



THE CENTER FOR STATE AND LOCAL TAXATION

The Future of the Property Tax

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“The property tax is likely to remain a shelter from the perfect fiscal storm for the future, perhaps reversing its recent decline in importance.”

Frank Shafroth,
“The Tax Doctor”
State Tax Notes,
August 25, 2003



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Outline

- National Trends
- California Trends
- Future California Reforms
 - Split Roll
 - Swap
 - AB 8 Reform



National Trends: Role in State Revenue Systems

- 20th century decline of property tax share of state revenues
- Reversal of trend due to
 - school finance litigation and reform
 - erosion of the sales and use tax base
 - volatility of the income tax
 - challenges posed by an increasingly borderless global economy



National Trends: Examples

- Michigan introduced a state property tax in 1994. It represented 8% of state revenue in 2001.
- Vermont introduced its state property tax in 1997. It represented 23.7% of state revenue in 2001.
- New Hampshire introduced a state property tax in 1999. It represented 26.1% of state revenue in 2001.



National Trends: 2003 Proposals

- Maryland – increase state property tax
- New Mexico – raise state property tax for schools
- Texas – convert local property tax to state tax
- Utah – increase state reliance on property tax
- Washington – raise state property tax rate
- Wyoming – new state property tax for school construction



National Trends: Role in Local Revenue Systems

- the property tax constituted 70% of total local government revenue in the 1920's
- property tax share of local revenues fell to 40% in the 1950's and 1960's
- it fell further to 25% in the 1980's but has since stabilized

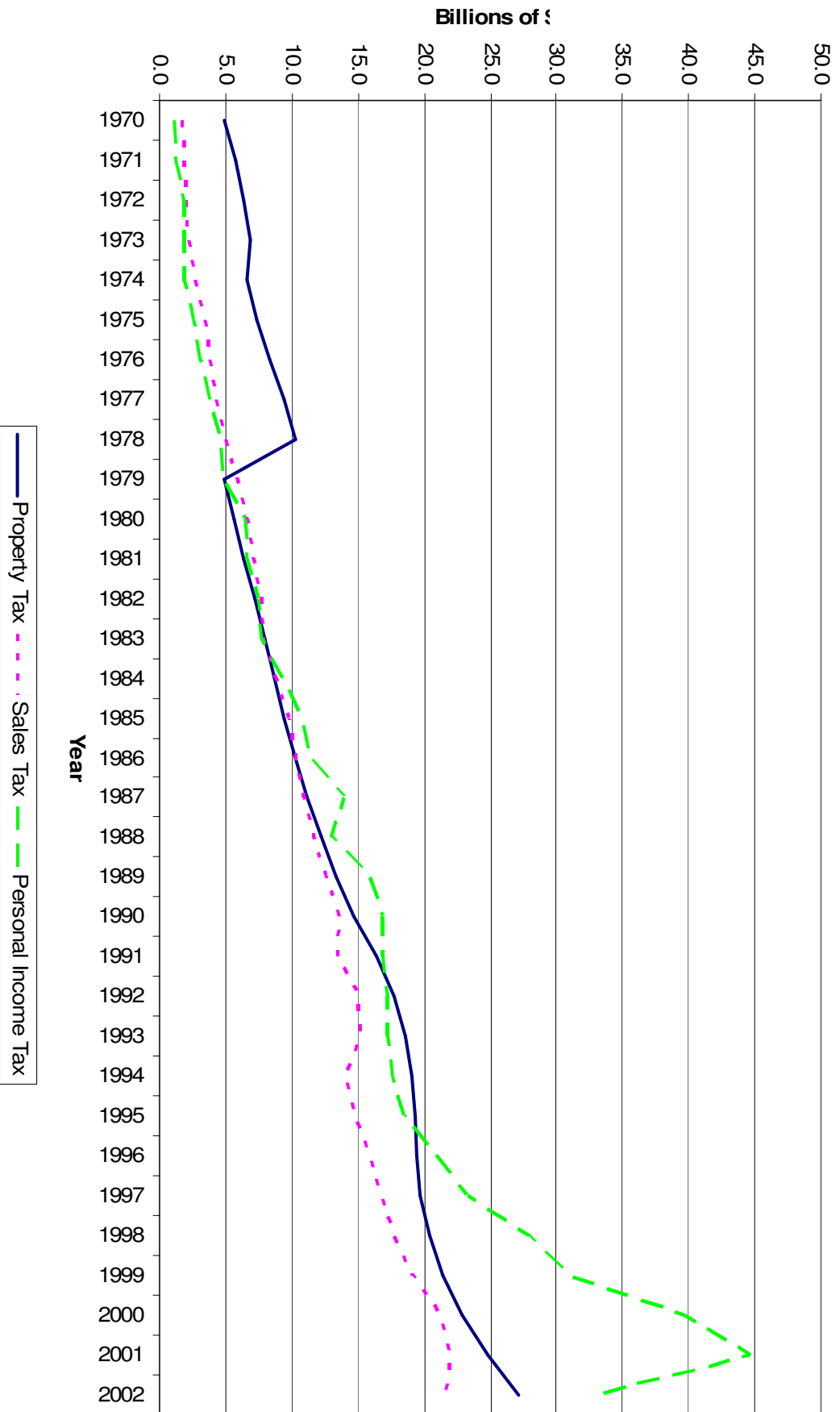


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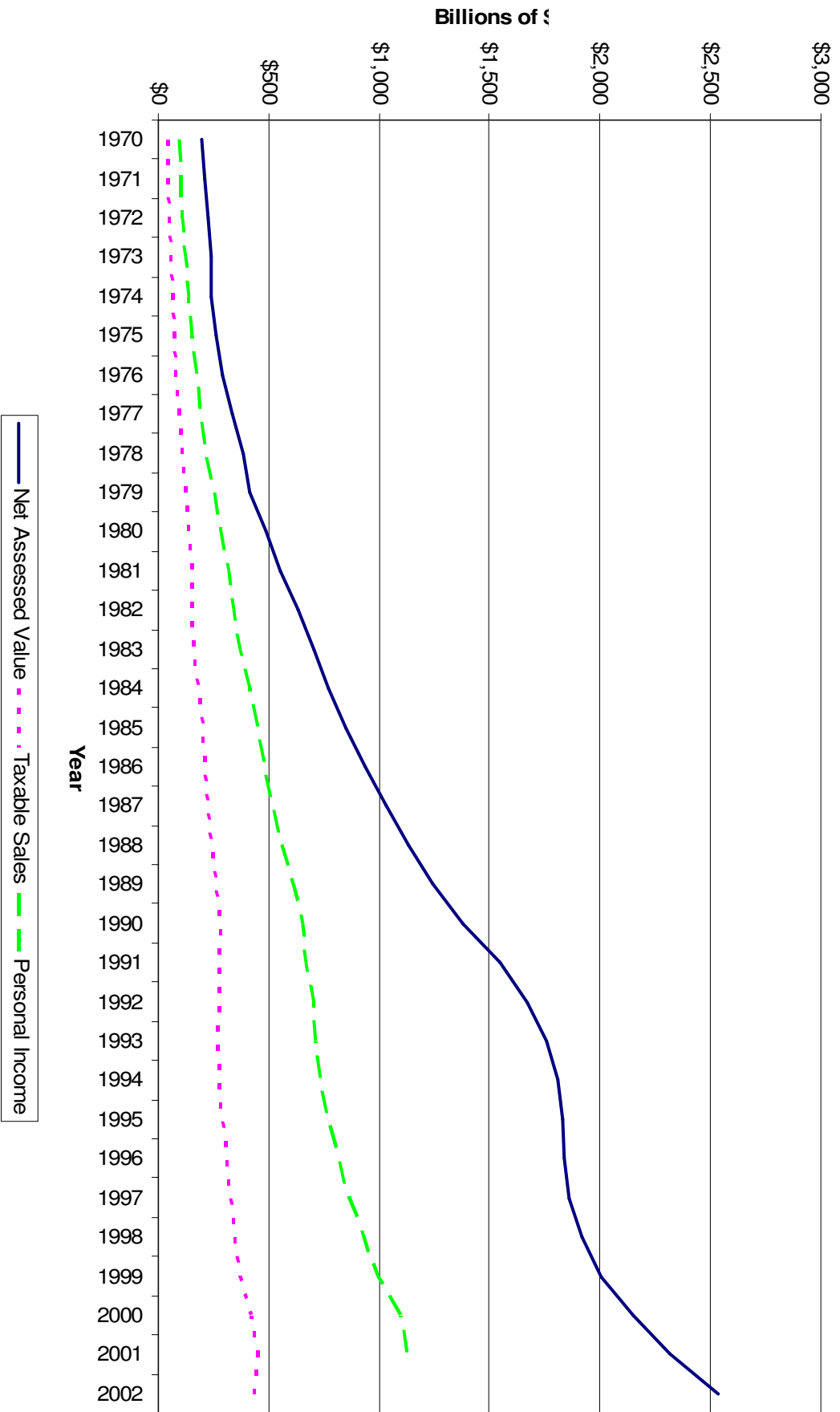
California Trends

- California tax revenues
- California tax bases
- Tax base growth
- Property tax as a percentage of city and county revenue

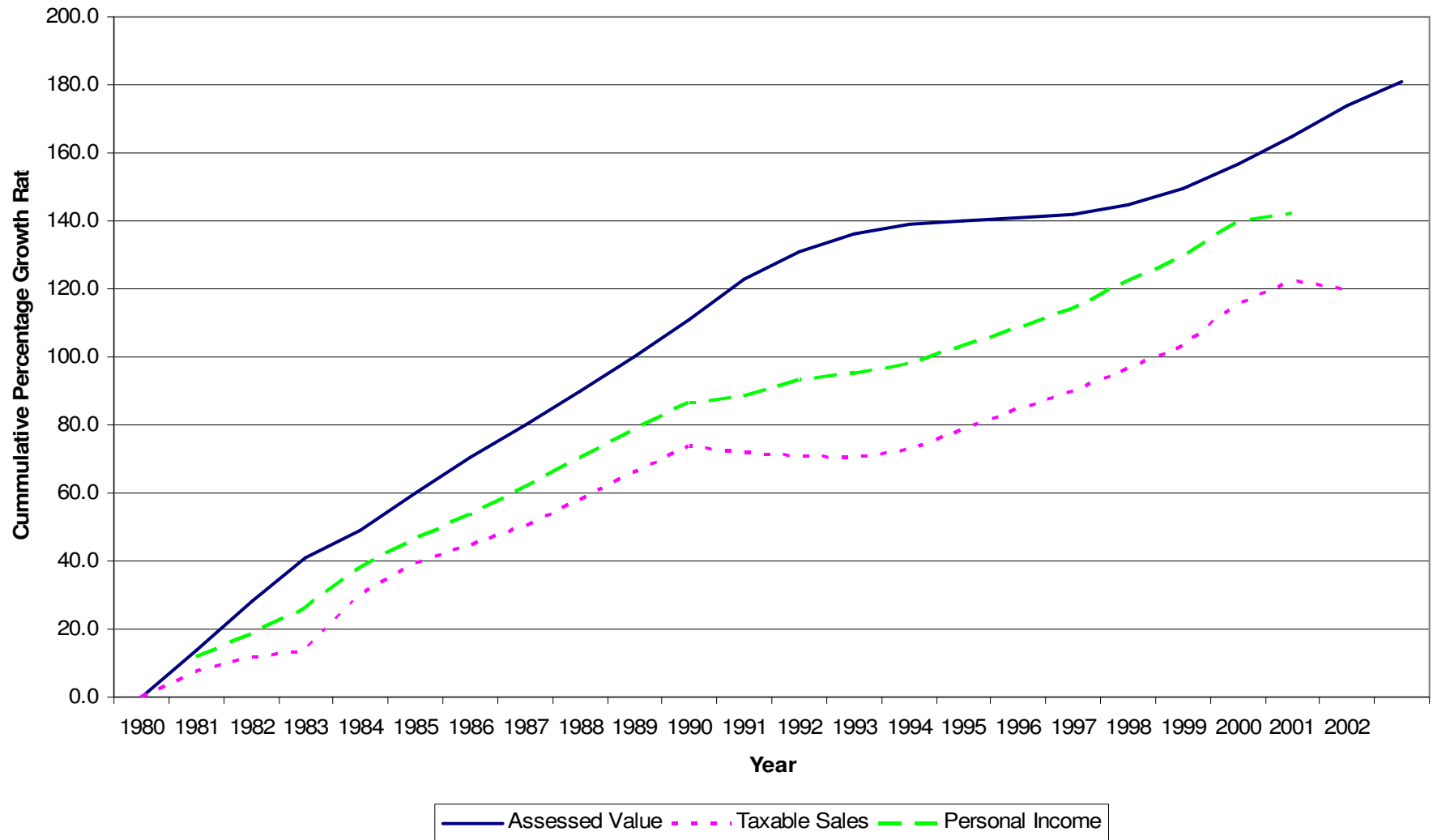
California Tax Revenues



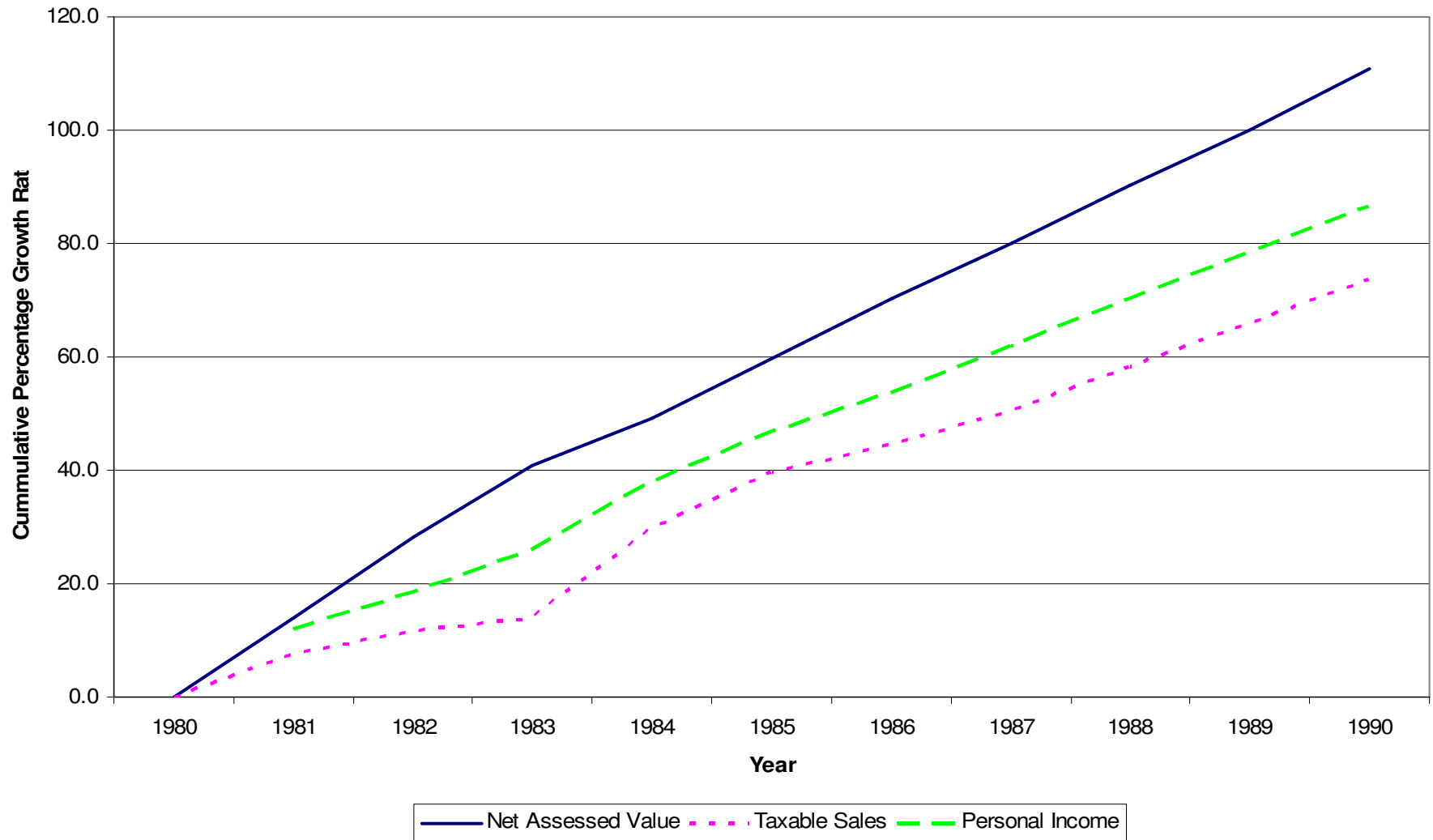
California Tax Bases



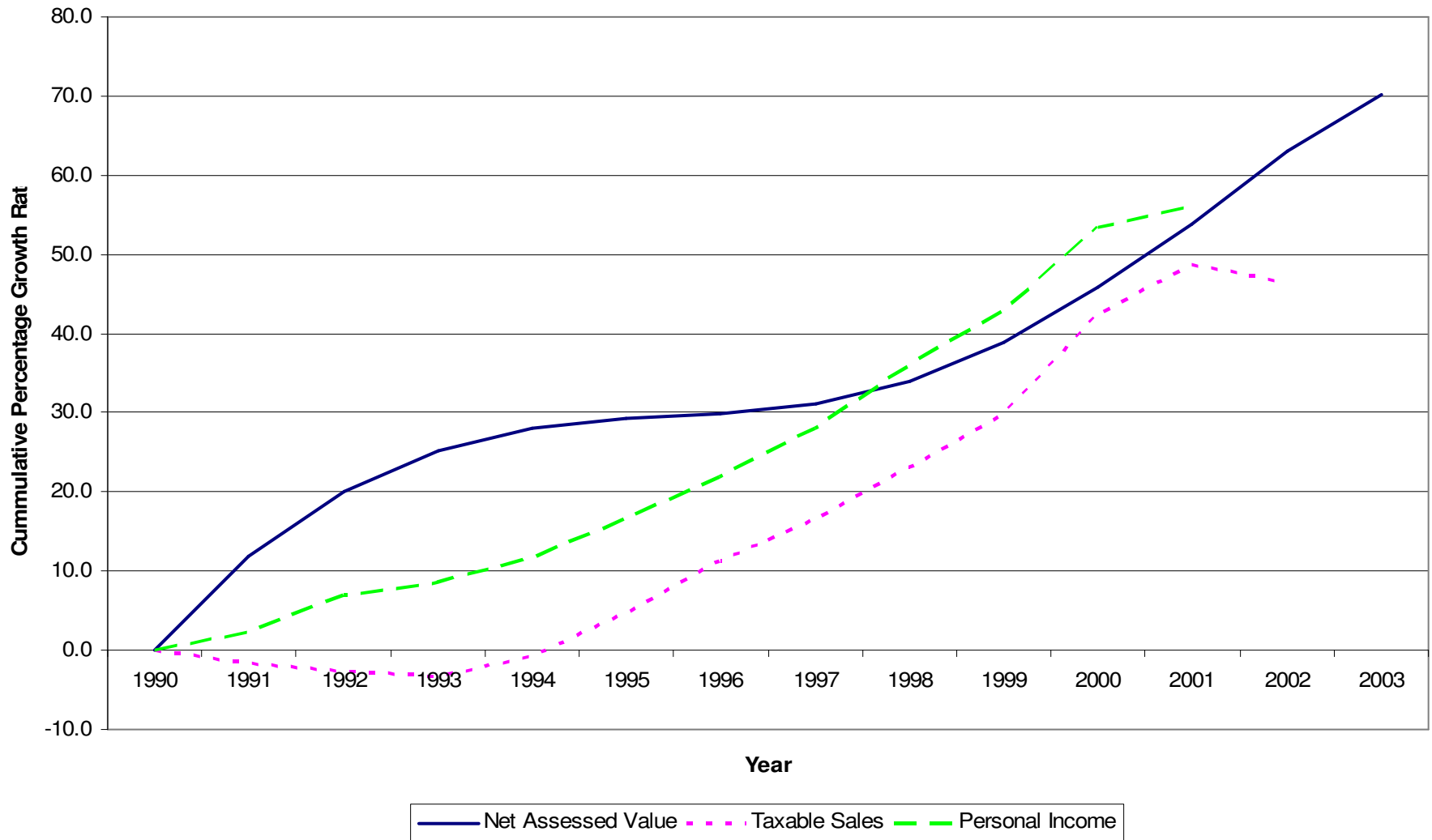
Cummulative Growth in Tax Bases Since 1980



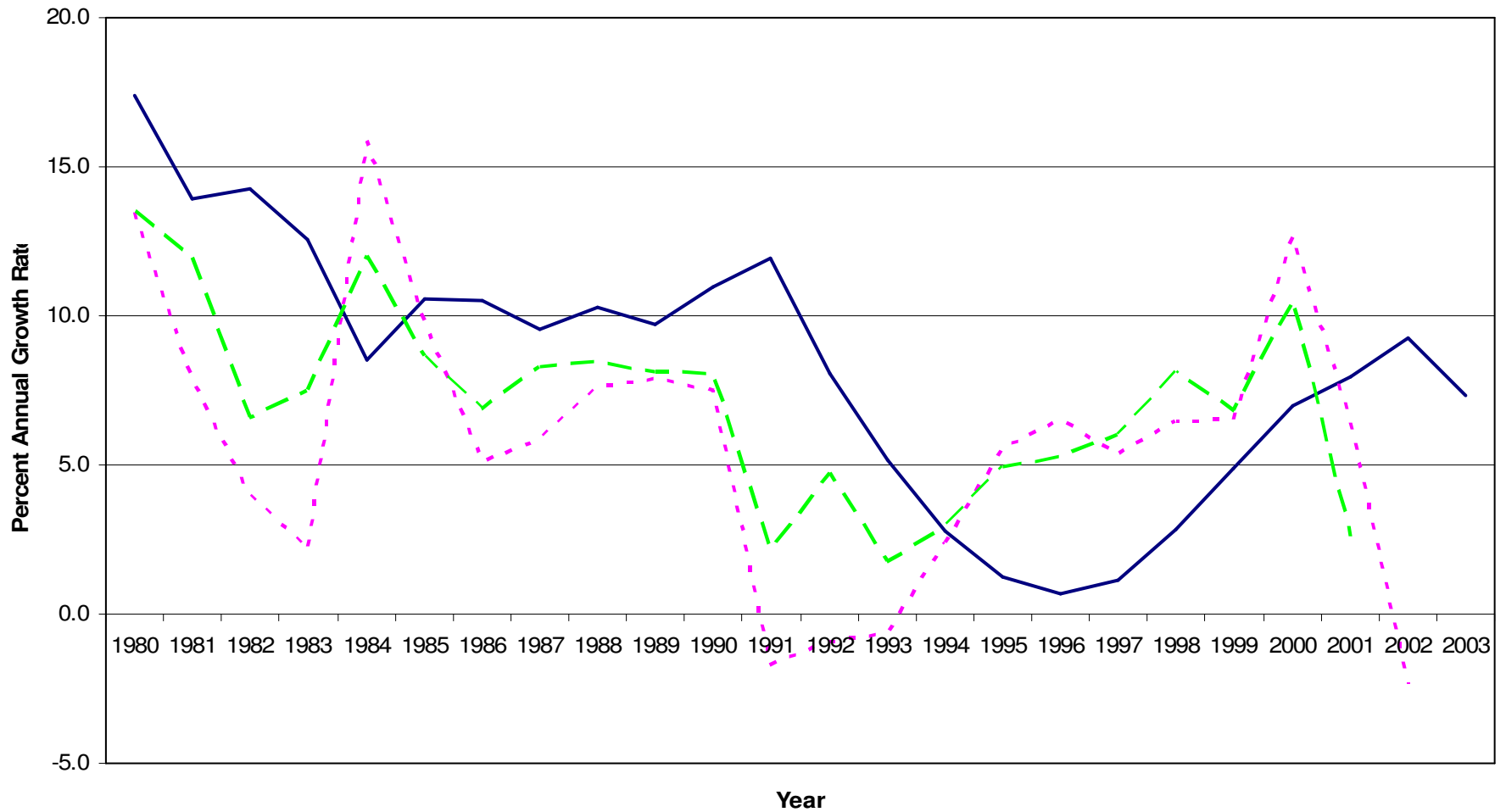
Cumulative Growth in Tax Bases 1980-1990



Cummulative Growth in Tax Bases 1990-2002

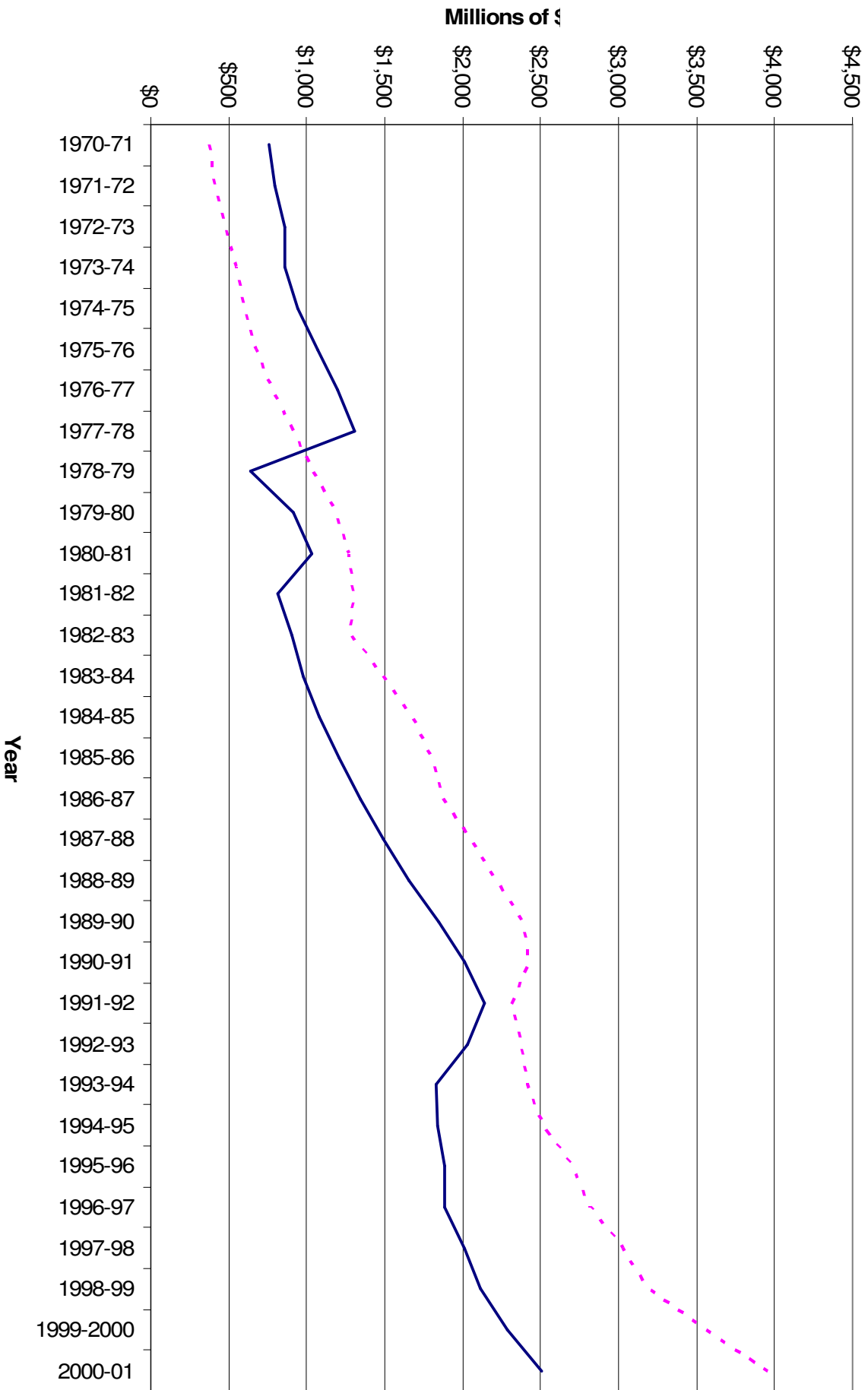


Annual Tax Base Growth (Volatility)

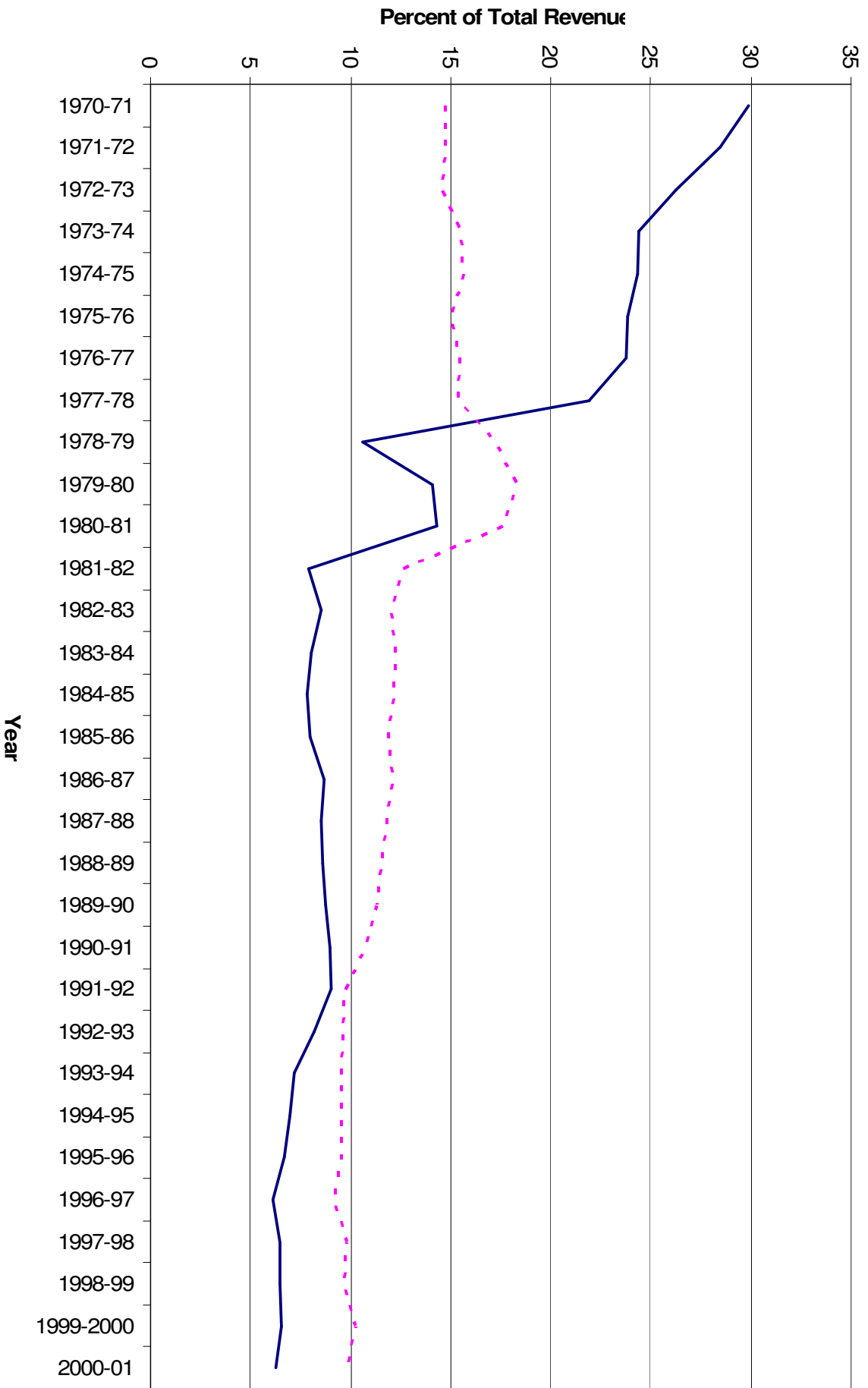


— Assessed Value - - - Taxable Sales - - - Personal Income

City Tax Revenue

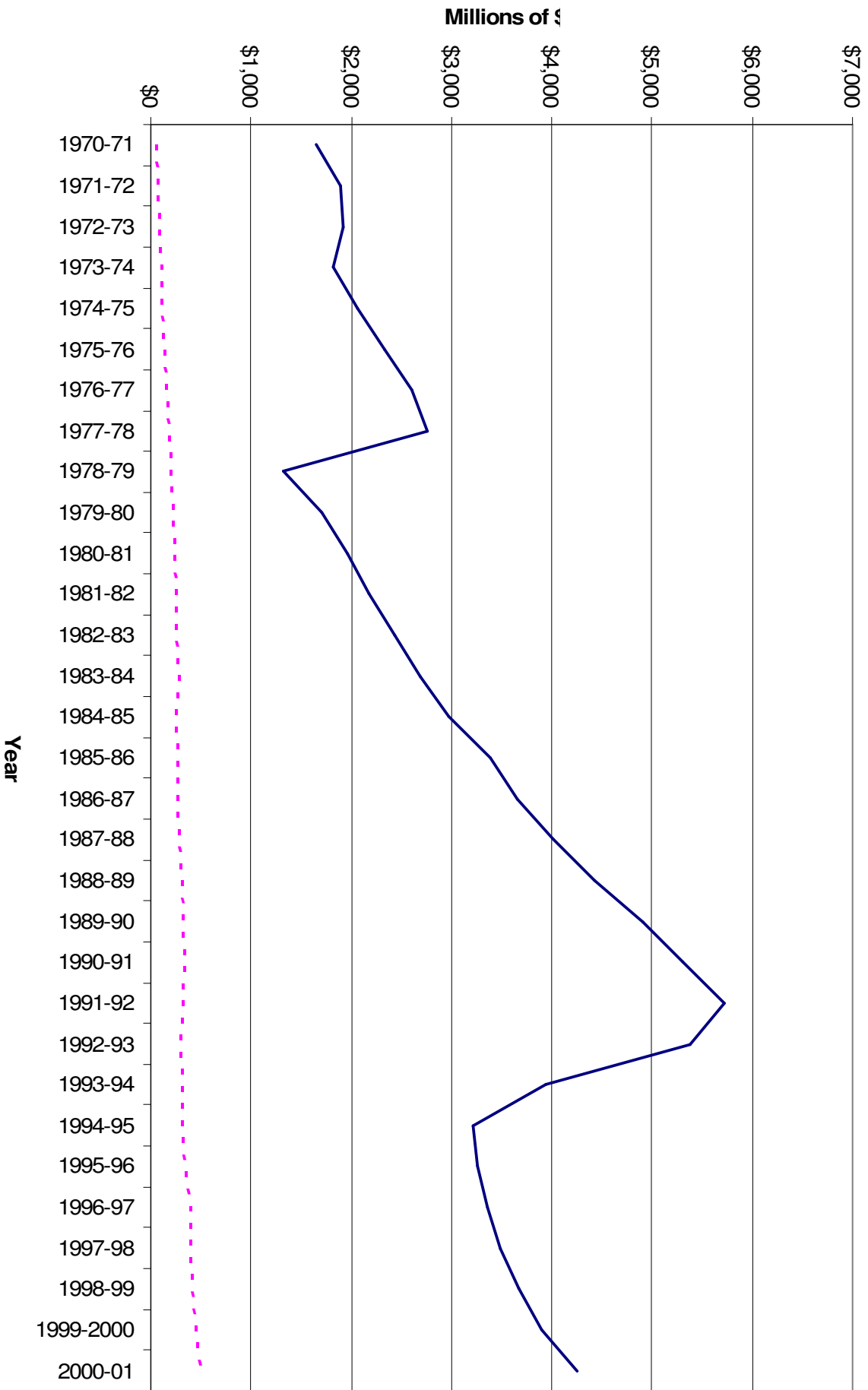


Taxes as Percent of Total City Revenue

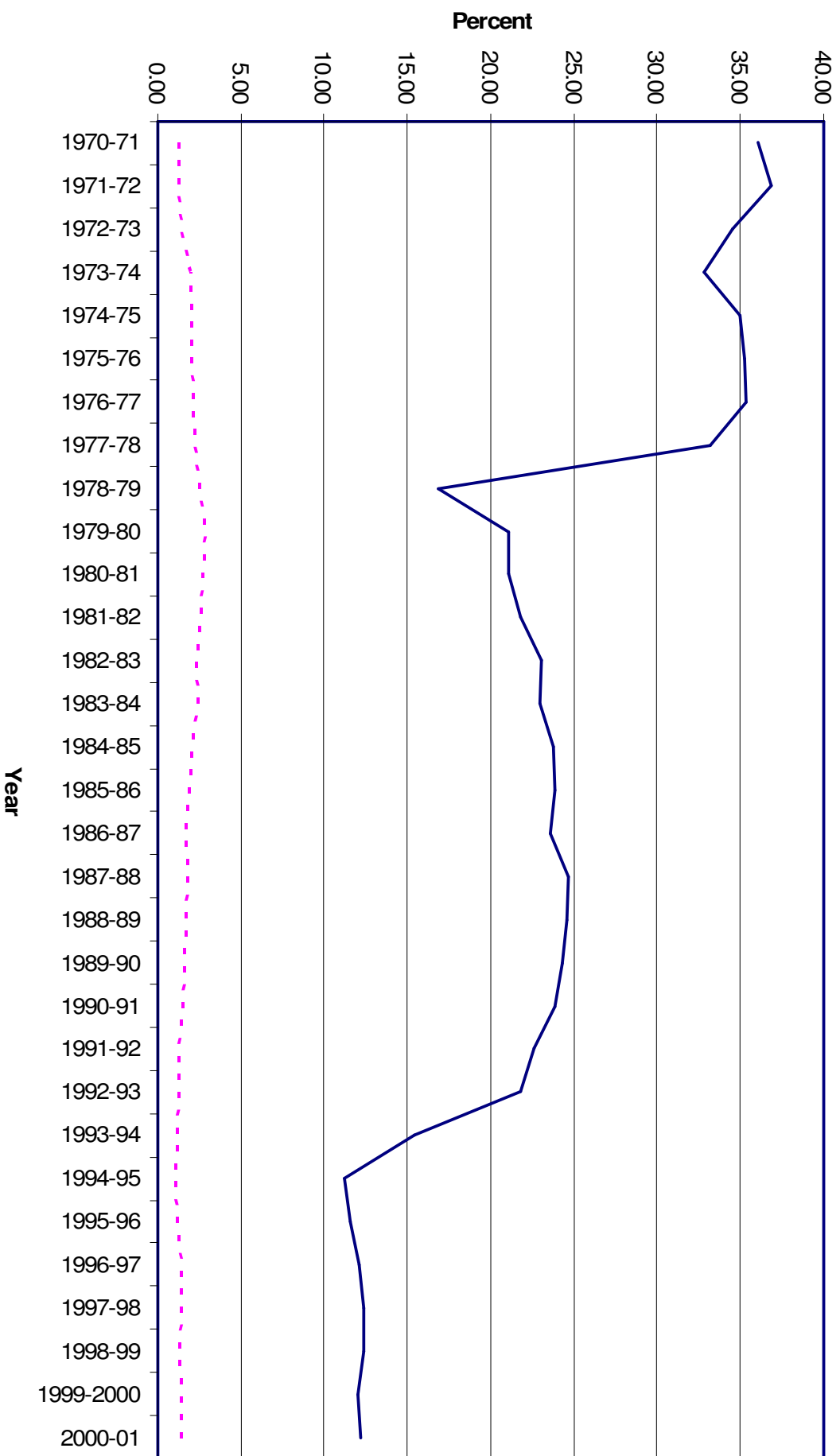


Property Tax
Sales and Use Tax

County Tax Revenues



County Taxes as Percent of Total County Revenue





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Future California Reforms: Split Roll

Advantages

- Levels the playing field for business
- Encourages better and higher uses for commercial property
- Increased revenue

Disadvantages

- Requires a constitutional amendment
- Increases tax burden on business



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Property Tax Burden on Homeowners

Year	AV of HOE Properties as % of All	Year	AV of HOE Properties as % of All
1979-80	32.0	1991-92	32.4
1980-81	33.8	1992-93	33.7
1981-82	33.2	1993-94	34.9
1982-83	32.5	1994-95	36.4
1983-84	31.8	1995-96	37.3
1984-85	31.3	1996-97	37.8
1985-86	31.0	1997-98	37.8
1986-87	31.1	1998-99	38.1
1987-88	31.3	1999-00	38.2
1988-89	31.6	2000-01	38.2
1989-90	32.2	2001-02	38.1
1990-91	32.1		

Assessed value excluding all exemptions. Includes business inventories for year in which they appeared on tax roll (1979-80) but not subsequent years when they no longer appeared on the tax roll (1980-81 and after).



Differential Treatment of Business Property in Other States:

- Florida assesses homeowner property at acquisition value and all other property at market value
- 25 states use classification systems
 - 15 of these assess homeowner property at a lower percentage of market value than other property
 - 4 of these tax homeowner property at a lower rate than other property



Future California Reforms: Sales Tax/Property Tax Swap

The “Triple Flip”

Beginning in 2004-05 the California Fiscal Recovery Financing Act

- Redirects local sales tax (.5%) to the state to use to repay deficit reduction bonds
- Shifts an equal \$ amount of property taxes from ERAF to cities and counties
- Increases state education apportionments to mitigate school revenue losses of ERAF funds

This swap ends after deficit bonds are repaid



AB 1221 (Steinberg and Campbell)

- Local sales and use tax rate would be reduced by .5%
- Lost sales tax revenues would be replaced with property tax revenues from County ERAF
- State sales and use tax rate would increase by .5% with additional funds sent to schools to cover ERAF reduction
- Each city's and the county share of property tax would change (increase) and relative shares would change
- In subsequent years each city and county would get the amount received in the previous year plus a share of the property tax attributable to growth in assessed value within their jurisdiction
- Each agency's share would be based on its new, increased base amount relative to that of other agencies in their jurisdiction



Effects of AB 1221 Swap

- Historical patterns suggest California local governments will be better off with more property tax and less sales tax
- If future property tax growth rates exceed sales tax growth rates, cities and counties will gain from the swap (property tax estimated to grow 8% for 2003-4 and sales tax 3.9%)
- Cities less likely to gain would be those whose future growth involves a large amount of retail development and those with a large proportion in redevelopment
- Property tax allocation would be further complicated
- Swap would improve revenue diversity and economic stability



Future California Reforms: AB 8 Reform

- Based on taxing and spending patterns from 25 years ago
- Extremely complex—understood by few!
- Possible reforms:
 - Update to a new statewide fixed formula
 - Introduce a flexible formula that would reflect changing demographics
 - Allow each county to negotiate its own allocation formula that would reflect its unique circumstances



Conclusion

The property tax will persist because:

- It is a proven, relatively stable, revenue raiser
- Land, an essential element of the property tax base, is immobile and thus, ideally suited for local taxation
- The major alternatives, sales and income taxes, both have flaws as local taxes and are more sensitive to the business cycle