JOINT LEGISLATIVE HEARING

ASSEMBLY COMMITTEES ON BUDGET AND REVENUE AND TAXATION
SENATE COMMITTEE ON GOVERNANCE AND FINANCE

June 11, 2018

Committee Background

This background paper prepares the members of the Assembly Budget and Revenue and Taxation Committees and the Senate Governance and Finance Committee for the June 11, 2018, hearing on Initiative No. 17-0013, titled by its proponents as "People's Initiative to Protect Proposition 13 Savings, Version 3." The proposed initiative amends the California Constitution to expand the ability for a taxpayer to transfer the base year value for his/her current residence to another residence. The proposed initiative also expands the ability of a taxpayer to transfer the base year value of other property types, such as commercial or agricultural, in limited instances involving disasters or contamination. This paper:

- Provides background regarding base year value transfers under existing law.
- Summarizes the proposed initiative.

Initiative Review Process

Elections Code Section 9034, as amended by SB 1253 (Steinberg), Chapter 90, Statutes of 2014, requires:

- Proponents of a proposed initiative who have gathered 25 percent of required signatures to certify under penalty of perjury to the Secretary of State they have done so.
- The Secretary of State to transmit the certification, along with the Attorney General's title and summary, to the Senate and the Assembly.
- The two houses to refer the proposed initiative to appropriate policy committees for joint hearings, to be held not later than 131 days before the election at which voters will consider the proposed initiative -- June 28, 2018.

The Legislature can neither amend the proposed initiative, nor prevent it from appearing on the ballot. Secretary of State Alex Padilla determined that Initiative No. 17-0013 has received sufficient signatures to be eligible for the November 2018 ballot. Should proponents not withdraw the proposed initiative before June 28th, the proposed initiative officially qualifies for the November ballot on July 1st.

Base Year Value Transfers

Article XIII of the California Constitution provides that all property is taxable unless explicitly exempted by the Constitution or federal law. Article XIIIA of the Constitution limits the maximum amount of any ad valorem tax on real property at one percent of full cash value, and directs assessors to set assessed values at 1975 market value levels and only reappraise property thereafter if there is a change in ownership (Proposition 13, 1978). Proposition 13 also established constitutional limits on assessed value inflationary growth of real property to two percent per year. State law implementing Proposition 13 generally sets a property's value as its sales price when purchased or, when there is no sales price, at its fair market value when ownership changes (base year value). Thereafter, the law requires an annual inflation adjustment to that value that does not exceed 2% (factored base year value). The inflation amount is based upon the California Consumer Price Index for all items as calculated by the Department of Industrial Relations.

Base year value transfers allow a taxpayer to continue to pay property taxes at the factored base year value of his/her previous home (or other property types where the law allows) and not on the value of their newly purchased home, often resulting in tax savings. For example, a taxpayer who purchased her residence for $100,000 in 1975 now has a base year value under Proposition 13 that cannot exceed $230,000 under the 2% cap in annual inflationary growth, regardless of its market value. If that taxpayer sold his/her residence for $400,000 and purchased a new one for the same amount, a base year value transfer allows him/her to continue to pay property taxes based on the $230,000 value, not $400,000, which at the 1% rate results in $1,700 in annual tax savings ($400,000 - $230,000 = $170,000 x 1% = $1,700).

Disaster-Related Transfers (All Property Types). In June 1986, voters amended the California Constitution to allow base year values transfers for certain disasters (Proposition 50, 1986). Proposition 50 allowed a taxpayer to transfer his/her base year value when his/her property is damaged by a major misfortune or calamity, and located in an area declared to be in a state of disaster by the Governor.

All property types. Revenue and Taxation Code (R&TC) Section 69 implements Proposition 50 to allow the transfer when:

- The damaged property sustains physical damages amounting to more than 50 percent of its full cash value immediately prior to the disaster;
- The replacement property is located in the same county as the damaged property and is acquired or newly constructed within five years after the disaster;
- The replacement property is comparable to the damaged property in size, utility, and function. For example, a residential property can be replacement property for a damaged residence, but not for a commercial, agricultural, or industrial property;

- The market value of the replacement property does not exceed 120 percent of the fair market value of the replaced property in its pre-damaged condition. Property owners can still receive the disaster relief in cases where the value of the replacement property exceeds the 120 percent limitation, but any amount over this threshold is assessed at full market value and added to the transferred base year value; and,
- The buyer of the replacement property was the owner of the damaged property at the time of damage.

Homes only. In November 1993, voters additionally allowed taxpayers to transfer base year values to other counties when their property is damaged by a major misfortune or calamity and located in an area declared to be in a state of disaster by the Governor (Proposition 171). However, Proposition 171 only allowed transfers to other counties for a taxpayer's principal place of residence, and solely when the board of supervisors in the county where the replacement property is located has adopted an ordinance making this benefit available. Additionally, replacement homes must be purchased within three years rather than five years. Eleven counties have such an ordinance: Contra Costa, Los Angeles, Modoc, Orange, San Diego, San Francisco, Santa Clara, Solano, Sonoma, Sutter, and Ventura.

Revenue and Taxation Code Section 69.3 implements Proposition 171's provisions for base year value transfers for out-of-county replacement homes.

Age and Disabled-Related Transfers (Homes Only). In November 1986, voters approved Proposition 60 to amend the Constitution to let a homeowner over the age of 55 transfer his/her base year value to a replacement home of equal or lesser value within the same county under specified circumstances.

Two years later, in November 1988, voters expanded base year value transfer availability to allow transfers to counties that adopt ordinances allowing the transfer (intercounty transfers). Today, eleven counties allow these out-of-county transfers: Alameda, El Dorado, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Mateo, Santa Clara, Tuolumne, and Ventura. (Proposition 90, 1988.)

In June 1990, voters approved Proposition 110 to allow disabled individuals regardless of age to transfer base year values to a purchased or newly constructed replacement property. (Proposition 110, 1990.)

Revenue and Taxation Code Section 69.5 provides further details to implement all three propositions for individuals over the age of 55 and disabled persons. Among the conditions, the property must be eligible for the homeowners' exemption, and the replacement property must be purchased or newly constructed within two years of the sale of the original property. This law limits base year value transfers to one per taxpayer; however, the Legislature added a sole exception to the one-time limit for a taxpayer who claims the benefit first as a person 55 years of age or older, and subsequently becomes disabled (SB 1692 (Petris), 1996). In that case, the taxpayer can transfer the base year value from the original home twice; however, the law does not similarly treat a taxpayer who initially claims the transfer a disabled person cannot then subsequently claim another benefit after they turn 55. The Legislature approved SB 246 (Bates), 2017, which would have allowed a second transfer for a disabled person after he/she turns 55; however, Governor Brown vetoed the measure.

Contamination-Related Transfers (All Property Types). In November 1998, voters approved Proposition 1 which allows a taxpayer to transfer the base year value of qualified contaminated property to a replacement or newly constructed property of equal or lesser value than the value of the contaminated property if that property was not contaminated. (Proposition 1, 1998.)

Revenue and Taxation Code Section 69.4 sets forth the details for transfers of qualified contaminated property.

Proposed Initiative Summary

On September 25, 2017, Attorney General Xavier Becerra prepared the title and summary for Initiative No. 17-0013, as follows:

> CHANGES REQUIREMENTS FOR CERTAIN PROPERTY OWNERS TO TRANSFER THEIR PROPERTY TAX BASE TO REPLACEMENT PROPERTY. INITIATIVE CONSTITUTIONAL AMENDMENT AND STATUTE.
>
> Removes the following current requirements for homeowners who are over 55 years old or severely disabled to transfer their property tax base to a replacement residence: that replacement property be of equal or lesser value, replacement residence be in a specific county, and the transfer occur only once. Removes similar replacement-value and location requirements on transfers for contaminated or disaster-destroyed property. Requires adjustments to the replacement property's tax base, based on the new property's value.

Included with the title and summary is an estimate of the proposed initiative's fiscal impact from the Legislative Analyst's Office (LAO) and the Director of Finance, which reads:

> Annual property tax losses for cities, counties, and special districts of around $150 million in the near term, growing over time to $1 billion or more per year (in today's dollars). Annual property tax losses for schools of around $150 million per year in the near term, growing over time to $1 billion or more per year (in today's dollars). Increase in state costs for schools of an equivalent amount in most years.

Initiative 17-0013 amends Section Two of Article XIIIA of the California Constitution to allow disabled taxpayers or those over the age of 55 to:

- Claim an infinite number of base year value transfers;
- Transfer base year values to other counties regardless of whether the county in which the replacement property is located has approved an ordinance allowing the transfer;
- Allow a base year value transfer to a property of equal or greater value as long as the difference in value between the sales price of the original property and the sales price of

the replacement property is subsequently added to the base year value. For example, if the original property has a base year value of $230,000 sells for $400,000 and the taxpayer purchases a $500,000 replacement property, its new base year value is $330,000 ($500,000 - $400,000 = $100,000 + $230,000 = $330,000); and,

- Alter the method for determining the value of a replacement property of equal or lesser value to produce additional tax reductions. Instead of simply transferring the base year value from the original property to the replacement, the base year value of the original property is further reduced under a formula set forth in the proposed initiative that increases the tax reduction in accordance with the taxpayer's current difference between assessed and market value. The formula provides that the base year value is divided by the sales price of the original property to derive a percentage, which is then multiplied by the base year value. Using the example above, except that the taxpayer purchases a $300,000 replacement property instead of a $500,000 one, his/her new base year value is $132,500 ($230,000/$400,000 = 57% x $230,000 = $132,500). As a result, the taxpayer pays $1,325 annually in property taxes at the one percent rate because he/she moved, instead of $2300 if he/she had stayed.

Initiative 17-0013 makes similar changes to the California Constitution's provisions for disaster base year value transfers to:

- Allow base year value transfers to other counties regardless of whether the county in which the replacement property is located has approved an ordinance allowing the transfer;
- Remove the requirement that the replacement property be comparable to the original property; and,
- Apply the same adjustments specified above when the taxpayer acquires a property of greater or lesser value.

Initiative 17-0013 also makes conforming changes to the California Constitution's provisions for contaminated property base year value transfers, including to:

- Allow the transfer to replacement property of equal or greater value than the contaminated property's value if that property were not contaminated;
- Permit base year value transfers to other counties; and,
- Apply the same adjustments specified above when the taxpayer acquires a property of greater or lesser value.

Initiative 17-0013 also makes changes to R&TC Section 69.5 related to Propositions 60, 90, 110 to:

- Delete the restriction of one base year value transfer per taxpayer;
- Replace references to "claimant" with "person";
- Conform with the proposed initiative's Constitutional changes; and,

- Require future amendments to R&TC Section 69.5 to be approved by a 2/3 vote so long as the amendments are consistent with and further this proposed initiative's intent.

Initiative 17-0013, however, does *not* make any changes to the following R&T Code provisions related to Propositions 50, 171, and 1:

- R&TC Section 69 implements disaster base year value transfers within the same county;
- R&TC Section 69.3 guides disaster base year value transfers to other counties; and,
- R&TC Section 69.4 controls transfers of qualified contaminated property.

Initiative 17-0013 does *not* amend Article XIIIA, Section 2(d) and its implementing provisions set forth in R&TC Section 68, which relates to base year value transfer provisions for property owners that are displaced by eminent domain, acquisition by public entity, or inverse condemnation. These base year value transfer provisions apply to any comparable property. (Proposition 3, June 1982.)

The proposed initiative applies to transfers occurring on or after January 1, 2019, and also makes technical and conforming changes.