TAX RELIEF
GENERAL SUMMARY

Items 424–431

Summary of State Tax Relief Expenditures

The state provides local tax relief, both as subventions to local governments and as direct payments to eligible individual taxpayers, through eight different programs, each of which is funded under a separate item. Table 1 summarizes, by item number and program, total state tax relief expenditures for the current and budget years.

Table 1
Tax Relief Expenditures
Summary by Program
(amounts in millions)

Item number	*Tax Relief Program*	*Actual 1977–78*	*Estimated 1978–79*	*Proposed 1979–80*	*Change Amount*	*Change Percent*
424	Senior citizens' property tax assistance..	$78.4	$70.0	$39.0	–$31.0	–44.3%
425	Senior citizens' property tax deferral	12.7	10.0	12.0	2.0	20.0
426	Senior citizen renters' tax assistance......	6.9	5.5	101.0	95.5	N.A.
427	Personal property tax relief......................	417.8	216.5	244.6	28.1	13.0
428	Homeowners' property tax relief............	759.0	347.0	132.0	–215.0	–62.0
429	Open-space subventions to local government........	18.8	15.0	16.0	1.0	6.7
430	Payments to local government for sales and property tax revenue losses......	5.5	4.9	4.5	–0.4	–8.2
431	Renters' tax relief..	126.5	135.0	148.0	13.0	9.6
	Total tax relief expenditures	$1,425.6	$803.9	$697.1	–$106.8	–13.3%

Of the $697.1 million budgeted for tax relief expenditures in 1979–80, nearly $245 million, or about 35 percent of the total, will be subvened to local governments as reimbursement for revenue losses resulting from personal property tax relief (consisting largely of a 50-percent business inventory exemption). Another $132 million has been requested to fund homeowners' property tax relief, which the Governor proposes to provide directly to claimants as a flat $87 refundable income tax credit. Under current law, homeowners' tax relief is provided as a subvention to local governments for reimbursement of revenue losses resulting from the $7,000 homeowners' property tax exemption. Tax relief for renters will require $148 million (a flat $37 per renter) and is provided as a refundable income tax credit. A total of over $150 million will go to low- and moderate-income senior citizens through three different programs, which provide direct cash assistance to both homeowners and renters (in amounts that are inversely related to income) and allow homeowners to postpone the payment of property taxes. The remaining budgeted expenditures of just over $20 million have been requested for subventions to local government for property tax revenue losses resulting from enforceable open-space restrictions under the California Land Conservation Act of 1965 (the Williamson Act) and for sales and property tax revenue losses resulting from the effect of specified statutory changes under Chapter 1406, Statutes of 1972 (SB 90).

As shown in Table 1, the $697.1 million budgeted for 1979–80 represents a 13.3 percent decrease from the $803.9 million estimated in the current year and a 51 percent decrease from the $1,425.6 million actually expended in 1977–78. The sharp decline over this two-year period largely reflects three factors: (1) the effects of Proposition 13, (2) changes proposed by the Governor in the method of paying and accounting for homeowner property tax relief, and (3) expanded eligibility and increased assistance payments under the senior citizen homeowner and renter programs as a result of Chapter 569, Statutes of 1978 (AB 3802).

Effects of Proposition 13

Lower tax rates brought about by the passage of Proposition 13 have reduced expenditures by over 50 percent for certain tax relief items. The effects of Proposition 13 will not occur at the same time in all programs. Proposition 13 tax rate reductions affect estimated *current-year* expenditures for homeowners' tax relief, personal property tax relief, open-space subventions and payments to local governments for property tax revenue losses. Senior citizens' property tax assistance, which is based on prior-year property taxes, will not be affected by Proposition 13 until the *budget year*. Proposition 13 will have no direct impact on the renters' tax relief and senior citizen renters' assistance programs.

Proposition 13 had the direct effect of reducing state property tax relief costs, and had the indirect effect of reducing the number of claimants in several of the tax relief programs. As discussed under Items 424, 425, and 426, there have been significant reductions in the number of claimants for the senior citizen homeowners' and renters' assistance programs.

Proposed Changes in Homeowners' Exemption

The $132 million budgeted for the homeowners' exemption (Item 428) represents a decrease of $215 million from expenditures estimated in the current year. This decrease results from the Governor's proposal to (1) replace the existing $7,000 homeowners' tax exemption with a flat $87 refundable credit administered through the personal income tax program and (2) appropriate only that amount in the budget which results in direct payments to homeowners whose income tax liabilities are less than the $87 credit. The portion of the proposed credit which would reduce amounts owed for income taxes would be treated as a reduction in revenues rather than as an expenditure. One important effect of this proposal, which is discussed in detail under Item 428, is that it distorts the growth in the total cost of this program from the current to the budget year. Revised Department of Finance estimates indicate that, if expenditures and revenue losses are combined, the total "cost" of homeowners' tax relief proposed for 1979–80 will be $374 million—$27 million (or 7.8 percent) above estimated current-year expenditures.

Effects of 1978 Legislation

Chapter 569, Statutes of 1978, will substantially increase budget-year expenditures for three tax relief programs.

The major provisions of Chapter 569 affecting tax relief:

- extended eligibility for renters' tax relief to persons who receive public assistance;

GENERAL SUMMARY—Continued

- extended eligibility for the senior citizen homeowners' and renters' assistance programs to totally disabled persons under 62; and
- raised the income limits applicable to the senior citizen renters' assistance program from $5,000 to $12,000 and increased the amounts of assistance provided under this program.

This legislation primarily affected costs for the Senior Citizen Renters' Assistance program (Item 426), but also affected costs for the Renters' Tax Relief (Item 431) and Senior Citizens' Property Tax Assistance programs (Item 424).

Reexamination of Tax Relief Programs Needed

We have recommended, under Item 424, that the Legislature reexamine the justifications for, and the specific reimbursement formulas of, all state property tax assistance programs in view of the substantial reductions in local property taxes brought about by Proposition 13. The state's existing property tax relief measures were adopted during a period when property taxes were much higher than they are today. Because Proposition 13 has reduced average property tax burdens by over 50 percent, these measures may not have the same degree of justification as when originally approved by the Legislature. Consequently, we believe that this is an appropriate time to reevaluate the state's tax relief programs.

SENIOR CITIZENS' PROPERTY TAX ASSISTANCE

Item 424 from the General Fund — Budget p. 1203

Requested 1979–80	$39,000,000
Estimated 1978–79	70,000,000
Actual 1977–78	78,443,005
Requested decrease $31,000,000 (44.3 percent)	
Total recommended reduction	None

SUMMARY OF MAJOR ISSUES AND RECOMMENDATIONS	*Analysis page*
1. Reexamine Tax Relief Programs. Recommend that the Legislature reevaluate all of the state's tax relief programs in light of the lower property tax burdens under Proposition 13.	1352

GENERAL PROGRAM STATEMENT

The Senior Citizens' Property Tax Assistance program provides partial reimbursement for property taxes paid by homeowners with less than $12,000 of household income who are (1) 62 years and over or (2) totally disabled, regardless of age. Assistance varies inversely with income and ranges from 96 percent of the tax for homeowners with household incomes not exceeding $3,000 to 4 percent of the tax for those with incomes between $11,500 and $12,000. Senior citizens' property tax assistance is available only on that portion of taxes paid on the first $34,000 of appraised market value after taking into account the $7,000 homeowners' property tax exemption. Assistance disbursed in 1979–80 will be based on taxes paid in 1978–79.

Table 1 shows the total number of approved claimants and the total assistance they received for four fiscal years. The table also shows for all claimants average income, average property taxes and average assistance received. Preliminary data indicate that, in 1978–79, the average income of the 275,000 claimants was $6,529, and the average property tax was $645. The average assistance payment of $251 amounted to approximately 39 percent of the property taxes.

Table 1
Senior Citizens' Property Tax Assistance
1975–76 through 1978–79

	Actual 1975–76	*Actual 1976–77*	*Actual 1977–78*	*Preliminary 1978–79*
Number of claimants	300,737	293,198	325,667	274,337
Total assistance [a] (millions)	$50.8	$52.1	$77.8	$68.9
Per claimant averages:				
Household income	$5,307	$5,551	$6,318	$6,529
Property taxes	438	494	579	645
Assistance:				
Amount	169	178	239	251
Percent of taxes	38.5%	36.0%	41.3%	38.9%

[a] Based on Franchise Tax Board workload data and will differ somewhat from fiscal year expenditures shown in the budget.

ANALYSIS AND RECOMMENDATIONS

We recommend approval.

The Governor's Budget recommends an appropriation of $39 million in 1979–80, a *decrease* of 44 percent from the $70 million estimated for the current year. The 350,000 participants projected in the budget year, however, represent a 27 percent *increase* over the 275,000 claimants estimated in 1978–79. The expenditure decrease primarily reflects the effects of Proposition 13, which reduced the 1978–79 property taxes of program participants by over one-half.

The increase in participants results from program changes enacted by Chapter 569, Statutes of 1978 (AB 3802). Chapter 569 expanded eligibility for senior citizens' property tax assistance to include totally disabled persons, regardless of age. It is estimated that this change will result in an additional 75,000 claimants and increase program costs by $8 million. Average assistance in the budget year is estimated at $106 per claimant, a substantial decline from the $251 average in 1978–79.

Unexplained Drop in Current-Year Participation

The 1978 Budget Act appropriated $85 million for disbursement in the 1978–79 fiscal year. This was based on an estimated 320,000 claimants. As of November 1978, the number of claimants was 274,337 and total assistance was estimated at $68.9 million. Although there may be some late claims before the end of the fiscal year which would increase these numbers, preliminary data indicate participation will fall 14 percent below the expected level and total payments will be 17 percent less than originally estimated.

The reasons for the decline in the number of claimants are not known. It has been suggested that eligible homeowners may have been confused by, first, the enactment and then the repeal of Chapter 24, Statutes of 1978 (SB 1), and the resulting delay in the mailing of renewal applications. Chapter 24 would have increased the income limit to $13,000 and thus would have increased the number of homeowners eligible for the program. Because the implementation of Chapter 24 was contingent upon voter rejection of Proposition 13 and approval of Proposition 8, the mailing of applications (normally done in May) was delayed until after the June 1978 election.

A more likely reason for the lower-than-expected participation, in our judgment, is the reduction in property taxes caused by Proposition 13. Not only has Proposition 13 reduced property taxes substantially (by more than one-half, on the average), and thus the tax burden imposed on senior citizens, but it also has reduced the dollar amount of property tax assistance payments to senior citizens. In anticipation of these large tax reductions and reduced assistance payments, many eligible homeowners may have elected not to participate in the program. Whatever the reason for the current-year decline, all homeowners receive notices annually informing them of the availability of this program, and thus have an opportunity to consider or reconsider participating.

Reexamination of Tax Relief Programs Needed

We recommend that the Legislature reexamine the justifications for, and the specific reimbursements formulas of, all state property tax assistance programs, in view of the substantial reductions in local property taxes brought about by Proposition 13.

The state's existing property tax relief measures were adopted during a period when property taxes were much higher than they are today because Proposition 13 has reduced average property tax burdens by over 50 percent. These measures may not have the same degree of justification as when originally approved by the Legislature. Consequently, we believe that this is an appropriate time to reevaluate the state's tax relief programs.

The impact of Proposition 13 on senior citizens' assistance provides a good example of the dramatic changes which have occurred. Table 2 illustrates the net (after assistance) property taxes likely to be paid by eligible senior citizen homeowners before and after passage of Proposition 13. Data in this table (1) reflect "typical" relationships between average taxes and income for existing claimants and (2) assume, for illustration purposes, a 50 percent reduction in property taxes due to Proposition 13.

As Table 2 illustrates, for most eligible senior citizen homeowners above approximately $7,000 of income, post-Proposition 13 property taxes *before* assistance payments are lower than pre-Proposition 13 taxes *after* assistance payments, both in absolute dollars and as a percentage of income. For example, at $8,000 of income, average pre-Proposition 13 taxes after assistance were $531, while average post-Proposition 13 taxes before assistance are $341. This table also shows that eligible homeowners at higher income levels typically will receive a much greater dollar reduction in their taxes under Proposition 13 than those at lower levels of income.

Given that the senior citizens' assistance program was intended originally to address the problem of high property taxes paid by low income homeowners, the Legislature may now wish to reconsider the level and distribution of assistance in light of the much lower property tax burdens under Proposition 13.

Table 2
Senior Citizens' Property Tax Assistance Program
Illustration of the Impact of Proposition 13

	Pre-Proposition 13				*Post-Proposition 13*[a]			
	Before-Assistance Property Taxes		*After-Assistance Property Taxes*		*Before-Assistance Property Taxes*		*After-Assistance Property Taxes*	
Income Level	*Amount*	*Percent of Income*	*Amount*	*Percent of Income*	*Amount*	*Percent of Income*	*Amount*	*Percent of Income*
$3,000	$541	18.0%	$22	0.73%	$271	9.0%	$11	0.4%
4,000	569	14.2	80	2.0	285	7.1	40	1.0
5,000	597	11.9	143	2.9	299	6.0	72	1.4
6,000	625	10.4	268	4.5	313	5.2	134	2.2
7,000	653	9.3	411	5.9	327	4.7	206	2.9
8,000	681	8.5	531	6.6	341	4.3	265	3.3
9,000	709	7.9	624	6.9	355	3.9	312	3.5
10,000	737	7.4	678	6.8	369	3.7	339	3.4
11,000	765	7.0	719	6.5	383	3.5	360	3.3
12,000	793	6.6	761	6.3	397	3.3	381	3.2

[a] Assumes, for illustrative purposes, a 50 percent reduction in property taxes due to Proposition 13.

SENIOR CITIZEN PROPERTY TAX POSTPONEMENT

Item 425 from the General Fund — Budget p. 1203

Requested 1979–80	$12,000,000
Estimated 1978–79	10,000,000
Actual 1977–78	12,000,000
Requested increase $2,000,000 (20.0 percent)	
Total recommended reduction	$7,800,000

SUMMARY OF MAJOR ISSUES AND RECOMMENDATIONS	Analysis page
1. *Payments of Postponed Taxes. Reduce Item 425 by $7,800,000* due to reduced participation.	1356
2. Single Administrative Agency. Recommend legislation to assign program responsibility to State Controller's office.	1358

SENIOR CITIZEN PROPERTY TAX POSTPONEMENT

GENERAL PROGRAM STATEMENT

The property tax postponement program allows eligible homeowners to defer payment of all or a portion of the property taxes on their residences. Deferred taxes are paid to local governments by the state, which puts a lien on the property to assure that the taxes are paid when the property is transferred. Thus, the program is essentially a loan to the eligible property owners by the state, to be repaid when the property is sold. Interest is charged on amounts deferred at 7 percent annually.

To be eligible for the program, persons must be 62 years of age or older, own and occupy the property, have an equity of 20 percent of full value and meet specified income limits. The income limits are adjusted annually to account for changes in the cost of living. To postpone taxes for the current year, a person must have had a household income of less than $21,500 in 1977. The income limit in the budget year, which will be determined in March 1979, is estimated at $23,200. The program is jointly administered by the State Controller's office and the Franchise Tax Board.

Chapter 43, Statutes of 1978, extended the property tax postponement program to include persons who are tenant-stockholders of property in cooperative housing corporations and who occupy as their principal residence a unit owned by the corporation. Chapter 576, Statutes of 1978, extended the program to persons who hold a possessary interest in real property and who occupy as their principal residence a dwelling on the property. Both changes were initially effective for the 1978–79 fiscal year. This Budget Bill item appropriates funds to the Controller from which payments will be made for postponed taxes. Administrative costs of this program are discussed in this item, although the appropriations for these costs are included in Item 52 (State Controller) and Item 113 (Franchise Tax Board).

ANALYSIS AND RECOMMENDATIONS

I. PAYMENTS OF POSTPONED TAXES

The Governor's Budget requests $12 million in the budget year for payments to local governments for reimbursement of postponed property taxes. Table 1 summarizes the results of the program's first year, 1977–78, and the preliminary results for 1978–79.

Table 1
Senior Citizens' Property Tax Postponement Program
Summary of Activity

	Actual 1977–78	*Preliminary 1978–79*[a]
Claims Filed	12,953	7,386
Certificates Issued	12,172	7,110
Certificates used	9,838	3,578
Total Appropriation	12,700,000	10,000,000
Total Amount Postponed	$11,125,333	$1,773,067
Average Amount Postponed	$1,131	$495

[a] As of January 1979.

The $12 million proposed appropriation for 1979–80 reflects the uncertainty about participation in this program in the budget year. As shown in Table 1, approximately 9,800 persons postponed taxes in 1977–78 totaling $11.1 million. The $10 million appropriation for 1978–79 took into account the expected reduction in property taxes resulting from Proposition 13 but not its potential impact on the number of participants. Because claimants had to file by December 31, 1978 to postpone property taxes during 1978–79, the effects of Proposition 13 on this program are beginning to emerge.

Taxes and Participation Decline Sharply

We recommend that Item 425 be reduced by $7.8 million due to decreased participation in the program.

As of January 1979, the State Controller's office had issued 7,110 certificates of eligibility, a decline of 42 percent from the previous year's 12,200 approved claimants. Approximately 50 percent (3,578) of these certificates have been utilized, resulting in the postponement of $1.8 million in taxes. Additional postponements will result as local governments complete processing of the December claims. In 1977–78, 81 percent of the 12,200 approved claimants actually postponed taxes. If the ratio of actual postponements to eligible persons is the same this year as last, approximately 5,800 of the 7,100 persons receiving certificates would postpone taxes.

The average amount postponed to date in the current year is $495. Because the Controller indicates that, for approximately 80 percent of these claims, both the December and April property tax installments have been postponed, we estimate the average amount postponed at year end will be approximately $550. Thus, assuming 5,800 participants and an average postponement of $550, current-year program costs are unlikely to exceed $3.2 million.

In the budget year, allowing for higher taxes and more participants, we would estimate that an appropriation of $4.2 million should be sufficient.

This would allow for property taxes to increase 5 percent and for participation to increase by over 20 percent. Thus, we are recommending that Item 425 be reduced by $7.8 million.

II. ADMINISTRATION

The Property Tax Postponement program is administered by the State Controller's Office (SCO) and the Franchise Tax Board (FTB). The FTB is responsible for (1) distributing forms and instruction booklets, (2) determining the eligibility of applicants, (3) notifying the SCO of eligible claimants and (4) notifying the SCO of the claimants for senior citizens' property tax assistance who also have postponed taxes (the assistance is then offset against the amount postponed). The State Controller is responsible for (1) issuing the certificate of eligibility to eligible persons as determined by the FTB, (2) maintaining an account for persons who have postponed taxes, (3) applying interest charges, additional deferrals, payments from taxpayers or from the Senior Citizens' Property Tax Assistance program, (4) maintaining a record of each property on which liens have been recorded and related information, including the amount of the lien, and (5) protecting the state's interest at foreclosure sales of such properties through specified means.

Local governments also have responsiblities in operating this program. Local tax collectors must determine at the time the certificate of eligibility is accepted for property taxes if there is a lien recorded in favor of the state. If no lien exists, the tax collector, in conjunction with the assessor and county recorder, must place a lien on the appropriate property. Although local costs may be reimbursable under Chapter 1135, Statutes of 1977, no claims have been filed according to the Controller's office. Table 2 summarizes the identifiable administrative costs.

Table 2

Senior Citizens' Property Tax Postponement Administrative Costs

	Actual 1977–78	*Estimated 1978–79*	*Estimated 1979–80*
State Operations:			
State Controller			
Expenditures	$160,603	$338,087	$355,599
Personnel-years	3.3	8.5	8.4
Franchise Tax Board			
Expenditures	$197,000	$60,000	$60,000
Personnel-years	11.6	3.5	3.5
State Totals	$357,603	$398,087	$415,599
Local Costs	Unknown	Unknown	Unknown

Program Responsibility Should be Assigned to a Single Agency

We recommend that legislation be enacted assigning responsibility for the entire program to the State Controller's Office (SCO).

In the supplemental language report of the 1978 Budget Bill, the Legislature requested that we examine the joint administration of this program and offer recommendations on possible ways to improve the program administration.

In the Analysis of the 1978 Budget Bill, we indicated that the involvement of two state agencies in this program was unnecessary and would:

(1) Compound the difficulties facing an already complex program that requires eligible homeowners to deal with local government and state government;

(2) Tend to result in the duplication of some activities; and

(3) Tend to result in avoidance of responsibility and lack of accountability for all aspects of the program.

At that time, we noted that the FTB appeared to be the appropriate organization to administer this program. However, both organizations requested that any changes in the program be postponed until after the current year to avoid reorganization problems in the first year of the program.

The experience since that time has reinforced our judgment that responsibility for this program should be assigned to one state agency. However, it now appears that the State Controller should be assigned responsibility for this program, rather than the Franchise Tax Board. While both agencies have characteristics which would qualify them to operate the program, the problems which are emerging in the program are in areas where the Controller is currently involved. The Controller's office is willing to accept responsibility for this program, and the Franchise Tax Board prefers to relinquish its responsibility.

Problems in the Postponement Program

While assigning responsibility to a single state agency would facilitate administration of this program, there are several other problems which need to be addressed. These include (1) adequacy of the state's security interest, (2) workload and (3) costs.

1. *Adequacy of the State's Security Interest.* The repayment of the state loan is secured by a lien placed on the property for which taxes have been postponed. The lien notices are the responsibility of local government officials (assessor, tax collector, and recorder). The Controller has begun to review the liens to assure their accuracy and validity. In one county, 50 percent of the liens have been defective. Statewide, the SCO estimates that 10–12 percent of the liens may be defective. To correct these problems, SCO staff must visit the appropriate county. The Controller's office estimates it needs approximately 2.5 personnel-years to complete this task. We believe that consideration needs to be given to changes in the system so that less errors are made at the local level. One way this could be done would be to hold counties liable for losses to the state from defective liens.

2. *Workload.* Participation in the current year is substantially less than was originally expected. However, the SCO reports that existing staff is

not adequate to administer the program properly. The workload problem is caused, in part, by the exceptional cases rather than the typical cases. The exceptional cases are both more numerous and more time consuming than originally expected. These exceptional cases include the defective lien problems discussed previously and foreclosure situations where defaults by participants on prior liens require the SCO to act to protect the state's interests.

Recent legislation has extended the postponement program to new types of property holders. The original postponement legislation allows eligible owners with "fee" titles to postpone property taxes. Chapters 43 and 576, Statutes of 1978, have extended the program to (1) tenant stockholders who occupy a unit in a property which is owned by a corporation in which the tenant-stockholder owns shares, and (2) persons who have "possessory interests", that is, who occupy property owned by others by virtue of long-term leases. The extension of the program to these new types of ownership requires extensive involvement of the SCO in each case. Because the problems in the existing fee-owner program have required the use of all available resources, the SCO has been unable to extend the program to these new groups. There are at least 30 persons who have applied for postponement as tenant-stockholders. The Controller has requested six additional positions to implement these laws.

3. *Costs.* Article 13, Section 8.5 of the Constitution, under which this program is operated, provides for reimbursement to the state of any costs in connection with postponement payments. The Legislative Counsel has opined that costs can be defined by the Legislature. To date, the Legislature has not specifically defined which costs are to be reimbursed. From an economic standpoint, the following costs can be identified:

(1) *Administrative costs.* These include state and local government costs and certain costs of establishing claimant eligibility which currently can be deducted from loan balances.

(2) *Loss of Interest.* This represents a loss of investment income the state otherwise would have earned if local reimbursements under the postponement program were invested through the Pooled Money Investment program.

(3) *Loan Losses.*

Currently, the state recovers a portion of these costs through the 7 percent simple interest charged on the loans. However, since the Pooled Money Investment Account is currently earning over 8 percent, the state is not even recovering its lost interest. With respect to administrative costs, these occur primarily at the time of initial utilization of the program and at the termination of the loan. These costs could be recovered through a one-time fixed charge for program participation. We will attempt to develop information on the amount of fixed charges which would be necessary to make this program self-supporting.

Additional Information Needed

Before recommending any specific solutions to these problems, we need additional information on participation, amounts postponed, and the characteristics of participation. Actual participation in this program will be known in several months. In addition, it should be possible to determine the proportion of first time and repeat participants. Since the problems and workload are primarily related to first time participants, such information would provide a better basis for determining the need for additional staff. Lastly, at our request, the SCO and FTB have attempted to provide data on the characteristics of borrowers including their income, total taxes, and amounts postponed.

We will provide a supplemental analysis, based on this additional information, at the time of the legislative hearings on this item.

SENIOR CITIZEN RENTERS' TAX ASSISTANCE

Item 426 from the General Fund — Budget p. 1203

Requested 1979–80	$101,000,000
Estimated 1978–79	5,500,000
Actual 1977–78	6,849,516
Requested increase $95,500,000	
Total recommended reduction	None

GENERAL PROGRAM STATEMENT

This program provides property tax assistance in the form of a reimbursement to renters 62 years and over and totally disabled persons of any age, if their total household income is less than $12,000. Assistance varies inversely with income and assumes that all renters pay the equivalent of $250 in property taxes. Actual assistance ranges from $240 (96 percent of $250) for persons with less than $3,000 of total household income to $10 (4 percent of $250) for persons with income between $11,500 and $12,000. This assistance is in addition to the $37 of assistance provided all renters by the Renters' Tax Relief Act through the personal income tax.

ANALYSIS AND RECOMMENDATIONS

We recommend approval.

The Governor's Budget requests $101 million for the Senior Citizen Renters' Tax Assistance program in 1979–80, a 17 fold increase over the cost of the program in the current year. This increase results from Chapter 569, Statutes of 1978, which (1) expanded eligibility to include totally disabled persons under 62 and (2) revised the reimbursement schedule by increasing the annual household income limit from $5,000 to $12,000, raising the reimbursement percentages, and increasing the statutory property tax equivalent from $220 to $250. Table 1 displays estimates of the increased participation and costs associated with these new provisions.

Table 1
Estimated Effects of Chapter 569 on Senior Citizens Renters' Program 1979–80

	Number of Participants	*Amount of Assistance (millions)*
Prior Law	75,000	$4.4
Chapter 569:		
(1) Assistance for totally disabled	275,000	44.0
(2) Reimbursement schedule revisions	250,000	52.6
Total	600,000	$101.0

As shown in Table 1, estimated budget-year costs associated with the 75,000 participants under prior law are $4.4 million. This amount is less than experienced in previous years because general increases in average household income levels would result in fewer renters qualifying under the previous $5,000 income limit. It is estimated that Chapter 569 will add 250,000 claimants as a result of the increased income limit for persons 62 years and over, and 275,000 claimants for assistance to the totally disabled. Average assistance in the budget year is estimated at $168 per eligible claimant.

Participation Continues to Lag Expectations

Preliminary data from the Franchise Tax Board indicate that actual participation in 1978–79 will be less than originally expected and less than the actual participation in 1977–78. Table 2 compares the actual results in 1977–78 and 1978–79 with the original estimates for those years.

Table 2
Senior Citizen Renters' Tax Assistance Program Comparison of Estimated and Actual Program Activity 1977–78 and 1978–79

1978–79	*Number of Claimants*	*Total Assistance*
Budget Estimates	120,000	$9,000,000
Preliminary Actuals	77,300	5,144,900
1977–78		
Budget Estimates	200,000	20,000,000
Actuals	91,700	6,849,516

In last year's *Analysis of the Budget Bill* we noted that in 1977–78 the actual participation of approximately 90,000 persons was substantially less than the preliminary estimate of 200,000 participants. The preliminary estimate of 200,000 claimants was based on a 70 percent participation rate applied to the estimated 285,000 senior citizen renters who were believed to be eligible. The 1978–79 budget assumed that participation could increase by as much as 29 percent as more persons became aware of the new program. Preliminary results show that, instead of an increase, there has been a 16 percent decline from prior-year actual participation.

The reasons for this decline are unclear. The same phenomenon occurred in the Senior Citizens' Property Tax Assistance (homeowners) program. Several possible explanations for the decline are discussed in the analysis of Item 424.

SENIOR CITIZEN RENTERS' TAX ASSISTANCE—Continued

The unexplained trend in participation under prior law coupled with the lack of experience under the new law makes the budget-year estimate of 600,000 participants highly speculative. Although we believe it is possible that participation could be substantially less than the estimate, thereby reducing actual costs substantially below the $101 million requested, the uncertainty about program participation makes inadvisable any reduction in this item at this time.

PERSONAL PROPERTY TAX RELIEF

Item 427 from the General Fund — Budget p. 1203

Requested 1979–80	$244,600,000
Estimated 1978–79	216,500,000
Actual 1977–78	417,776,829
Requested increase $28,100,000 (13.0 percent)	
Total recommended reduction	None

GENERAL PROGRAM STATEMENT

The Personal Property Tax Relief program reimburses local governments for the revenue losses resulting from the 50 percent property tax exemption on business inventories. Local governments are also reimbursed under this program for revenue losses due to a 50 percent exemption of livestock head-day taxes and special provisions for assessing motion picture films, and wine and brandy.

ANALYSIS AND RECOMMENDATIONS

We recommend approval.

Table 1 summarizes actual expenditures for personal property tax relief in the 1977–78 fiscal year and estimated expenditures for the current and budget years. The $244.6 million budgeted for 1979–80 is a 13 percent increase over the $216.5 million estimated for the current year. Ninety-eight percent of personal property tax relief expenditures—about $241 million—consists of subventions to local government for revenue losses resulting from the business inventory exemption. Chapter 173, Statutes of 1977, provided additional tax relief for livestock owners for the 1977–78 tax year only. The act provided for a *complete* exemption from the head-day tax to owners of livestock adversely affected by the drought. The exact amount of this additional relief is not known, but it is not thought to be a significant part of the total for the 1977–78 fiscal year.

As shown in Table 1, reimbursements for the motion picture film and the wine and brandy exemptions are budgeted to increase 7.1 percent above expenditures estimated for the current year. The statutory reimbursement formulas for these exemptions specify that the amount of the reimbursement shall be based on the applicable tax rate and an average of the assessed valuation prior to the original effective date of the exemption. Thus, because assessed values are fixed for reimbursement purposes and because the tax rate should not change significantly given the one percent limit imposed by Proposition 13, the reimbursement for these exemptions also should not change from the current to the budget year. However, given the substantial uncertainty about the rate at which the value of business inventories will grow, we do not believe a reduction in this item is necessary.

Table 1
Personal Property Tax Relief
Summary of Expenditures

	Actual 1977–78	*Estimated 1978–79*	*Proposed 1979–80*	*Percent Change*
Business Inventory Exemption	$412,634,204	$212,578,400	$240,800,000	13.3%
Motion Picture Films	3,039,199	1,400,000	1,500,000	7.1
Wine and Brandy	29,842	14,000	15,000	7.1
Livestock Head-Day Tax Exemption	2,073,584	2,100,000	2,200,000	4.8
Total	$417,776,829	$216,092,400	$244,515,000	13.2%

Table 2 provides a breakdown of exempt assessed values, tax rates, and expenditures under the business inventory exemption.

Table 2
Business Inventory Exemption
Exempt Assessed Values and Expenditures
(in millions)

	Actual 1977–78	*Estimated 1978–79*	*Proposed 1979–80*	*Percent Change*
Exempt Assessed Values	$3,643	$4,252	$4,760	12.0%
Chapter 1394, Statutes of 1978	—	—	56	N.A.
Less Nonreimbursable Escape Assessments [a]	−28	—	—	N.A.
Net Reimbursable	$3,615	$4,252	$4,816	13.3
Average Property Tax Rate	$11.41	$5.00	$5.00	—
Expenditures	$412.5	$212.6	$240.8	13.3

[a] Represents exemption allowed on escape assessments made under a U.S. Supreme Court decision (*Michelin Tire Corp. v. Wages*) which permitted taxation of certain imported goods. Claims for reimbursements have been disallowed (see text).

The estimate for the budget year assumes a 12 percent growth rate in the base assessed value of business inventories. This compares to a nearly 17 percent increase for 1978–79 and reflects the expectation that the recent rapid growth in the value of business inventories will decline somewhat in the coming year. Projected expenditures for the business inventories exemption of $240.8 million in 1979–80 represents slightly more than a 13 percent increase over the 1978–79 subventions of $212.6 million. This expenditure growth rate is slightly higher than the anticipated 12 percent increase in the base value of business inventories because of the enactment of Chapter 1394, Statutes of 1978. This act defined business inventories to include goods held by a licensed contractor but not yet incorporated into real property. The assessed value of these goods has been estimated to be $56 million for the 1979–80 tax year.

PERSONAL PROPERTY TAX RELIEF—Continued

Effects of Proposition 13

Proposition 13 requires the assessed valuation of existing *real* property to be rolled back to 1975–76 values and inflated thereafter by increases in the Consumer Price Index up to 2 percent per year. Real property may be reassessed at market value only in the event of a change in ownership. Because business inventories are *personal* property, they are not affected by the provisions which roll back and restrict the growth of real property assessed values. Thus, except for the possible influence of Proposition 13 on general economic conditions, we would expect the total assessed valuation of business inventories ($8,504 million in the current year) to grow at approximately the same rate that it has over the last several years, or by about 11 to 12 percent annually.

The impact of Proposition 13 on the tax *rate* applied to business inventories in 1978–79 is currently the subject of litigation. Proposition 13 provides that the tax rate applied to *real* property shall be no greater than 1 percent of market value (plus that rate required to retire voter approved indebtedness).

Because the Constitution requires that the tax rate not be higher on personal property than on real property in the same taxing jurisdiction, the Attorney General has opined that personal property is subject to the same 1 percent limitation as real property. The Constitution also requires, however, that the tax rate applicable to the unsecured roll (most of which is personal property) shall be the *prior year's* secured tax rate. Last year's (1977–78) secured tax rates were considerably higher than the 1 percent limitation imposed by Proposition 13 beginning in the current year. Therefore, the issue is whether those prior-year rates or the tax rate set by Proposition 13 should apply to property on the unsecured roll in 1978–79. (This will not be a problem in future years because the prior-year rate applicable to unsecured property will clearly be subject to the 1 percent limitation beginning in 1979–80.) Because most business inventories (63 percent) appear on the *unsecured* roll, the resolution of this controversy will affect the amount of taxes paid in 1978–79 by owners of business inventories *and* the state's cost for reimbursement of the 50-percent exemption.

Initially, 13 counties filed statements with the Controller for reimbursement of the exemption based on the use of last year's secured tax rate. On the basis of the Attorney General's opinion, however, the Controller has refused to reimburse local governments for amounts that exceed those derived by using the 1 percent limitation (plus indebtedness). Following that decision, 11 counties refiled claims for reimbursement using the Proposition 13 tax rate (currently estimated to average about $4.93), though some have filed under protest.

The relative tax burden borne by business inventories will increase in the near future because, as was mentioned above, Proposition 13's limit on the growth of assessed value does not apply to business inventories. Therefore, until an equilibrium rate of changes in ownership is reached for other types of property, the assessed value of business inventories should grow at a rate somewhat higher than the growth of the rest of the locally-assessed property tax roll.

Disallowed Reimbursements for Exempt Escape Assessments

In *Michelin Tire Corp.* v *Wages,* the U.S. Supreme Court ruled that counties are permitted to assess certain imported goods which previously were considered exempt under the federal Constitution. Escape assessments on affected property were specifically prohibited by Chapter 335, Statutes of 1976, but this prohibition was challenged. In *Schettler v. County of Santa Clara,* the state Court of Appeal held that the Legislature could prohibit escape assessments on property affected under the *Michelin* decision. While this litigation was still pending, the Department of Finance indicated that, regardless of the outcome of the litigation, claims for reimbursement of exemptions allowed on escape assessments made as a result of the *Michelin* decision would *not* be allowed. Accordingly, as shown in Table 2, exempt escape assessments estimated at $28 million in 1977–78 have been excluded from reimbursable exempt assessed values of business inventories.

HOMEOWNERS' PROPERTY TAX RELIEF

Item 428 from the General Fund — Budget p. 1203

Requested 1979–80	$132,000,000
Estimated 1978–79	347,000,000
Actual 1977–78	758,981,306
Requested decrease $215,000,000 (62.0 percent)	
Total recommended reduction	$20,000,000

SUMMARY OF MAJOR ISSUES AND RECOMMENDATIONS — *Analysis page*

1. *Overestimate. Reduce Item 428 by $20 million to reflect revised estimate of direct refunds to homeowners.* 1367

GENERAL PROGRAM STATEMENT

The homeowners' property tax exemption is $1,750 of the assessed value ($7,000 full value) of an owner-occupied dwelling. For the current year, this exemption will provide over 4 million homeowners with an estimated average property tax reduction of $87. The state reimburses local government for all revenue losses resulting from the exemption.

Chapter 1060, Statutes of 1976, extended the homeowners' exemption to welfare recipients, effective with the 1976–77 fiscal year. Because this extension was enacted after the April 15, 1976, filing deadline, only late claims (limited to 80 percent of the exemption) could be filed for 1976–77. Although actual data on late claims filed by welfare recipients for 1976–77

HOMEOWNERS' PROPERTY TAX RELIEF—Continued

are not available, it is estimated that reimbursements of about $7 million for 40,000 to 60,000 such claims were included in the total 1977–78 reimbursements of $759 million.

Proposition 13 Reduces State Relief Cost

Table 1 summarizes the number of claims, exempt assessed value, and expenditures related to the Homeowners' Property Tax Exemption program. Figures shown in this table for the budget year are based on provisions of current law. As discussed below, expenditures actually budgeted for 1979–80 assume the enactment of legislation which would change the program from a property tax exemption to an income tax credit or rebate. The budget request for this item represents only the money that would actually be refunded to homeowners whose income tax liability is less than the proposed credit.

Table 1
Homeowners' Property Tax Exemption
Summary of Current-Law Expenditures

	Actual 1977–78	*Estimated 1978–79*	*Estimated 1979–80*	*Percent Change*
Claimants (thousands)	3,890	3,967	4,050	2.1%
Exempt Assessed Value (millions)	$6,787	$6,938	$7,088	2.2
Per Claimant Averages:				
Exempt assessed value	$1,745	$1,749	$1,750	0.1
Tax benefit	193	87	88	1.1
Property Tax Rate	$11.08	$5.00	$5.00	—
State Expenditures (millions):				
Current year	$752	$347	$354	2.0
Adjustments [a]	7	—	—	—
Total Expenditures	$759	$347	$354	2.0

[a] Represents reimbursements in 1977–78 for an estimated 40,000 to 60,000 late claims filed for 1976–77 by welfare recipients under Chapter 1060, Statutes of 1976 (Chapter 1060 extended the homeowners' exemption to welfare recipients).

Estimated current-year costs under this program of $347 million represent a substantial (54 percent) reduction from total reimbursements of $759 million in 1977–78. The reduction was caused by the lower property tax rates brought about by Proposition 13, and it was only nominally offset by the 2 percent growth in the number of claimants. Because the homeowners' exemption is fixed at $1,750 of assessed value, state costs for this program are not affected by changes in property *values* or the limits on assessed value growth set by Proposition 13. They depend on the *number of homeowners* and the *level of tax rates* applicable to owner-occupied property. In the current year, Proposition 13 reduced tax rates by more than one-half from the previous year.

ANALYSIS AND RECOMMENDATIONS

The budget requests $132 million for this program in 1979–80, which is $215 million, or 62 percent, below estimated expenditures in the current year. This substantial reduction reflects the assumption that legislation will be enacted to revise the program. Specifically, the Governor's Budget proposes that the existing $1,750 homeowners' property tax exemption be replaced by an $87 income tax credit or direct rebate. The rebate would be paid to those homeowners whose income tax liability is less than the credit. The proposed $87 credit is about equal to the estimated *statewide average* property tax benefit currently provided by the $1,750 homeowners' exemption. During the current year (1978–79), the exemption will result in an average property tax reduction of about $87 per homeowner, based on an assumed statewide average homeowners' tax rate of $5 per $100 of assessed valuation. (The current estimate of this rate is actually $4.86, which represents the effective maximum tax rate under Proposition 13 of $4, plus an allowable override for debt service averaging about $0.86. However, because of some uncertainty as to what the actual rate will be, a $5 rate has been used to estimate the required reimbursement.)

Reduce Item to Adjust for Overestimation

We recommend that the appropriation for Item 428 be reduced by $20 million to reflect the Department of Finance's revised estimate of funds to be refunded to homeowners.

The budget request of $132 million for 1979–80 is intended to represent that portion of the cost of the proposed income tax credit which actually would have to be *refunded* to those homeowners whose state income tax liability is less than the $87 credit. The Department of Finance indicates, however, that since release of the budget it has revised downward the $132 million estimate by $20 million. Accordingly, the department now estimates that direct refunds under the proposed credit would be $112 million. We recommend that the appropriation be reduced by $20 million to reflect this revised estimate.

Our recommendation recognizes that the proposed change to an income tax credit requires legislation in order to become effective. If this legislation is *not* passed, the appropriation will be *deficient* by an estimated $242 million—the difference between our estimate of program costs under current law ($354 million) and Finance's revised estimate of the cost of the proposed credit ($112 million).

The following discussion outlines some of our basic concerns regarding the income tax credit given our general understanding of the proposal.

Proposed Credit Results in Higher Program Cost

Table 2 summarizes Department of Finance estimates of both the General Fund expenditure and revenue effects of the proposed shift from a property tax exemption to an income tax credit or rebate. In addition to the revised figure of $112 million ~~in~~ direct outlays, Finance's estimates indicate that personal income tax revenues projected for 1979–80 have been reduced by $262 million to reflect that portion of the proposed $87 credit which would be an offset against homeowners' income tax liabilities. As Table 2 shows, this figure includes offsetting interactions with (1) existing income tax law provisions and (2) the tax reduction proposal made in the budget. In effect, this $262 million income tax reduction is the "tax expenditure" portion of the estimated total cost resulting from the proposed homeowners' $87 tax credit.

Although the proposed credit is about equal to the average tax relief

HOMEOWNERS' PROPERTY TAX RELIEF—Continued

provided by the existing exemption, the cost of the credit would be higher than the cost of the exemption because of the indirect effect this change would have on income tax revenues. Replacement of the exemption by a tax credit would increase homeowners' net property tax liability, resulting in a corresponding increase in property tax deductions taken on income tax returns and a consequent decrease in income tax revenues which Finance has estimated at about $20 million. It is this $20 million revenue decrease which effectively raises the state "cost" of the tax credit program from $354 million to $374 million.

It is not clear that the proposed credit is *intended* to increase total benefits provided by the homeowners' tax relief program. In any case, we believe that *all* existing property tax relief programs should be reevaluated in light of the substantially lower property tax burdens brought about by the passage of Proposition 13. In this context, it may be difficult to justify a $20 million increase in homeowner tax relief benefits.

Table 2
Proposed Homeowners' Income Tax Credit
Summary of Department of Finance Estimates
Expenditure and Revenue Effects

	Actual 1977–78	*Estimated 1978–79*	*Proposed 1979–80*	*Percent Change*
Expenditures				
Shown in Budget	$759	$347	$132	–62%
Less Adjustment for Overestimate	—	—	–20	—
Net Expenditures	$759	$347	$112	–68%
Revenue Reductions				
Homeowners' Income Tax Reduction	—	—	262	—
Plus Reduction Due to Higher Property Tax Deductions [a]	—	—	20	—
Less Interaction with Tax Reduction Proposal [b]	—	—	–20	—
Net Revenue Reduction	—	—	$262	—
Net General Fund Impact	$759	$347	$374	7.8%

[a] The proposed credit will cause homeowners' income tax revenues to decrease by *more* than the $87 credit because of higher property taxes and, thus, higher itemized deductions (see text).
[b] The tax credit proposed for *all* income taxpayers in the budget will decrease tax liabilities for homeowners by $20 million and, consequently, will increase the number of homeowners whose income tax liability is less than the proposed credit. This will require a corresponding increase in direct refunds (the higher refunds are included in the budgeted appropriation).

Constitutionality of the Proposed Change

The homeowners' exemption is currently provided under Article XIII, Section 3, Subdivision (k) of the State Constitution, which specifies that $7,000 of the full value ($1,750 assessed value) of an owner-occupied dwelling shall be exempt from property taxation. A constitutional issue arises because, while an $87 tax credit is about equal to the average tax benefits that will be derived from the homeowners' exemption based on the *average* statewide tax rate, there are some homeowners for whom the applicable tax rate is *higher* or *lower* than the estimated average rate of $5. The application of that higher or lower tax rate to the $1,750 exempt assessed value will result in a higher or lower tax benefit than the $87 average benefit.

Both the Attorney General and the Legislative Counsel have indicated that the proposed income tax credit is constitutional in view of language in the Constitution which states that the Legislature may deny the exemption if homeowners received state aid to pay all or a portion of their property taxes. The Attorney General qualified his position with the statement that any *substantial* reduction of the tax benefit below that conferred by the exemption would be subject to the challenge that the in-lieu income tax credit subverts the exemption.

Tax Shift

Regardless of the constitutionality of the proposed change, the move to an $87 income tax credit would result in a shift in tax relief benefits to an unknown number of taxpayers. For certain individual homeowners, the property tax reduction currently provided by the $7,000 exemption could be *greater* than the proposed $87 income tax credit. This is because, although debt service levies allowed under Proposition 13 are estimated to average $0.86 statewide in 1978–79, debt service levies imposed within a significant number of taxing jurisdictions are reported to be higher than $2. When combined with the $4 maximum rate, debt service levies of this magnitude would result in a property tax reduction under the current homeowners' exemption of over $105. (In very rare cases, where debt service levies are reported to exceed $16, the property tax reduction under current law would be over $350.)

Administrative Costs of the Current Program

Local Costs. The most significant local costs associated with the administration of the existing homeowners' exemption program are incurred by several agencies of county government. County assessors spend a total of about $4 million statewide to send notices to homeowners, maintain their files of claims, and make additions and deletions to those files. County auditors incur relatively minor costs to produce claims for reimbursement by the state of the local tax loss resulting from the exemption. Finally, the largest local costs associated with the administration of the exemption are those resulting from the need to make formal corrections to the locally assessed property tax roll on the basis of changes in claims that are filed after the assessor has turned the roll over to the county auditor. Estimates of this cost range from $4 million to $10 million statewide. Thus, the total cost of administering the current homeowners' exemption program at the local level is estimated at *$8 million to $14 million* per year.

State Costs. State costs incurred under the current program are minor. The Board of Equalization collects records of claims from all counties. This file is checked for duplicate claims and then given to the Franchise Tax Board, which checks it against its own records to disqualify persons from a renter's credit who have already claimed a homeowners' exemption. Total state costs for this process are slightly more than $40,000 per year. Approximately $1.5 million in state income tax revenues are saved as a result of renters' credits disallowed through this process.

HOMEOWNERS' PROPERTY TAX RELIEF—Continued

Potential Impact on Administrative Costs

Local. The Governor's Budget states that the shift from the homeowners' exemption to an income tax credit would reduce *local* administrative costs by over $10 million annually. Without more specific information as to the details of the proposed change, it is difficult to evaluate this claim. It is likely that the $4 million to $10 million spent by local agencies to process corrections to the tax roll after it has been filed by the assessor would no longer be incurred. Because a tax credit presumably would be paid after the close of the prior calendar year, there would be no need to accommodate late claims by homeowners.

It is not clear whether the costs incurred by county assessors to register homeowners would be saved. The proposal does not specify whether there would be a continuing need to verify ownership and/or residency under the new program. If verification is still required, county assessors are the most appropriate agency to make this check, in which case the $4 million expenditure for this purpose would continue. (If notices to homeowners were no longer required, this cost could be significantly reduced, but the ability of the assessor to verify ownership would also be reduced.)

State. If verification of homeownership is not required, significant costs could result from fraudulent claims for the tax credit. Because homeowners would receive $87 under the proposal and renters only the $37 provided under existing law, there would be an incentive for renters to fraudulently claim the homeowners' tax credit. The potential for abuse is uncertain, but the cost in terms of higher revenue losses could be substantial. Higher program costs also would result if late claims (currently those filed after March 1) were given the *full* benefit of the tax credit as opposed to receiving only the 80-percent exemption allowed under the current program. This potential revenue loss, estimated to be as high as $2 million, could be avoided if the proposed tax credit were prorated based on that portion of the year during which an individual owns a home.

Although it appears that there may be very minor cost savings in the area of claims verification currently conducted at the state level, a significant *additional* cost would be incurred due to the need to send tax refund checks to homeowners whose income tax liability is less than the $87 credit.

Impact on California's Revenue Sharing Allocation

One significant effect of a shift from the homeowners' exemption to an income tax credit would result from the manner in which the expenditures for the proposed credit would be treated in the budget. As indicated above, the bulk of the actual cost of the income tax credit is reflected in the budget as a reduction of personal income tax revenues. Only that portion of the total expenditures for the tax credit that will actually be refunded to homeowners is appropriated under this item. While the reduction in income tax revenues is partially offset by increased local property tax revenue, the net result of this method of accounting could be about an $8.5 million *reduction* in California's revenue-sharing allocation. In making this estimate, we have assumed that the federal revenue-sharing program will be extended beyond its current September 30, 1980, termination date and that the allocation formula would remain the same. State allocations under the current revenue-sharing program would *not* be affected because the data that will be used to determine California's allocation through the end of the program have already been collected.

If the total cost of the proposed program were appropriated rather than being accounted for as a "tax expenditure", the result would be approximately a $2 million *increase* in the state's revenue sharing allocation under the same assumptions as above. This is due to the increase in local property taxes resulting from the proposed elimination of the exemption.

An even more significant effect on the state's revenue sharing allocation could result from changes over time in the amount of intergovernmental transfers from the state to local governments. Under *present law,* a reduction of state transfers below the level of transfers during the prior 24-month period results in a *dollar-for-dollar* reduction of the state's revenue sharing allocation. A change of the homeowners' exemption program to an income tax credit and the elimination of the state subvention to reimburse local governments for the property loss from the exemption might be considered a reduction of intergovernmental transfers by the federal Office of Revenue Sharing.

Creation of a "Tax Expenditure"

In addition to its potential impact on California's revenue sharing allocation, the accounting procedure which would be utilized by the proposed homeowners' tax credit has another potential drawback. Under existing law, the *entire* cost of the homeowners' tax relief program is treated as an expenditure and, as such, is subject to annual legislative review through the budgetary process. However, as discussed above (and shown in Table 2), only that portion of the total cost of the proposed tax credit actually refunded to homeowners would be appropriated in the budget. The balance of this program's total impact on the General Fund ($262 million) would be reflected as a reduction in income tax revenues.

A reduction of state income taxes for purposes of providing a subsidy or benefit to selected taxpayers can generally be termed a "tax expenditure" (as opposed to "income tax relief"), if the revenue reduction is unrelated to *income* tax policy goals. The problem with such "tax expenditures", from a budgetary standpoint, is that they represent hidden state costs. They often are difficult to document or estimate and are not directly included or reviewed as part of the overall state spending plan.

Accordingly, we believe that, if the proposed homeowners' tax credit is enacted, the *entire* cost of the credit should be appropriated in the budget, as is now the case for the existing renters' income tax credit. In addition to subjecting the total cost of the program to budgetary review, this also would minimize the potential reduction in federal revenue sharing funds discussed above.

OPEN-SPACE PAYMENTS TO LOCAL GOVERNMENT

Item 429 from the General Fund — Budget p. 1203

Requested 1979–80	$16,000,000
Estimated 1978–79	15,000,000
Actual 1977–78	18,818,252
Requested increase $1,000,000 (6.7 percent)	
Total recommended reduction	$16,000,000

SUMMARY OF MAJOR ISSUES AND RECOMMENDATIONS

Analysis page

1. *Eliminate funding. Reduce Item 429 by $16 million.* Recommend funds budgeted for open-space subventions be eliminated. 1373

GENERAL PROGRAM STATEMENT

The open-space subventions provide replacement revenues to cities and counties to compensate for reduced property tax revenues on open-space and agricultural land.

The Constitution authorizes the Legislature to provide for the assessment of land at less than market value if it is under enforceable restrictions. Under the California Land Conservation Act of 1965 (the Williamson Act) and related open-space laws, cities and counties may enter into contracts with landowners to restrict the use of property to open-space and agricultural use.

The Secretary of the Resources Agency, through the Department of Conservation, administers subventions to cities and counties.

ANALYSIS AND RECOMMENDATIONS

Section 16140 of the Government Code appropriates General Fund money for open-space subventions to counties and cities. However, Budget Act appropriations have superseded the statutory authorization since the subventions began in 1972.

The budget requests $16 million for the 47 counties and 20 cities which are expected to have under contract a total of about 17 million acres during 1979–80. The subvention for cities and counties is determined by a formula which bases the amount of money provided for each acre of land under contract on the type of land and its location. For this purpose, land is classified as "prime" or "nonprime". "Prime" agricultural land is defined as land rated as class I or II in the Soil and Conservation Service land use capability classification, or other comparable classification.

As of the current year, school districts no longer qualify for subventions for open space contracts because post-Proposition 13 tax rates have fallen below limits specified by Section 16148 of the Government Code. To account for this change, the appropriation for the current year was reduced by $7 million from the $22 million initially budgeted.

Eliminate Program Funding

We recommend that (1) the funding for open-space subventions be eliminated by revising this item to reappropriate the $16 million to the surplus in the General Fund, and (2) Section 16140 of the Government Code be repealed to eliminate the statutory appropriation.

We believe that funding for the open-space program should be eliminated for two major reasons. First, a substantial portion of the state subvention is paid for land under contract that is not subject to development pressures. Second, Proposition 13 has significantly reduced any incentive that may have existed for an owner whose land is threatened by development to place that land under contract.

In past years, we have criticized the open-space program as providing a reduction in property taxes, and a state subvention, for land that was not threatened by development and, presumably, not in need of an incentive to remain in agricultural or open-space use. We also have questioned whether the reduced tax liability provided by an open-space contract was a sufficient incentive for an owner of land that was threatened by development to place that land under contract for a 10-year period. These basic concerns, in our judgment, continue to be valid. Moreover, the effect of property tax reductions under Proposition 13 has been to reduce further any incentives provided under this program.

Land Not Threatened by Development. The Department of Conservation is currently developing estimates of the amount of nonprime land under contract in nonurban areas. We estimate that more than 75 percent of the nonprime land is outside urban areas and not threatened by development. Reimbursements for this nonprime land will amount to at least $3.4 million of the $16 million subvention request. Similarly, the bulk of the prime land under contract is located outside of urban areas. Because it is outside urban areas, most of this land presumably is not threatened by development. Table 1 shows, for the 1977–78 fiscal year, the breakdown of acreage under open-space contract by counties and cities and type of land.

Table 1
Actual Open-Space Acreage Under Contract in Counties and Cities for 1977–78

	Urban Prime Land[a]	*Other Prime Land*	*Nonprime Land*	*Total Acreage*
Counties	501,203	4,276,897	10,800,022	15,578,122
Cities	7,216	202	39,921	47,339
Total	508,419	4,277,099	10,839,943	15,625,461

[a] Land that is located within three miles of a city with a population of 15,000 or more.

It is difficult to identify specifically the amount of land that is not located in an urban area and yet might be threatened by development. At the same time, we believe it is not in the state's interest to provide a property tax reduction for land which is not in danger of being converted from agricultural or open-space use.

Effect of Proposition 13. Proposition 13 reduces the likelihood that

OPEN-SPACE PAYMENTS TO LOCAL GOVERNMENT—Continued

restricted valuation of land is an effective inducement to the placement of land under an open-space contract. A favorable differential still exists between the taxes on restricted and unrestricted value, but because property taxes have been reduced by over 50 percent under Proposition 13, the amount and, consequently, the effectiveness of this tax differential as an incentive to restrict the use of land also has been reduced. Moreover, because Proposition 13 limits the growth of the assessed value of land not under contract (except when that land is sold), increases in property taxes will not exert the same pressure for development as they may have prior to Proposition 13.

For these reasons, we recommend that the subventions to local governments for open-space contracts be eliminated and that the Legislature consider more direct methods of protecting agricultural and open-space land that is threatened by development. Because of the continuing appropriation in statutory law for the subventions, this recommendation will require rewriting the item to reappropriate the money to the surplus in the General Fund. We also recommend that Section 16140 of the Government Code be repealed to eliminate the continuing appropriation.

Our recommendation would have the effect of reducing state subventions to the approximately 70 local jurisdictions which will participate in the open-space program by an estimated $16 million in the budget year. In light of the limitations placed on local fiscal resources by Proposition 13, it is important to note that our purpose in making this recommendation is *not* to generate state General Fund savings at the expense of local government revenues. Rather, we believe that these funds should not be expended to support what is, in our judgement, an ineffective program. The $16 million budgeted for open space subventions would, of course, continue to be available for other forms of local assistance.

PAYMENTS TO LOCAL GOVERNMENTS FOR SALES AND PROPERTY TAX REVENUE LOSS

Item 430 from the General Fund — Budget p. 1203

Requested 1979–80	$4,454,500
Estimated 1978–79	4,885,000
Actual 1977–78	5,529,835
Requested decrease $430,500 (8.8 percent)	
Total recommended reduction	$2,063,500

GENERAL PROGRAM STATEMENT

Chapter 1406, Statutes of 1972, as amended by Chapter 1135, Statutes of 1977, requires the state to reimburse local government for the net loss resulting from sales or property tax exemptions enacted after January 1, 1973. The budget identifies nine statutes which have ongoing funding requirements and therefore need annual Budget Act appropriations. All of the statutes are funded from this single budget item, which allows the State Controller flexibility to cover deficits resulting from some statutes with surplus funds for others.

ANALYSIS AND RECOMMENDATIONS

The budget estimates that required reimbursements in 1978–79 to local government for property tax revenue losses under six of the statutes funded by this item will be significantly less than originally appropriated for the current year. This is because passage of Proposition 13, by reducing the level of property tax rates, reduced the revenue loss resulting from the property tax exemptions contained in these statutes. The Department of Finance has estimated the state's current-year savings to be $1,832,000.

The amounts budgeted for the following statutes in 1979–80 appear to reflect the applicable revenue loss, and we recommend that they be approved.

	Estimated 1978–79	*Requested 1979–80*
Chapter 16, Statutes of 1973	$35,000	$40,000

This measure increased the property tax exemption for blind veterans residing in corporate-owned residences from $5,000 to $10,000 of assessed value.

	Estimated 1978–79	*Requested 1979–80*
Chapter 456, Statutes of 1974	$7,000	$7,000

This measure exempts the intangible value of business records, including the information they contain or the value of their use. Title records are an example of documents having intangible value which became exempt from taxation under this statute.

	Estimated 1978–79	*Requested 1979–80*
Chapter 1467, Statutes of 1974	$195,000	$215,000

This statute provides that documented commercial fishing vessels (including party boats) are to be assessed at 1 percent rather than 25 percent of full cash value.

	Estimated 1978–79	*Requested 1979–80*
Chapter 961, Statutes of 1977	$385,000	$395,000

This statute extends disabled veterans' property tax exemption benefits to the unmarried surviving spouses of disabled veterans who died prior to January 1, 1977, but who would have been eligible for the exemption under laws in effect on that date.

	Estimated 1978–79	*Requested 1979–80*
Chapter 878, Statutes of 1978	$1,600	$2,500

This statute exempts from sales taxes medical alert tags furnished by nonprofit organizations.

PAYMENTS TO LOCAL GOVERNMENTS FOR SALES AND PROPERTY TAX REVENUE LOSS—Continued

	Estimated 1978–79	Requested 1979–80
Chapter 1273, Statutes of 1978	—	$35,000

This measure extends disabled veterans' benefits to disabled veterans and their unmarried surviving spouses if the veteran's disability is the result of a disease incurred during military service.

	Estimated 1978–79	Requested 1979–80
Chapter 1276, Statutes of 1978	—	$125,000

This statute increases from $10,000 to $15,000 of assessed value the property tax exemption for disabled veterans, and their surviving spouses, whose income satisfies the criteria for the Senior Citizens' Tax Deferral program.

Reimbursement in Excess of Revenue Loss

We recommend that Item 430 be reduced by $2,063,500 to more accurately reflect actual losses to local governments in light of lower post-Proposition 13 tax rates.

We believe that for two of the statutes the estimated revenue loss on which the reimbursement amount is based is too high. Additional changes should be made to more accurately reflect actual tax revenue losses to local governments in light of lower tax levels. The net result of these modifications, which are discussed below, is our recommended reduction of $2,063,500.

	Estimated 1978–79	Requested 1979–80
Chapter 1165, Statutes of 1973	$80,000	$85,000

This statute requires that lands governed under a wildlife habitat contract shall be valued on a restricted basis similar to the method of valuing open-space lands. The statute also provides that local governments shall be reimbursed for the actual revenue loss that results from the use of restricted value. However, the budget request related to this statute does not reflect the drop in applicable property tax rates as a result of Proposition 13. Therefore, we recommend that the item be reduced by $40,000 to reflect the estimated change in tax rates.

	Estimated 1978–79	Requested 1979–80
Chapter 1169, Statutes of 1973	$3,350,000	$3,550,000

This statute excludes from the computation of certificated aircraft assessed value any time spent by the aircraft in California prior to first revenue flight and any subsequent ground time in excess of 12 hours. The measure does not require local governments to keep records of the actual revenue loss resulting from the exemption. Instead, it provides that the amount of reimbursement to each local government be determined by taking the revenue reduction computed to result from the exemption in 1972–73 and increasing it by 12 percent for 1974–75 and by 6 percent for each subsequent year.

The dramatic reduction in property tax rates brought about by Proposition 13 has significantly reduced the local revenue loss resulting from Chapter 1169. Because the effects of Proposition 13 could not have been anticipated when the subvention formula was developed, this formula will result in reimbursements that exceed the actual local revenue losses which the statute intended to cover in both the current and the budget years. For this reason, we recommend that the scheduled reimbursement be reduced in each county by the average percent decrease in the countywide average property tax rate brought about by the proposition. We estimate that this adjustment would reduce the average reimbursement by 57 percent, for a savings of $2,023,500.

RENTERS' TAX RELIEF

Item 431 from the General Fund — Budget p. 1203

Requested 1979–80	$148,000,000
Estimated 1978–79	135,000,000
Actual 1977–78	126,471,603
Requested increase $13,000,000 (9.6 percent)	
Total recommended reduction	None

GENERAL PROGRAM STATEMENT

The Renters' Tax Relief program provides a flat $37 payment to qualified renters without regard to age or income. Qualified renters include persons who (1) are residents of California and (2) rented and occupied a dwelling in California as their principal residence on March 1. Married persons are generally entitled to one credit. The renters' credit is not available to persons who (1) rent property that is exempt from property taxes, (2) are claimed as a dependent for income tax purposes by persons with whom they are living, or (3) receive the homeowners' property tax exemption. A partial credit is available for persons with less than 12 months' residence. The program is administered through the Personal Income Tax program as a refundable credit. That is, the $37 credit is applied first to any income taxes due, with the balance refunded to the renter. Persons with no income tax liability must file a return to receive the tax relief payment.

ANALYSIS AND RECOMMENDATIONS

We recommend approval.

The Governor's Budget recommends an appropriation of $148 million in the budget year, an increase of 9.6 percent over the current year.

Table 1 displays information on the number of claimants and the ex-

RENTERS' TAX RELIEF—Continued

penditures under this program for the 1977–78 through 1979–80 fiscal years. The large increase (14.4 percent) forecast in the budget year reflects (1) a continuation of historical growth in the renter population (3.8 percent) and (2) expanded eligibility due to Chapter 569, Statutes of 1978 (10.6 percent). Chapter 569 allows renters who receive public assistance to receive the full amount of the renters' credit. Formerly, such persons could claim only a portion of the credit based on the number of months during which they did not receive public assistance. This change is expected to result in an additional 378,000 persons claiming renters' tax relief totaling $14.0 million.

Table 1
Renters' Tax Relief Program
Summary of Claimants and Expenditures

	Actual 1977–78	*Estimated 1978–79*	*Proposed 1979–80*
Claimants			
Number	3,468,000	3,561,000	4,074,000
Percent increase over prior year	7.8%	2.7%	14.4%
Expenditures			
Amount	$126,471,603	$135,000,000	$148,000,000
Percent increase over prior year	3.1%	6.7%	9.6%

FEDERAL REVENUE SHARING

Item 432 from the Federal Revenue Sharing Fund — Budget p. 1209

Requested 1979–80	$276,200,000
Estimated 1978–79	276,200,000
Actual 1977–78	215,000,000
Requested increase—None	
Total recommended reduction	None

ANALYSIS AND RECOMMENDATIONS

We recommend approval.

The State and Local Fiscal Assistance Act of 1972 (general revenue sharing) was enacted on October 20, 1972.

The act was designed to give financial aid to state and local governments. The allocation of general revenue sharing funds among the recipient governments for each entitlement period is made according to statutory formulas using data such as population, general tax effort, and income tax collections.

The State and Local Fiscal Assistance Amendment of 1976 extended the program to September 30, 1980. No substantive changes were made to the allocation formulas. The new law, however, requires recipient governments to hold public hearings on proposed uses of the funds.

Table 1 gives a breakdown of (1) the total federal revenue sharing funds