10-10-2018

Changes Requirements for Certain Property Owners When Transferring Their Property Tax Base to Replacement Property. Initiative Constitutional Amendment and Statute

October 9, 2018
Initiative 18-0006 (Amdt. #1)

The Attorney General of California has prepared the following title and summary of the chief purpose and points of the proposed measure:

CHANGES REQUIREMENTS FOR CERTAIN PROPERTY OWNERS WHEN TRANSFERRING THEIR PROPERTY TAX BASE TO REPLACEMENT PROPERTY. INITIATIVE CONSTITUTIONAL AMENDMENT AND STATUTE.

Removes the following requirements for homeowners who are over 55 or severely disabled to transfer property tax base to replacement residence: that replacement property be of equal or lesser value; that replacement property be in an eligible county; and that transfer occur only once. Removes location and replacement-value requirements on transfers of contaminated or disaster-destroyed property. Adjusts replacement property's tax base, based on market value. Limits tax benefit for eligible familial transfers. Expands circumstances triggering corporate property reassessment. Summary of estimate by Legislative Analyst and Director of Finance of fiscal impact on state and local governments: **Local governments and schools each could gain or lose low tens of millions of dollars of property tax revenue per year, likely growing over time. State school spending would increase (decrease) by an amount similar to school property tax losses (gains). Other local and state revenues each could increase by tens of millions of dollars per year. County property tax administration costs likely would increase by tens of millions of dollars per year.** (18-0006)

18 - 0006 Amdt. # 1

CALIFORNIA ASSOCIATION OF REALTORS®

August 30, 2018

Anabel Renteria, Initiative Coordinator
Office of the Attorney General
1300 I Street, 17th Floor
Sacramento, CA 95814

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AUG 30 2018

INITIATIVE COORDINATOR
ATTORNEY GENERAL'S OFFICE

Re: 18-0006 Replacement Property 2020

Dear Ms. Renteria:

I am writing to submit enclosed amendments to the above referenced initiative, which was submitted to the Attorney General for preparation of title and summary.

The amendments are as follows:

1. Subdivision (c)(5) relating to rain water capture systems should not have been underlined as it is already a part of the state constitution.

2. Subdivision (h)(1) was amended to clarify that the value of the intergenerational transfer exclusion is limited to one million dollars.

3. Subdivision (h)(3) was amended to specify that adjustment of the one-million-dollar exclusion for intergenerational transfers should commence in 2022 not 2021.

The amendments are highlighted in yellow in the enclosed document.

I respectfully request that the Attorney General prepare a title and summary for the amended language.

If you have any questions, please contact Christopher C. Carlisle, 1121 L Street, Suite 600, Sacramento, CA 95814; (916) 492-5200.

Sincerely,

Alexander E. Creel
Senior Vice-President Government Affairs

Enclosure

November 2020 Version with Amendments

SECTION 1. Section 2 of Article XIII A of the State Constitution is amended to read:

SEC. 2. (a) (1) The "full cash value" means the county assessor's valuation of real property as shown on the 1975-76 tax bill under "full cash value" or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment. All real property not already assessed up to the 1975-76 full cash value may be reassessed to reflect that valuation. For purposes of this section, "newly constructed" does not include real property that is reconstructed after a disaster, as declared by the Governor, where the fair market value of the real property, as reconstructed, is comparable to its fair market value prior to the disaster. For purposes of this section, the term "newly constructed" does not include that portion of an existing structure that consists of the construction or reconstruction of seismic retrofitting components, as defined by the Legislature.

~~However, the~~

(2) On and after November 5, 1986, and until January 1, 2021, the Legislature may provide that, under appropriate circumstances and pursuant to definitions and procedures established by the Legislature, any person over the age of 55 years who resides in property that is eligible for the homeowner's exemption under subdivision (k) of Section 3 of Article XIII and any implementing legislation may transfer the base year value of the property entitled to exemption, with the adjustments authorized by subdivision (b), to any replacement dwelling of equal or lesser value located within the same county and purchased or newly constructed by that person as his or her principal residence within two years of the sale of the original property. ~~For~~

(3) (A) For purposes of this section, ~~"any~~ the following definitions shall apply:

(i) "Any person over the age of 55 years" includes a married couple, one member of which is over the age of 55 years. ~~For purposes of this section, "replacement~~

(ii) "Replacement dwelling" means a building, structure, or other shelter constituting a place of abode, whether real property or personal property, and any land on which it may be situated. For purposes of this section, a two-dwelling unit shall be considered as two separate single-family dwellings. ~~This~~

(B) This paragraph shall apply to any replacement dwelling that was purchased or newly constructed on or after November 5, 1986.

~~In addition, the~~

(4) On and after November 9, 1988, and until January 1, 2021, the Legislature may authorize each county board of supervisors, after consultation with the local affected agencies within the county's boundaries, to adopt an ordinance making the provisions of this subdivision relating to transfer of base year value also applicable to situations in which the replacement dwellings are located in that county and the original properties are located in another county within this State. For purposes of this paragraph, "local affected agency" means any city, special district, school district, or community college district that receives an annual property tax revenue allocation. This paragraph applies to any replacement dwelling that was purchased or newly constructed on or after the date the county adopted the provisions of this subdivision relating to transfer of base year value, but does not apply to any replacement dwelling that was purchased or newly constructed before November 9, 1988.

~~The~~

(5) On and after June 6, 1990, and until January l, 2021, the Legislature may extend the provisions of this subdivision relating to the transfer of base year values from original properties to replacement dwellings of homeowners over the age of 55 years to severely disabled homeowners, but only with respect to those replacement dwellings purchased or newly constructed on or after the effective date of this paragraph.

(6) (A) On and after January 1, 2021, subject to applicable procedures and definitions as provided by statute, the base year value of property that is eligible for the homeowner's exemption under subdivision (k) of Section 3 of Article XIII of any person over 55 years of age or any severely disabled homeowner shall be transferred to any replacement dwelling, regardless of the number of prior transfers or the value of the replacement dwelling or whether the replacement dwelling is located within the same county, that is purchased or newly constructed by that person as his or her principal residence within two years of the sale of the original property.

(B) For purposes of this paragraph, the following shall apply:

(i) For any replacement dwelling of greater value and purchased or newly constructed by a person eligible to transfer the base year value of his or her original property, the base year value of the replacement dwelling shall be calculated by adding the difference between the full cash value of the original property and the full cash value of the replacement dwelling to the base year value of the original property.

(ii) For any replacement dwelling of equal or lesser value purchased or newly constructed by a person eligible to transfer the base year value of his or her original property, the base year value of the replacement dwelling shall be calculated by dividing the base year value of the original property by the full cash value of the replacement property, and multiplying the result by the full cash value of the replacement dwelling.

(b) The full cash value base may reflect from year to year the inflationary rate not to exceed 2 percent for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction, or may be reduced to reflect substantial damage, destruction, or other factors causing a decline in value.

(c) For purposes of subdivision (a), the Legislature may provide that the term "newly constructed" does not include any of the following:

(1) The construction or addition of any active solar energy system.

(2) The construction or installation of any fire sprinkler system, other fire extinguishing system, fire detection system, or fire-related egress improvement, as defined by the Legislature, that is constructed or installed after the effective date of this paragraph.

(3) The construction, installation, or modification on or after the effective date of this paragraph of any portion or structural component of a single- or multiple-family dwelling that is eligible for the homeowner's exemption if the construction, installation, or modification is for the purpose of making the dwelling more accessible to a severely disabled person.

(4) The construction, installation, removal, or modification on or after the effective date of this paragraph of any portion or structural component of an existing building or structure if the construction, installation, removal, or modification is for the purpose of making the building more accessible to, or more usable by, a disabled person.

(5) The construction or addition, completed on or after January 1, 2019, of a rain water capture system, as defined by the Legislature.

(d) For purposes of this section, the term "change in ownership" does not include the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from the property replaced by eminent domain proceedings, by acquisition by a public entity, or governmental action that has resulted in a judgment of inverse condemnation. The real property acquired shall be deemed comparable to the property replaced if it is similar in size, utility, and function, or if it conforms to state regulations defined by the Legislature governing the relocation of persons displaced by governmental actions. This subdivision applies to any property acquired after March 1, 1975, but affects only those assessments of that property that occur after the provisions of this subdivision take effect.

(e) (1) (A) Notwithstanding any other provision of this section, the Legislature shall provide that the base year value of property that is substantially damaged or destroyed by a disaster, as declared by the Governor, may be transferred to comparable property within the same county that is acquired or newly constructed as a replacement for the substantially damaged or destroyed property.

~~(2)~~

(B) Except as provided in ~~paragraph (3), this subdivision~~ subparagraph (C), this paragraph applies to any comparable replacement property acquired or newly constructed on or after July 1, 1985, until January 1, 2021, and to the determination of base year values for the 1985-86 fiscal year and fiscal years ~~thereafter.~~ until the 2020-21 fiscal year.

~~(3)~~

(C) (i) In addition to the transfer of base year value of property within the same county that is permitted by ~~paragraph (1),~~ subparagraph (A), the Legislature may authorize each county board of supervisors to adopt, after consultation with affected local agencies within the county, an ordinance allowing the transfer of the base year value of property that is located within another county in the State and is substantially damaged or destroyed by a disaster, as declared by the Governor, to comparable replacement property of equal or lesser value that is located within the adopting county and is acquired or newly constructed within three years of the substantial damage or destruction of the original property as a replacement for that property. The scope and amount of the benefit provided to a property owner by the transfer of base year value of property pursuant to this paragraph shall not exceed the scope and amount of the benefit provided to a property owner by the transfer of base year value of property pursuant to subdivision (a). For purposes of this ~~paragraph~~, subparagraph, "affected local agency" means any city, special district, school district, or community college district that receives an annual allocation of ad valorem property tax revenues.
~~This paragraph~~

(ii) This subparagraph applies to any comparable replacement property that is acquired or newly constructed as a replacement for property substantially damaged or destroyed by a disaster, as declared by the Governor, occurring on or after October 20, 1991, and before January 1, 2021, and to the determination of base year values for the 1991-92 fiscal year and fiscal years ~~thereafter.~~ until the 2020-21 fiscal year.

(2) (A) Notwithstanding any other provision of this section, on and after January 1, 2020, the base year value of property that is substantially damaged or destroyed by a disaster, as declared by the Governor, shall be transferred to any property that is acquired or newly constructed as a replacement for the substantially damaged or destroyed property, regardless of whether that replacement property is comparable, as specified in paragraph (2) of subdivision (f), or whether the replacement property is located within the same county.

(B) For purposes of this paragraph, the following shall apply:

(i) For any replacement property of greater value and purchased or newly constructed by a person eligible to transfer the base year value of his or he r original property, the base year value of the replacement property shall be calculated by adding the difference between the full cash value of the original property and the full cash value of the replacement property to the base year value of the original property.

(ii) For any replacement property of equal or lesser value purchased or newly constructed by a person eligible to transfer the base year value of his or her original property, the base year value of the replacement property shall be calculated by dividing the base year value of the original property by the full cash value of the replacement property, and multiplying the result by the full cash value of the replacement property.

(f) For the purposes of subdivision (e):

(1) Property is substantially damaged or destroyed if it sustains physical damage amounting to more than 50 percent of its value immediately before the disaster. Damage includes a diminution in the value of property as a result of restricted access caused by the disaster.

(2) Replacement property is comparable to the property substantially damaged or destroyed if it is similar in size, utility, and function to the property that it replaces, and if the fair market value of the acquired property is comparable to the fair market value of the replaced property prior to the disaster.

(g) For purposes of subdivision (a), the terms "purchased" and "change in ownership" do not include the purchase or transfer of real prope1iy between spouses since March 1, 1975, including, but not limited to, all of the following:

(1) Transfers to a trustee for the beneficial use of a spouse, or the surviving spouse of a deceased transferor, or by a trustee of such a trust to the spouse of the trustor.

(2) Transfers to a spouse that take effect upon the death of a spouse.

(3) Transfers to a spouse or former spouse in connection with a property settlement agreement or decree of dissolution of a marriage or legal separation.

(4) The creation, transfer, or termination, solely between spouses, of any coowner's interest.

(5) The distribution of a legal entity's property to a spouse or former spouse in exchange for the interest of the spouse in the legal entity in connection with a property settlement agreement or a decree of dissolution of a marriage or legal separation.

(h) (1) For purposes of subdivision (a), the terms "purchased" and "change in ownership" do not include the purchase or ~~transfer of the principal residence of the transferor~~ transfer, in the case of a purchase or transfer between parents and their children, as defined by the Legislature, ~~and the purchase or transfer of the first one million dollars ($1,000,000) of the full cash value of all other real property between parents and their children, as defined by the Legislature.~~the sum of the base year value of the principal residence of the transferor, as adjusted as authorized by subdivision (b), and the next one million dollars ($1,000,000) of the full cash value of that property, if the residence continues as a principal residence of the transferee. This subdivision applies to both voluntary transfers and transfers resulting from a court order or judicial decree.

(2) ~~(A) Subject to subparagraph (B), commencing~~ Commencing with purchases or transfers that occur on or after the date upon which the measure adding this paragraph becomes effective, the exclusion established by paragraph (1) also applies to a purchase or transfer of real property between grandparents and their grandchild or grandchildren, as defined by the Legislature, that otherwise qualifies under paragraph (1), if all of the parents of that grandchild or those grandchildren, who qualify as the children of the grandparents, are deceased as of the date of the purchase or transfer.

~~(B) A purchase or transfer of a principal residence shall not be excluded pursuant to subparagraph (A) if the transferee grandchild or grandchildren also received a principal residence, or interest therein, through another purchase or transfer that was excludable pursuant to paragraph (1). The full cash value of any real property, other than a pri11cipal residence, that was transferred to the grandchild or grandchildren pursuant to a purchase or transfer that was excludable pursuant to paragraph (1), and the full cash value of a principal residence that fails to qualify for exclusion as a result of the preceding sentence, shall be included in applying, for purposes of subparagraph (A), the one million dollar ($1,000,000) full cash value limit specified in paragraph (1).~~

(3) Commencing January 1, 2022, and each January 1 thereafter, the assessor shall adjust the exclusion amount of the prior fiscal year by the percentage change, rounded to the nearest one-thousandth of I percent, in the House Price Index for California for the first three quarters of the prior calendar year, as determined by the Federal Housing Finance Agency.

(4) The amendments made to this subdivision by the act adding this paragraph shall apply to purchases or transfers that occur on or after January 1, 2021.

(i) (1) Notwithstanding any other provision of this section, except as otherwise provided in paragraph (5), the Legislature shall provide with respect to a qualified contaminated property, as defined in paragraph (2), that either, but not both, of the following apply:

(A) (i) Subject to the limitation of clause (ii), on and after November 4, 1998, and until January I, 2021, the base year value of the qualified contaminated property, as adjusted as authorized by subdivision (b), may be transferred to a replacement property that is acquired or newly constructed as a replacement for the qualified contaminated property, if the replacement real property has a fair market value that is equal to or less than the fair market value of the qualified contaminated property if that property were not contaminated and, except as otherwise provided by this clause, is located within the same county. The base year value of the qualified contaminated property may be transferred to a replacement real property located within another county if the board of supervisors of that other county has, after consultation with the affected local agencies within that county, adopted a resolution authorizing an intercounty transfer of base year value as so described.

(ii) This subparagraph applies only to replacement property that is acquired or newly constructed within five years after ownership in the qualified contaminated property is sold or otherwise transferred.

(B) In the case in which the remediation of the environmental problems on the qualified contaminated property requires the destruction of, or results in substantial damage to, a structure located on that property, the term "new construction" does not include the repair of a substantially damaged structure, or the construction of a structure replacing a destroyed structure on the qualified contaminated property, performed after the remediation of the environmental problems on that property, provided that the repaired or replacement structure is similar in size, utility, and function to the original structure.

(2) For purposes of this subdivision, "qualified contaminated property" means residential or nonresidential real property that is all of the following:

(A) In the case of residential real property, rendered uninhabitable, and in the case of nonresidential real property, rendered unusable, as the result of either environmental problems, in the nature of and including, but not limited to, the presence of toxic or hazardous materials, or the remediation of those environmental problems, except where the existence of the environmental problems was known to the owner, or to a related individual or entity as described in paragraph (3), at the time the real property was acquired or constructed. For purposes of this subparagraph, residential real property is "uninhabitable" if that property, as a result of health hazards caused by or associated with the environmental problems, is unfit for human habitation, and nonresidential real property is "unusable" if that property, as a result of health hazards caused by or associated with the environmental problems, is unhealthy and unsuitable for occupancy.

(B) Located on a site that has been designated as a toxic or environmental hazard or as an environmental cleanup site by an agency of the State of California or the federal government.

(C) Real property that contains a structure or structures thereon prior to the completion of environmental cleanup activities, and that structure or structures are substantially damaged or destroyed as a result of those environmental cleanup activities.

(D) Stipulated by the lead governmental agency, with respect to the environmental problems or environmental cleanup of the real property, not to have been rendered uninhabitable or unusable, as applicable, as described in subparagraph (A), by any act or omission in which an owner of that real property participated or acquiesced.

(3) It shall be rebuttably presumed that an owner of the real property participated or acquiesced in any act or omission that rendered the real property uninhabitable or unusable, as applicable, if that owner is related to any individual or entity that committed that act or omission in any of the following ways:

(A) Is a spouse, parent, child, grandparent, grandchild, or sibling of that individual.

(B) Is a corporate parent, subsidiary, or affiliate of that entity.

(C) Is an owner of, or has control of, that entity.

(D) Is owned or controlled by that entity.

If this presumption is not overcome, the owner shall not receive the relief provided for in subparagraph (A) or (B) of paragraph (1). The presumption may be overcome by presentation of satisfactory evidence to the assessor, who shall not be bound by the findings of the lead governmental agency in determining whether the presumption has been overcome.

(4) This subdivision applies only to replacement property that is acquired or constructed on or after January 1, 1995, and to property repairs performed on or after that date.

(5) (A) Notwithstanding any other provision of this section, on and after January 1, 2021, and subject to the limitation of clause (ii) of subparagraph (A) of paragraph (1), the base year value of the qualified contaminated property shall be transferred to a replacement property that is acquired or newly constructed as a replacement for the qualified contaminated property, regardless of whether the replacement real property has a fair market value that is equal to or less than the fair market value of the qualified contaminated property if that property were not contaminated or whether the replacement property is located within the same county.

(B) For purposes of this paragraph, the following shall apply:

(i) For any replacement property of greater value and purchased or newly constructed by a person eligible to transfer the base year value of his or her original property pursuant to this clause, the base year value of the replacement property shall be calculated by adding the difference between the full cash value of the original property and the full cash value of the replacement property to the base year value of the original property.

(ii) For any replacement property of equal or lesser value purchased or newly constructed by a person eligible to transfer the base year value of his or her original property pursuant to this clause, the base year value of the replacement property shall be calculated by dividing the base year value of the original property by the full cash value of the replacement property, and multiplying the result by the full cash value of the replacement property.

(j) Unless specifically provided otherwise, amendments to this section adopted prior to November 1, 1988, are effective for changes in ownership that occur, and new construction that is completed, after the effective date of the amendment. Unless specifically provided otherwise, amendments to this section adopted after November 1, 1988, are effective for changes in ownership that occur, and new construction that is completed, on or after the effective date of the amendment.

(k) (1) (A) When a corporation, partnership, limited liability company, other legal entity, or any other person obtains control through direct or indirect ownership or control of more than 50 percent of the voting stock of any corporation, or obtains a majority ownership interest in any partnership, limited liability company, or other legal entity through the purchase or transfer of corporate stock, partnership, or limited liability company interest, or ownership interests in other legal entities, including any purchase or transfer of 50 percent or less of the ownership interest through which control or a majority ownership interest is obtained, the purchase or transfer of that stock or other interest shall be a change of ownership of the real property owned by the corporation, partnership, limited liability company, or other legal entity in which the controlling interest is obtained.

(B) (i) (I) On or after January 1, 2021, whenever 90 percent or more of the direct or indirect ownership interests in a legal entity are cumulatively transferred in one or more transactions, the transfer of the ownership interest is a change in ownership of the real property owned by the legal entity, including the real property owned by a legal entity under its control, whether or not any one legal entity or person acquires control of the ownership interests.

<u>(II) The date of reappraisal shall be the date of the transfer of the ownership interest representing individually or cumulatively 90 percent of the ownership interest.</u>

<u>(ii) For purposes of this subparagraph:</u>

<u>(I) "Control" means control as described in subparagraph (A).</u>

<u>(II) "Legal entity" means a corporation, partnership, limited liability company, or other legal entity.</u>

<u>(III) "Ownership interests" means corporate voting stock, partnership capital and profits interests, limited liability company membership interests, and other ownership interests in legal entities.</u>

<u>(IV) "Transferred" does not include a sale of stock or interests of a publicly traded corporation or a publicly traded partnership in the regular course of a trading activity on an established securities market, as defined in Section 1.7704-1(b) of Title 26 of the Code of Federal Regulations, unless shares are acquired as part of a merger, acquisition, private equity buyout, transfer of partnership shares, or any other means by which a change of ownership would otherwise occur pursuant to this subparagraph.</u>

<u>(V) Multiple transfers of the same ownership interest shall be counted only once in determining whether cumulatively 90 percent or more of the ownership interests have transferred.</u>

<u>(2) For purposes of this subsection, legal entity ownership interests owned by a legal entity shall be considered as being owned by or transferred to its owners proportionately.</u>

<u>(3) A change in ownership of real property owned by a legal entity under this subsection restarts the cumulating of transferred ownership interests for purposes of determining whether another change in ownership of that real property occurs under this section.</u>

SECTION 2. The provisions of this act are severable. If any provision of this act or its application is held invalid, that invalidity shall not affect other provisions or applications that can be given effect without the invalid provision or application.

LAO

September 24, 2018

RECEIVED

SEP 24 2018

INITIATIVE COORDINATOR
ATTORNEY GENERAL'S OFFICE

Hon. Xavier Becerra
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Anabel Renteria
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional initiative (A.G. File No. 18-0006, Amdt. #1) related to property tax assessment.

Background

Local Governments Levy Taxes on Property Owners. California local governments—cities, counties, schools, and special districts—levy property taxes on property owners based on the value of their property. Property taxes are a major revenue source for local governments, raising over $60 billion per year.

Calculating a Property Owner's Tax Bill. Each property owner's annual property tax bill is equal to the taxable value of his or her property multiplied by the property tax rate. The typical property owner's property tax rate is 1.1 percent. In the year a property is purchased, its taxable value is its purchase price. Each year after that the property's taxable value is adjusted for inflation by up to 2 percent. This continues until the property is sold and again is taxed at its purchase price (this often is referred to as the property being "reassessed").

Ownership Changes Increase Property Taxes. The market value of most homes (what they could be sold for) grows faster than 2 percent annually. This means the taxable values of most properties are less than their market values. Property transfers therefore typically trigger an increase in a property's taxable value. This, in turn, leads to higher property tax collections. Because of this, movers often face increased property tax bills because the purchase price of the newly purchased home often exceeds the taxable value of the buyer's prior home (even when the homes have similar market values).

Special Rules for Some Homeowners. In some cases, special rules allow existing homeowners to move to a different home without paying higher property taxes. These special rules apply to homeowners who are over 55 or severely disabled or whose property has been impacted by a natural disaster or contamination. (We refer to these homeowners as "eligible homeowners.") When moving within the same county, an eligible homeowner can transfer the taxable value of his or her existing home to a different home if the market value of the new home is the same or less than the existing home. Also, a county government may allow eligible homeowners to transfer their taxable values to homes in the county from homes in different counties. Eleven counties allow these transfers. Except in limited cases, homeowners who are over 55 or severely disabled can only transfer their taxable value once in their lifetime. The nearby box ("What Happens Under Current Law?") has an example of how these rules work.

What Happens Under Current Law?

A 55 year old couple purchased their home 30 years ago for $110,000. Their home's taxable value is now $200,000 ($110,000 increased by 2 percent each year for 30 years). Their yearly property tax bill is $2,200 (1.1 percent of the taxable value). Their home now could be sold for $600,000. The couple is considering moving to one of two different homes.

- ***More Expensive Home.*** The first option is to move to a home that costs $700,000. This move is not eligible for the special rules because the new home is more expensive than the existing home. If the couple made this move, the taxable value of their new home would be $700,000 (the home's purchase price). Their yearly property tax bill would increase to $7,700.
- ***Less Expensive Home.*** The second option is to move to a home that costs $450,000. In this case, the special rules would apply. Their new home's taxable value would be $200,000 (the same as their old home). Their yearly property tax bill would remain $2,200.

Special Rules for Inherited Properties. Special rules also exclude from reassessment certain property transfers between parents and children. These rules also apply to grandparents and grandchildren if the grandchildren's parents are deceased. (We refer to properties transferred between parents and children or grandparents and grandchildren as "inherited property." This includes properties transferred before and after the death of the parent or grandparent.) The rules apply to all types of property including primary residences, vacation homes, and business properties. There is, however, a cap of $1 million in aggregate value of all inherited properties that were not used as the parent's primary residence.

Change in Ownership of a Business Property May Not Lead to Reassessment. Property can be owned by individuals or legal entities. Legal entities include sole proprietorships, partnerships, limited liability companies, and corporations. Properties owned by a legal entity are not necessarily reassessed when ownership of the legal entity changes. This is because while the owners of the legal entity change, the legal entity remains the owner of the property. Reassessment can occur, however, in two specific cases. First, if any person or entity obtains more than 50 percent ownership of the legal entity, the legal entity's properties are reassessed. Second, if an original owner of the legal entity transfers more than 50 percent of their ownership to one or more parties, the legal entity's properties are reassessed.

Other Taxes on Property Sales. Cities and counties collect taxes on the transfer of homes and other real estate. Statewide, transfer taxes raise around $1 billion for cities and counties.

Counties Administer the Property Tax. County assessors determine the taxable value of property. Statewide, county spending for assessors' offices totals around $600 million each year.

California Taxes Personal Income. The state collects a personal income tax on income earned within the state. Taxable income can include profits from selling real estate. The personal income tax raises over $90 billion each year.

PROPOSAL

The measure amends the State Constitution to make various changes to the special rules for eligible homeowners and inherited properties, as well as the rules for taxation of properties held by legal entities. These changes would take effect January 1, 2021.

Expands Special Rules for Eligible Homeowners. The measure expands the special rules that give property tax savings to eligible homeowners when they buy a different home. Specifically, the measure:

- ***Allows Moves Anywhere in the State.*** Eligible homeowners could transfer the taxable value of their existing home to another home anywhere in the state.
- ***Allows the Purchase of a More Expensive Home.*** Eligible homeowners could transfer the taxable value of their existing home (with some adjustment) to a more expensive home. The taxable value transferred from the existing home to the new home is adjusted upward. The new home's taxable value is greater than the prior home's taxable value but less than the new home's market value. An example is shown in the nearby box ("What Happens Under the Measure?").
- ***Reduces Taxes for Newly Purchased Homes That Are Less Expensive.*** When an eligible homeowner moves to a less expensive home, the taxable value transferred from the existing home to the new home is adjusted downward. An example is shown in the box ("What Happens Under the Measure?").
- ***Removes Limits on How Many Times a Homeowner Can Use the Special Rules.*** There is no limit on the number of times an eligible homeowner can transfer their taxable value.

The measure's changes to the special rules for eligible homeowners are the same as the changes proposed by Proposition 5, which will be on the November 2018 ballot.

Narrows the Special Rules for Inherited Properties. The measure narrows the special rules for inherited properties. Specifically, the measure:

- ***Eliminates Exclusion for Properties Not Used as Primary Residence.*** The inheritance exclusion would apply only to properties used as the inheritor's primary residence. Inherited property used for any other purpose than the inheritor's primary residence—such as rental homes or business properties—would be reassessed to market value.
- ***Caps Amount of the Tax Benefit for Primary Residences.*** The assessor would exclude only the first $1 million of value that would be added upon reassessment. For example, consider a home with a taxable value of $500,000 that could be sold for $2 million. Were the home reassessed to market value, its taxable value would increase by $1.5 million. Instead, under the measure, $1 million of this increase would be excluded. Upon inheritance, the home's taxable value would be $1 million—$500,000 (original taxable value) + $500,000 ($1.5 million [gap between original taxable value and market value] - $1 million [inheritance exclusion]).

What Happens Under the Measure?

Using the same couple from the earlier example, their current home has a taxable value of $200,000 and a market value of $600,000. If they move, the taxable value of their new home would be:

- ***More Expensive Home.*** If the couple buys the home for $700,000, the new home's taxable value would be $300,000 (as shown below). Their yearly property tax bill would be $3,300. This is more than they paid at their prior home ($2,200) but much less than they would pay under current law ($7,700).

$$\underset{\left[\text{New home's taxable value}\right]}{\mathbf{\$300{,}000}} = \underset{\left[\text{Prior home's taxable value}\right]}{\mathbf{\$200{,}000}} + \underset{\left[\text{\$700,000 New home's market value} - \text{\$600,000 Prior home's market value}\right]}{\mathbf{\$100{,}000}}$$

- ***Less Expensive Home.*** If the couple buys the home for $450,000, the new home's taxable value would be $150,000 (as shown below). Their yearly property tax bill would be $1,650. This is less than what they paid at their prior home and what they would pay under current law ($2,200).

$$\underset{\left[\text{New home's taxable value}\right]}{\mathbf{\$150{,}000}} = \underset{\left[\text{Prior home's taxable value}\right]}{\mathbf{\$200{,}000}} \times \underset{\left[\text{\$450,000 New home's market value} \div \text{\$600,000 Prior home's market value}\right]}{\mathbf{75\%}}$$

Broadens Scope of Legal Entity Ownership Changes. In addition to the existing circumstances defined in current law, the measure broadens the types of legal entity ownership changes that trigger reassessment. Specifically, the measure requires properties owned by a legal entity to be reassessed if 90 percent or more of the ownership of the legal entity is transferred, even if no single person or entity gains more than 50 percent ownership. The transfer of 90 percent of the ownership could occur in a single transaction or over time as part of multiple transactions. The sale of stock in a publicly traded company through an established stock market would not count as a change of ownership.

FISCAL EFFECT

Reduced Property Tax Revenues From Expanded Rules for Eligible Homeowners. The changes to the special rules for eligible homeowners could have multiple effects on property tax revenue:

- ***Reduced Taxes From People Who Would Have Moved Anyway.*** Right now, about 85,000 homeowners who are over 55 move to different houses each year without receiving a property tax break. Most of these movers end up paying higher property taxes. Under the measure, their property taxes would be much lower. This would reduce property tax revenue.

- ***Potentially Higher Taxes From Higher Home Prices and More Home Building.*** The measure would cause more people to sell their homes and buy different homes because it gives them a tax break to do so. The number of movers could increase by a few tens of thousands. More people being interested in buying and selling homes would have some effect on home prices and home building. Increases in home prices and home building would lead to more property tax revenue.

The revenue losses from people who would have moved anyway would be bigger than the gains from higher home prices and home building. This means this part of the measure would reduce property taxes for local governments. In the first few years, schools and other local governments each probably would lose over $100 million per year. Over time, these losses would grow, resulting in schools and other local governments each losing about $1 billion per year (in today's dollars).

Increased Property Tax Revenue From Inherited Property Rules. As the measure would narrow the inheritance reassessment exclusion, it would result in more properties being reassessed at the time of inheritance. Under current law, between 60,000 and 80,000 inherited properties statewide are excluded from reassessment each year. Somewhere around two-thirds of these properties are not used as primary residences. Further, it appears that roughly one-fifth of the tax benefit on inherited primary residences went to those who received a benefit greater than $1 million. Both of these types of inherited properties would see an increase in their taxable value under the measure. This suggests the measure could lead to increases in property tax payments for 40,000 to 60,000 properties each year. This, in turn, would increase property tax revenues for local governments. In the first few years, schools and other local governments each probably would gain over $100 million per year. Over time, these gains would grow, resulting in schools and other local governments each gaining about $1 billion per year (in today's dollars).

Increased Property Tax Revenue From Legal Entity Ownership Change Rules. By expanding the scope of legal entities ownership changes that can result in reassessment, the measure would result in more legal entities' properties being reassessed each year. This, in turn, would increase property tax payments by legal entities. Very little information is available about ownership changes of legal entities throughout the state. Because of this, the magnitude of the potential increase in property taxes paid by legal entities is unclear.

Net Change in Property Taxes for Local Governments. Some parts of the measure would decrease property tax revenues for local governments, while other parts would increase them. The size of the potential revenue gains are similar to the size of the potential revenue losses. There is, however, significant uncertainty in our estimates of the potential gains and losses. This means that, despite the similar size of the gains and losses, the net effect could be positive or negative. Overall, it is possible that schools and other local governments each could gain low tens of millions of dollars or lose low tens of millions of dollars in the first few years. These property tax effects likely would grow over time, reaching the high tens of millions of dollars or more.

Change in State Funding for Schools. Although the state receives no property tax revenue, property tax collections affect the state's budget. This is because state law guarantees schools and community colleges (schools) a minimum amount of funding each year through a combination of property taxes and state funds. Should schools gain property tax revenues under the measure, state funding for schools would decrease by a similar amount in most years. Conversely, should schools lose property tax revenues under the measure, state funding for schools would increase by a similar amount in most years.

Increase in Property Transfer Tax Revenues. As the measure would increase home sales, it also would increase property transfer taxes collected by cities and counties. This revenue increase likely would be in the tens of millions of dollars per year.

Increase in Income Tax Revenues. Because the measure would increase the number of homes sold each year, it likely would increase the number of taxpayers required to pay income taxes on the profits from the sale of their homes. This probably would increase state income tax revenues by tens of millions of dollars per year.

Higher Administrative Costs for Counties. The measure would require county assessors to create and carry out a variety of new processes, which could necessitate increased staffing and information technology upgrades. This likely would increase annual costs for county assessors by tens of millions of dollars, with potentially higher one-time costs in the first few years.

Summary of Fiscal Effects. The measure would have the following major impacts on state and local governments:

- Local governments and schools each could gain or lose low tens of millions of dollars of property tax revenue per year, likely growing over time. State school spending would increase (decrease) by an amount similar to school property tax losses (gains).
- Other local and state revenues each could increase by tens of millions of dollars per year.
- County property tax administration costs likely would increase by tens of millions of dollars per year.

Sincerely,

Mac Taylor
Legislative Analyst

for / Keely Martin Bosler
Director of Finance