San Diego County Taxpayers Association
Targeting Waste • Promoting Efficiency
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DISCUSSION DRAFT – DO NOT DISTRIBUTE – DISCUSSION DRAFT

Proposition 13 - the "People's Initiative to Limit Property Taxation"

Proposition 13 (Prop 13), the "People's Initiative to Limit Property Taxation" is a ballot initiative approved by 65 percent of California voters in 1978. Prop 13 limits the amount of property taxes that can be collected by local governments and mandates that any local "special tax" must be approved by a two-thirds vote. The revenue from these "special taxes" must be earmarked for specific uses as detailed in the language of the ballot measure.

This brief analysis will provide an overview of the vocabulary of Prop 13, the historical impetus for the implementation of Prop 13, and the five (5) main provisions of the proposition.

Prop 13 vocabulary

Table 1 below explains some of the relevant vocabulary used by Prop 13.

TABLE 1 Vocabulary of Proposition 13	
TAX	A charge on an individual or business that pays for government services and facilities that benefit the general public
Ad valorem tax	A tax based on the value of real estate or personal property
Property tax	A tax imposed by municipalities upon owners of property within their jurisdiction based on the value of such property
Special tax	A charge whose revenues are used for a specific purpose
ASSESSMENT	An official valuation of property for the purposes of taxation
Acquisition-value assessment	An official valuation of property that takes place when the property is acquired through a change in ownership or when the property experiences new construction
Market-value assessment	An official valuation of property in which the assessor's opinion of the market value of the property is the basis of the assessment
Best-use assessment	An official valuation of property based on the perceived best-use of the property
MARKET VALUE	The estimated amount for which a property should exchange between a buyer and a seller

The impetus behind Prop 13

Prior to Prop 13, property assessments were conducted under a market-value system, which gave assessors a large amount of freedom to determine levels of taxation. This subjective system led to a series of assessment abuses in the 1960s, with assessors setting artificially low assessments. These scandals prompted the California Legislature to enact the Tax Assessment Reform Law (Assembly Bill 80) in 1966, which functioned to keep assessments at a uniform percentage of market value. However, this reform caused home assessments to escalate rapidly when real estate values rose in the 1970s. At the local level, this led to "gentrification" of neighborhoods, often pricing out individuals (especially senior citizens) from their homes. This caused a "tax revolt" spearheaded by taxpayer advocates Howard Jarvis and Paul Gann, leading to the passage of Prop 13 in 1978.

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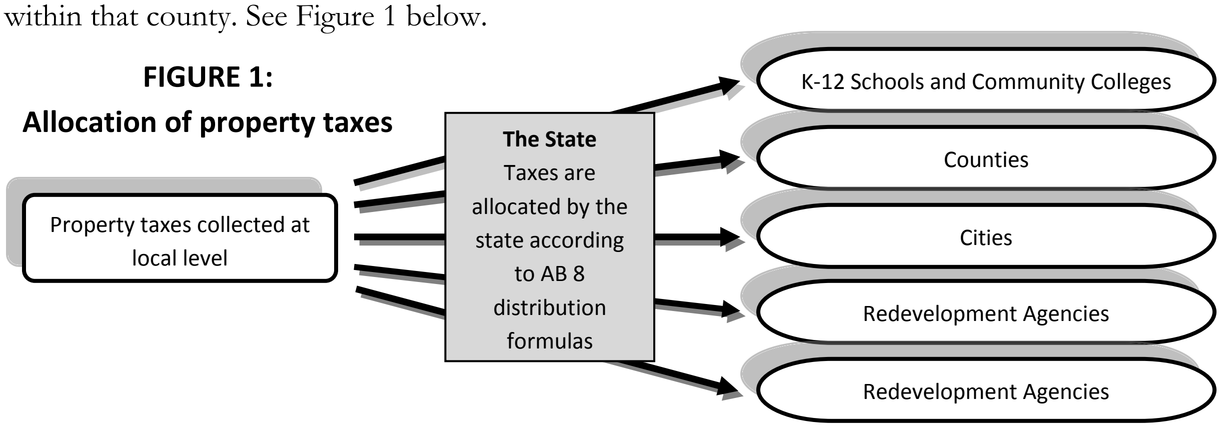
Main provisions

Prop 13 has five (5) main provisions that affect property taxes and voting requirements.

1) Property tax limit

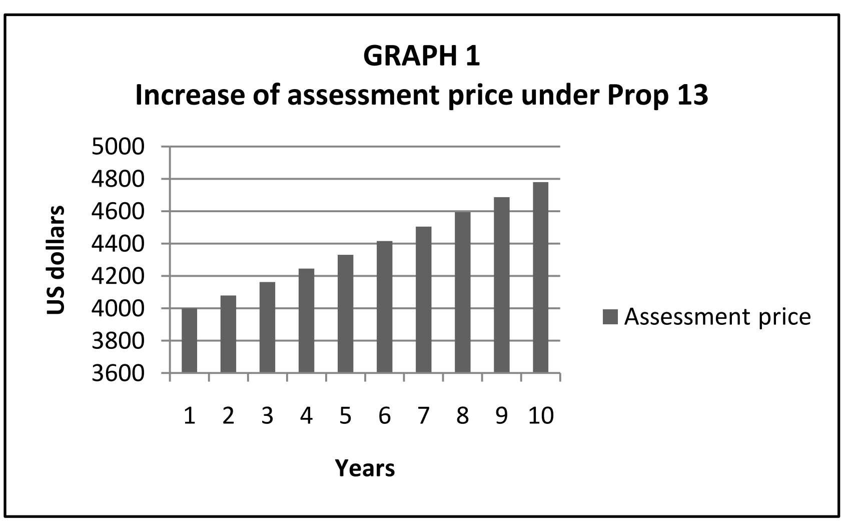
Prop 13 limits the amount of property taxes that can be collected by local and state governments. Under Prop 13, the amount of property taxes that can be collected is limited to 1 percent of the property's full cash value at first assessment. According to the allocation formulas in Assembly Bill 8 (AB 8), the State distributes the property tax revenue raised in each county to local governments within that county. See Figure 1 below.

FIGURE 1:
Allocation of property taxes



2) Restrict growth in the assessed value of property subject to taxation

Prop 13 restricts the growth of the assessed value of property that is subject to taxation. The assessed value of a newly constructed building is also set at the assessed value at the time of construction. Under Prop 13, as long as the property is owned by the same taxpayer the assessed value of a property subject to taxation can only increase annually by no more than the rate of inflation or two percent (whichever is less). Once a property is sold to a different taxpayer, the property is reassessed at the fair market value at the time of the sale. However, Prop 13 does allow commercial property (such as shopping malls) to be sold or merged without reassessment to the resale value, as long as the property remains deeded to the original corporate owner.



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The acquisition-value assessment system is more predictable for homeowners, eliminates some of the danger associated with subjective assessments, and protects property owners from extreme property tax increases during periods of rapidly rising property values. This predictability is seen in Graph 1 above (example assumes a property purchased for $400,000).

There are certain exceptions to the acquisition-value assessment system established by Prop 13. See Table 2 below.

TABLE 2
Exceptions to Prop 13 acquisition-value assessment system

Market value	If market value is lower than the acquisition value, then property can be temporarily reassessed at market value for tax purposes
Property transfers	If a property is transferred to a spouse or between children and parents, the property value is not reassessed
State Board of Equalization	If a property (such as the property of state-regulated utilities) is assessed by the State Board of Equalization, then that property is not subject to the Prop 13 acquisition value limitation

3) Increases in state taxes

Prop 13 requires that increases in state taxes can only be imposed with a two-thirds vote of the State Legislature. Prior to the enactment of Prop 13, state taxes could be increased with a majority vote in both houses of the Legislature and Gubernatorial approval. This two-thirds requirement has inhibited the ability of recent Legislatures to pass budgets without bipartisan cooperation. Furthermore, Prop 13 prohibits the Legislature from enacting new taxes based on the sale or value of real property.

4) Alternative local taxes

Prior to the passage of Prop 13, a larger share of local government revenue came from the collection of property taxes. Under Prop 13, local governments continue to collect revenue from property taxes as detailed above; additional revenue also comes from Proposition 18 fees, special taxes and Vehicle Licensing Fees (VLF). Prop 13 also states that counties, special districts and school districts can impose "special taxes" as an alternative revenue source. However, these taxes can only be imposed with a two-thirds public vote. This requirement has limited the ability of local governments to impose new taxes in order to replace property tax revenues.[1]

[1] For more discussion on alternative local taxes and accompanying legislation, see SDCTA staff analysis of Prop 218