LAO

August 4, 2023

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

Attention: Ms. Anabel Renteria
Initiative Coordinator

Dear Attorney General Bonta:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional amendment related to property taxes (A.G. File No. 23-0005).

BACKGROUND

Local Governments Collect Property Taxes From Property Owners. California local governments—cities, counties, schools, and special districts—levy property taxes on property owners. Property taxes are paid based on the taxable value of the property. Property taxes are a major revenue source for local governments, raising about $90 billion per year (annually) statewide.

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

Property Taxes Often Increase When a Property Changes Ownership. The taxable value of most properties is less than what they could be sold for. This is because, in most years, the price most properties could sell for grows faster than 2 percent per year. As a result, a property's taxable value often resets to a higher amount when it changes ownership. This leads to a higher property tax bill for that property.

Special Rules Prevent Property Tax Increases for Some Inherited Properties. Special rules allow some properties to pass between parents and children without an increase in the property

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tax bill. These rules also apply to grandparents and grandchildren if the grandchildren's parents are deceased. We call properties passed between parents and children or grandparents and grandchildren "inherited property."

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

- ***Ended Special Rules for Properties Not Used as a Primary Home or for Farming.*** Prior to Proposition 19, the rules applied to all types of inherited properties, including vacation homes and business properties. The special rules for vacation homes and business properties only applied to the first $1 million of combined property value. Proposition 19 narrowed these special rules. The rules now only apply to two types of properties: (1) homes that a child or grandchild uses as a primary residence and (2) farms.
- ***Limits Special Rules for High Value Homes.*** Prior to Proposition 19, the special rules were the same for all primary homes, regardless of value. Proposition 19 changed this. Specifically, if the price the inherited property can be sold for exceeds the property's taxable value by more than $1 million (adjusted for inflation), then the tax bill goes up but not as much as it would if the property were sold to someone else.

PROPOSAL

The measure amends the State Constitution to expand the special rules for inherited property. Beginning January 1, 2025, the measure reverses most of the major changes made by Proposition 19. The expanded special rules would apply to future property transfers. The rules would also apply to properties that have transferred since Proposition 19 took effect on February 16, 2021.

Expands Special Rules to All Inherited Properties. The measure makes all types of inherited properties eligible for the special rules that prevent property tax increases. The special rules for vacation homes and most business properties would only apply to the first $1 million of combined property value as was the case prior to Proposition 19.

Expands Special Rules for High Value Inherited Homes. The measure allows the special rules to fully apply to all inherited primary homes, regardless of the home's value as was the case prior to Proposition 19.

FISCAL EFFECTS

Reduced Property Tax Revenue for Schools and Other Local Governments. Expanding the special rules for inherited properties would lead to lower property tax bills for some inherited properties. This reduces property tax revenue going to schools and other local governments. Over the first few years, schools and other local governments would lose several hundred million dollars each year. Over time, these revenue losses would grow to between $1.5 billion and $2 billion annually. About half of the revenue losses would go to cities, counties, and special districts. The other half would go to schools. In some years, the state could face additional cost pressures to provide money to schools to offset their revenue losses.

Effects on County Administrative Costs. County governments administer the property tax. The measure's changes could affect counties' costs to do so. The net effect on county administrative costs is unclear, but likely would not exceed the low tens of millions of dollars annually.

Summary of Fiscal Effects. We estimate that this measure would have the following major fiscal effects:

- Some owners of inherited properties would pay lower property taxes. This would reduce revenue for local governments and schools by several hundred million dollars per year in the first few years. These losses would grow over time, reaching $1.5 billion to $2 billion annually.

Sincerely,

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for Gabriel Petek
Legislative Analyst

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for Joe Stephenshaw
Director of Finance