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June 22, 2015

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional and statutory initiative related to homeowners and renters tax relief (A.G. File No. 15-0028).

Background

Local Governments in California Levy Taxes on Property Owners. Local governments in California levy taxes on property owners based on a property's assessed value, known as ad valorem property taxes. (For the remainder of the letter, ad valorem property taxes are referred to simply as property taxes.) The State Constitution limits, with narrow exceptions, the property tax rate to 1 percent of the assessed value of a property. Local governments, with voter approval, may raise the property tax rate only for two purposes: (1) to pay debt approved by voters prior to July 1, 1978 and (2) to finance bonds for infrastructure projects.

Property Taxes Are a Major Source of Local Government Revenue. Californians paid around $52 billion in property taxes in 2013-14. County auditors distribute property tax revenues to local governments—schools, community colleges, counties, cities, and special districts—pursuant to state law. Property tax revenues typically are largest local revenue source for most local governments.

Homeowners Receive a Property Tax Exemption. The State Constitution grants a $7,000 property tax exemption for owner-occupied housing. This exemption reduces a homeowner's assessed value by $7,000, typically reducing the homeowner's tax payment by about $80 annually. Over 5 million homeowners claim the exemption. The state reimburses local governments for the reduction in property tax revenues resulting from the homeowners' property tax exemption. The cost to the state for reimbursing local governments is $427 million in 2014-15. This amount increases slightly each year, reflecting the growth in the number of homeowners claiming the exemption.

California Taxes Personal Income. California levies a tax, known as the personal income tax (PIT), on the income of state residents, as well as the income of nonresidents derived from California sources. The PIT is the state's largest revenue source, raising $67 million in 2013-14.

Property Owners Can Deduct Property Tax Payments From Taxable Income. Property owners may deduct from their taxable income property tax payments they make to local governments, effectively reducing their tax liability—the amount owed to the state.

Renters Can Receive an Income Tax Credit. Low-income Californians who rent their principal residence may claim an income tax credit, known as the renters' credit, which reduces their tax liability. Single renters with annual incomes of less than about $38,000 can claim a renters' credit of $60, and married couples and heads of households with incomes of less than about $76,000 can claim a credit of $120. The renters' credit is nonrefundable meaning that the credit a taxpayer receives may not exceed his or her tax liability. The renters' credit reduces PIT revenues collected by the state by about $100 million annually.

State General Fund Spending Exceeds $100 Billion. In 2014-15, the state is expected to spend almost $110 billion from its main account, the General Fund. About half of this spending is for education—principally for schools and community colleges but also for public universities. Most of the rest is for health, social services, and criminal justice programs.

Proposition 98 Governs State Spending on Schools and Community Colleges. Earlier propositions passed by voters generally require the state to provide a minimum amount of annual funding for schools and community colleges, known as the "minimum guarantee." The minimum guarantee tends to grow with the economy and number of students. A key input in calculation of the minimum guarantee is state tax revenues. Reductions (increases) in state tax revenues tend to reduce (raise) funding for schools and community colleges.

Proposal

Increases Homeowners' Property Tax Exemption. This measure amends the State Constitution to increase the homeowners' property tax exemption from $7,000 to $32,000, effective January 2017. This would increase a typical homeowner's exemption from around $80 to roughly $365 per year. The measure requires the amount of the exemption to be adjusted annually to reflect inflation. The state would reimburse local governments for their property tax losses resulting from the increase in the exemption. The measure specifies that these increased state reimbursements shall not have a net fiscal impact on the amount of funding received by schools and community colleges.

Creates a Supplemental Renters' Credit. The measure creates a supplemental credit for renters, which would be provided in addition to the existing renters' credit. The supplemental credit would be $125 per year for single renters and $250 per year for married couples and heads of households. These amounts would be adjusted annually to reflect inflation. In contrast to the existing renters' credit, renters could claim the supplemental credit regardless of their income. The measure specifies that the changes to the renters' credit shall not have a net fiscal impact on the amount of funding received by schools and community colleges.

Fiscal Effect

Decreased Local Property Tax Revenues, Increased State General Fund Costs. By increasing the homeowners' property tax exemption to $32,000, the measure would reduce local property tax revenues statewide by around $1.5 billion annually beginning in 2017-18. State costs to reimburse local governments for their property tax losses would increase by a like amount.

Decreased PIT Revenues Due to Renters' Credit Increase. By increasing the renters' credit, the measure would result in reduced state PIT revenues beginning in 2017-18, likely in the several hundreds of millions of dollars annually. (Because the measure's changes would be effective midway through the 2016-17 fiscal year, smaller revenue losses in 2016-17 are possible.) As mentioned above, the measure stipulates that this decrease in state revenue would not affect state funding provided to schools and community colleges.

Increased PIT Revenues From Decrease in Property Tax Deductions. The decrease in PIT revenues due to the change in the renters' credit would be partially offset by an increase in PIT revenues of around $100 million dollars annually arising from a reduction in the amount of property taxes deducted by income tax payers. As a result, state funding to schools and community colleges would tend to increase, likely by several tens of millions of dollars annually.

Decreased Resources for State Budget. In total, the increase in state reimbursements to local governments and net decrease in PIT revenues resulting from this measure would reduce resources in the state budget by around $2 billion per year. This means there would be less available for other state budget priorities, including programs and services, debt payments, budget reserves, infrastructure, and lowering taxes.

Summary of Fiscal Effects.

- Reduced state resources of around $2 billion annually.
- Likely increased funding for schools and community colleges, in the tens of millions of dollars annually.

Sincerely,

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Mac Taylor
Legislative Analyst

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Michael Cohen
Director of Finance