approved by the voters, this initiative would amend Prop. 13 and increase taxes by reassessing business property every three years to the market price. The initiative purports to alleviate the burden this tax increase would place on small businesses by exempting business owners with property holdings of less than $2 million in California.

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The Legislative Analyst's Office (LAO) estimates that the measure will raise between $6.5 billion to $10.5 billion per year. These funds would go first to the county assessors to cover their administrative costs—with no limits placed on such costs—and to the state General Fund to backfill income tax losses coming from higher property tax deductions. Of the amount left over, 60% of the new revenue would go to cities, counties and special districts, and 40% would go to schools and community colleges with little or no requirements on how the money would be spent.

POLICY CONCERNS WITH SPLIT ROLL

• *Split Roll Will Increase Costs for Consumers*

Faced with higher property taxes, commercial property owners are likely (given typical lease terms) to pass the increased costs to their tenants. Imagine a mall with a boutique and a nail salon. When faced with higher rent, those business owners will have no choice but to increase the cost of a shirt or a manicure. Higher taxes resulting from split roll ultimately will be passed on to consumers in the form of increased prices on just about everything people use and buy.

The timing couldn't be worse. Residents are already struggling with the high cost of living in California: some of the steepest taxes in this country, including the highest or second 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.

• *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 or even from keeping existing ones. The stability and predictability brought by Prop. 13 has allowed California businesses to compete nationally despite the high cost of doing business here. A split roll tax will force many to close or relocate to a state that actually welcomes business investment.

The LAO warned that if the split roll ballot initiative passes, it likely would 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.

• *Small Businesses and Their Employees Hardest Hit*

Smaller businesses will be even less able to absorb a sudden rent increase due to reassessment. Those small businesses that can't raise prices will need to cut costs, including by reducing employee compensation, benefits, or by reducing 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 lead to less economic activity, and thus less job opportunity.

• *Initiative Includes No Accountability Measures for New Revenue*

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 a great deal more 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 Prop. 13 in the first place. Prop. 13 stabilized the flow of property tax revenue by locking in acquisition values and allowing these values to increase slowly from year to year; these stabilizing protections should not be taken away.

• *Massive Additional Revenue Not Necessary*

California has record-high revenues and more than $17 billion in reserves. Local government revenue is at an all-time high as well. When Prop. 13 was passed in 1978, the 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 Prop. 13's sound protections is not warranted.

CALCHAMBER POSITION

Given the numerous concerns with passage of a split roll proposal, the California Chamber of Commerce is co-chairing a broad-based coalition to actively oppose the ballot initiative or any similar legislation. Such a significant tax increase layered on top of California's other high taxes would certainly harm consumers, employers, and ultimately the economy.

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