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INITIATIVE COORDINATOR
ATTORNEY GENERAL'S OFFICE

Hon. Rob Bonta
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Anabel Renteria
Initiative Coordinator

Dear Attorney General Bonta:

Pursuant to Elections Code Section 9005, we have reviewed the proposal constitutional initiative (A.G. File No. 21-0015, Amendment #1) related to property tax assessment.

Background

Local Governments Collect Property Taxes From Property Owners. California local governments—cities, counties, schools, and special districts—levy property taxes on property owners. Property taxes are paid based on the taxable value of the property. Property taxes are a major revenue source for local governments, raising about $75 billion per year statewide.

How Is a Property Tax Bill Calculated? Each property owner's annual property tax bill is equal to the taxable value of their property multiplied by their property tax rate. The typical property owner's property tax rate is 1.1 percent. In the year a new owner takes over a property, its taxable value typically is its purchase price. Each year after that, the property's taxable value is adjusted for inflation by up to 2 percent. When a property changes ownership again, its taxable value is reset to its new purchase price.

Property Taxes Increase When a Property Changes Ownership. The taxable value of most properties is less than what they could be sold for. This is because, in most years, the price most properties could sell for grows faster than 2 percent per year. Because of this, a property's taxable value often resets to a higher amount when it changes ownership. This leads to a higher property tax bill for that property. This means people who move usually end up paying higher property taxes for their new home than they paid for their old home.

Special Rules for Some Inherited Properties. Special rules also allow some properties to pass between parents and children without an increase in the property tax bill. These rules also apply to grandparents and grandchildren if the grandchildren's parents are deceased. We call properties passed between parents and children or grandparents and grandchildren "inherited property."

Voters Recently Limited Special Rules for Inherited Properties. Proposition 19, approved by the voters in 2020, narrowed the special rules for inherited property. Specifically, beginning February 16, 2021, Proposition 19:

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- ***Ended Special Rules for Properties Not Used as a Primary Home or for Farming.*** The special rules now only apply to two types of properties: (1) homes that a child or grandchild uses as a primary residence and (2) farms. Prior to Proposition 19, the rules applied to all types of inherited properties, including vacation homes and business properties.
- ***Required Tax Bill to Go Up for High Value Inherited Homes and Farms.*** The property tax bill for an inherited home or farm goes up if the price the property could be sold for exceeds the property's taxable value by more than $1 million. In this case, the tax bill goes up but not as much as it would if the property were sold to someone else. Prior to Proposition 19, these rules did not limit the value of inherited homes but did limit the value of all other property to $1 million.

Proposition 19 Increased Revenue for Local Governments. By narrowing the special rules for inherited properties, Proposition 19 leads to higher property tax bills for some inherited properties. This increases property taxes for local governments and schools. Over the next few years, schools and local governments each probably will gain hundreds of millions of dollars per year. Over time, these gains will grow resulting in schools and other local governments each gaining $1 billion or more per year.

PROPOSAL

The measure amends the State Constitution to expand the special rules for inherited property and offset local government revenue losses from other recent property tax changes.

Expands Special Rules for Inherited Property Exclusion. The measure makes all types of inherited properties eligible for the special rules. Currently only inherited primary homes and farms are eligible.

Removes Cap on Transfer Value for Inherited Homes. The measure removes the cap on the value of a primary home that can be transferred under the special rules.

Limits Combined Transfer Value for All Other Properties. For all other properties, the measure limits the combined taxable property value that can be transferred under the special rules to $2.4 million.

Requires State to Cover Local Costs of Other Recent Property Tax-Related Changes. Higher property taxes from Proposition 19's limits on inherited property transfers help replace property tax losses of schools and local governments from other changes that provided property tax savings to homeowners over 55 years old when they move. Under this measure, those revenues would not be available for schools and local governments. Instead, the state General Fund would transfer money to schools and local governments to cover their losses from the other recent changes.

FISCAL EFFECTS

Increased State Costs to Cover Other Property Tax Revenue Losses. State costs would increase under the measure to cover school and local government property tax losses from other recent changes. In the first few years, these new state costs would be hundreds of millions of dollars per year. These costs would grow over time, possibly to $1 billion or more per year.

Reduced Funding for Local Governments and Schools. The measure has different effects on funding for local governments and schools. We describe two important effects below. Overall, after accounting for increased state funding, funding for local governments and schools probably would decline. In the first few years, local governments would lose tens of millions of dollars per year. Over time, these losses would grow to hundreds of millions of dollars per year. Schools would have losses of similar amounts.

- ***Reduced Property Taxes.*** Removing limits on inherited property transfers would lower property taxes for some inherited properties. In turn, this would reduce property taxes for local governments and schools.
- ***Increases State Funding.*** Local governments and schools would receive additional state funding to cover their property tax losses from other recent changes.

State Appropriations Limit Consideration. The State Constitution limits how much tax revenues the state can spend each year. However, certain types of spending are excluded from the limit. This includes unrestricted funding to local governments, which are counted instead at the local level. In recent years, this limit has been an important consideration in state budgeting decisions. This measure would increase the amount the state distributes to local governments by hundreds of millions of dollars. As a result, the measure would somewhat increase the amount of revenue the state spends on purposes excluded from the limit. Spending more on purposes excluded from the limit would reduce the chances the state spends revenues in excess of the limit. Revenues in excess of the limit, over a two-year period, trigger a requirement for taxpayer rebates and additional school payments.

Summary of Fiscal Effects.

- Increased state costs of hundreds of millions of dollars per year to cover recent local government property tax losses. These costs would grow over time, possibly to $1 billion or more per year.
- Local government funding would decline by tens of millions of dollars per year. Over time, these losses would grow to hundreds of millions of dollars per year. Schools would have losses of similar amounts.

Sincerely,

Carolyn Chu

for Gabriel Petek
Legislative Analyst

Ken Kroeger

for Keely Martin Bosler
Director of Finance