STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**01/06/03**	Bill No:	**AB 82**
Tax:	**Property**	Author:	**Dutton**
Board Position:		Related Bills:	**AB 211 (Maze)**

BILL SUMMARY

This bill would, in part, increase the amount of the homeowners' exemption from $7,000 to $32,000 and thereafter annually increase that amount by an inflation factor, as specified.

ANALYSIS

Current Law

Article XIII, Section 3(k) of the California Constitution exempts the first $7,000 of assessed value of an owner-occupied principal place of residence. This exemption is commonly referred to as the "homeowners' exemption." The Constitution gives the Legislature the authority to increase the amount of the homeowners' exemption, provided that:

1. any increase is funded by increasing the "rate of State taxes" in an amount sufficient to reimburse local governments for property tax revenue loss; and,
2. benefits to renters, which under current practice are granted through the renters' income tax credit, are increased by a comparable amount.

Additionally, the Constitution provides that the Legislature may deny the exemption if the owner received state or local aid to pay taxes, either in whole or in part, and either directly or indirectly, on the dwelling.

Section 218 of the Revenue and Taxation Code specifies eligibility for the exemption and sets the exemption in the amount of $7,000 of full cash value.

Article XIII, Section 25 of the Constitution requires that the state reimburse local government for the property tax revenue loss resulting from the homeowners' exemption.

Proposed Law

This measure would amend Section 218 of the Revenue and Taxation Code to increase the amount of the homeowners' exemption to $32,000 of full cash value. It would also establish an annual inflation adjustment to that amount for each year thereafter. The inflation factor would be based upon the percentage change in the California Consumer Price Index (CCPI) for all items from June of the prior calendar year to June of the current year. It would require that the Board annually re-calculate the amount of the homeowners' exemption, as specified, and inform county assessors of the amount prior to January 1 of each year.

With respect to income taxes, it would amend Section 17053.5 of the Revenue and Taxation Code, to: (1) increase the amount of the renters' credit; and, (2) eliminate income levels that limit eligibility for the credit. The renters' credit would increase from $185 to $370 for married couples filing joint returns, heads of households, and surviving spouses; and it would increase for all other individuals from $60 to $185. An annual inflation adjustment to those amounts would also be established.

Background

The homeowners' exemption was created in 1968 via a constitutional amendment adopted by the voters. (Proposition 1-A; SCA 1 and SB 8, Stats. 1968). The amount of relief provided was equivalent to $3,000 of full cash value.[1] In 1972, legislation was passed to increase the amount of the exemption commencing in 1974 to its current equivalent level of $7,000 of full cash value.[2] (SB 90, Stats.1972)

During the 1960's and 1970's many property tax reform proposals were advocated. Existing law, at that time, provided that property would be reassessed to current market value levels on a cyclical basis. These periodic reassessments resulted in substantial property tax increases due to rapidly escalating real estate values. The homeowners' exemption was created in 1968 to provide some measure of property tax relief. In 1972, legislation increased the exemption, effective in 1974. Numerous bills were introduced in the Legislature between 1972 and 1978 to further increase the amount of the exemption. Apparently, these bills were rejected, in part, because some viewed the use of a homeowners' exemption as a temporary means of providing property tax relief, the benefits of which would erode over time due to inflation. Some argued that one proposal to fundamentally change the taxation system should be sought as a permanent means of containing rapidly increasing property taxes.

Ultimately, Proposition 13 (Article XIIIA of the California Constitution), approved by the voters in November 1978, rolled back real property values to 1975 market value levels and limited annual increases in assessed values thereafter to the rate of inflation, not to exceed 2%. Another key element of Proposition 13 is that it limited the tax rate to 1% of the full cash value of the property. Previously, each taxing agency could determine and levy its own rate. The statewide average tax rate at that time was 2.67%.

Under Proposition 13, property is reassessed to its current market value when a change in ownership occurs. The current market value for homes is generally the sales price, and, once again, annual increases to that value are limited to the rate of inflation, not to exceed 2%. Thus, Proposition 13 established a new assessment value standard that requires property to be assessed based upon the market value of the property at the time it is acquired by the taxpayer, rather than the value it has in the current real estate market. For property owners, especially homeowners, the primary benefits of this assessment value standard were that future property tax liability would be: (1) determinable; and, (2) future increases limited to a modest amount. One rationale for Proposition 13 was that, if the value of a home substantially increased after its initial purchase, the homeowner would not be "taxed" out of the home because he or she

[1] The actual amount was $750 of assessed value; however, at that time, property was assessed at 25%, rather than 100%, of value.
[2] The actual amount was $1,750 of assessed value.

could no longer afford property taxes based on the property's current market value, a value that could be realized by the homeowner only if he or she sold the home.

Thus, for property acquired after 1975, the property tax system was altered to an "acquisition value" basis, resulting in similar properties with disparate assessed values for property tax purposes. The constitutionality of this acquisition value system was ultimately appealed and upheld by the U.S. Supreme Court in *Nordlinger* v. *Hahn*, 505, U.S. 1 (1992).

Related Bills. Since the enactment of Proposition 13, numerous bills have been introduced in the Legislature to increase the amount of the homeowners' exemption. The proposals have used various methods: including increasing the exemption amount by a flat amount, varying the exemption amount according to the year of purchase, indexing the exemption amount for inflation, and increasing the exemption amount for certain classes of persons. In 2002, the initiative process was used for the first time to attempt to increase the amount of the exemption and the renters credit via a direct vote of the people, but insufficient signatures were collected to place the measure on the ballot.

Previous measures to increase the homeowners' exemption are summarized in the following table:

Bill Number	Legislative Session	Author	Type
Initiative	Signature drive ended 11/6/02	Howard-Jarvis Taxpayers Assoc. & Bill Simon	Increase to $32,000, plus index for inflation
AB 1844	2001-2002	Mountjoy	Increase to $17,000 for persons over 62, disabled, and blind
SB 48	2001-2002	McClintock	Index for inflation by California CPI
SB 48	2001-2002	McClintock	Increase to $25,000, plus index for inflation
AB 218	2000-2001	Dutra	Increase for 1st time homebuyers
AB 2288	1999-2000	Dutra	Increase for 1st time homebuyers
AB 2158	1999-2000	Strickland	Increase to $8,750 for persons over 62
SCA 8	1999-2000	Johannessen	Increase to $20,000; delete renter's credit parity
AB 2060	1997-1998	Granlund	Increase to $20,000
ACA 43	1997-1998	Granlund	Increase to $20,000
ACA 5	1991-1992	Elder	Variable, according to assessed value
ACA 31	1991-1992	Frizzelle	Index for inflation by California CPI
ACA 47	1991-1992	Jones	25% exemption; no assessed value cap
ACA 3	1989-1990	Elder	Variable, depending on year acquired
ACA 9	1989-1990	D. Brown	25% exemption; $250,000 assessed value cap
ACA 31	1989-1990	Hannigan	15% exemption; $150,000 assessed value cap
ACA 55	1989-1990	Wright	Increase to $48,000
ACA 1	1987-1988	Elder	Increased to $25,000, plus index for inflation
ACA 25	1987-1988	D. Brown	25% exemption; $250,000 assessed value cap
AB 2141	1985-1986	Klehs	20% exemption; $50,000 exemption cap
AB 2496	1985-1986	Cortese	Increase in years with General Fund Reserves
AB 3086	1985-1986	Elder	Variable, depending on year acquired
AB 3982	1985-1986	La Follette	Increase for 1st time home buyers
ACA 49	1985-1986	Elder	Variable, depending on year acquired

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the California Senior Legislature in an effort to increase the amount of the homeowners' exemption.

2. **Exemption Amount Unchanged Since the Enactment of Proposition 13.** The homeowners' exemption was enacted in 1968 and increased to its current level in 1974. Despite many attempts, the amount of the exemption has not increased in more than 28 years. Arguments against increasing the homeowners' exemption generally focus on the point that Proposition 13 has provided sufficient property tax relief and controls. Opponents of an increase have also expressed concern about the fiscal impact of funding both the homeowners' exemption and the renters' credit.

3. **The Constitution Specifies the Minimum Amount of the Exemption.** The $7,000 amount specified in the Constitution is the *minimum* amount of the exemption. The Constitution provides that the homeowners' exemption can be statutorily increased, as long as there is an equivalent increase in the amount of the renters' credit, and any increase is funded by increasing the rate of state taxes sufficiently to reimburse local governments for property tax revenue losses.

4. **Would Provide Annual Property Tax Savings of $342.** The homeowners' exemption, on average, provides annual property tax savings of about $75 ($7,000 x .0107). This measure would increase the annual property tax savings, on average, to $342 ($32,000 x .0107) for persons who own homes. This would provide additional tax savings of $267 ($342-$75) per year.

5. **The State Subvenes Property Tax Revenue Loss from the Homeowners' Exemption.** The homeowners' exemption is the only property tax exemption for which the state reimburses local government.

6. **Related Bills.** AB 211 (Maze) would increase the homeowners' exemption to $17,000 for persons over the age of 62 years.

COST ESTIMATE

The Board would incur some minor absorbable costs involved in annually calculating and informing local county assessors of the appropriate exemption amount for each fiscal year.

The revenue estimate below does not address the renters' tax credit provisions of this bill which are administered by the Franchise Tax Board

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Existing property tax law provides for a homeowners' exemption in the amount of $7,000 of the full value of a "dwelling," as specified. The exemption amount is reduced to $5,600 on claims that are filed late. The state is required to pay subventions to counties for the homeowners' exemptions to offset the resulting county property tax loss.

Over the course of the last few years, the state reimbursement to the counties to cover homeowners' exemption has grown slightly:

2001-02	$405,460,000
2000-01	$398,362,000
1999-00	$397,137,000
1998-99	$388,829,000
1997-98	$383,236,000

The total exempt value of the homeowners' exemption amounted to $37,109,934,000 on 5,310,623 claims in 2002-03. The average value of the homeowner's exemption in 2002-03 was $6,988, indicating that only a tiny percentage of all such claims do not currently receive the maximum $7,000.

The percentage of homeowners' exemption properties that would not receive the maximum exemption should not change appreciably if the amount of the exemption was increased to $32,000. This means that the total homeowners' exemption subvention for 2003-04, under this bill, is estimated to be:

$405,460,000 x ($32,000/$7,000) = $1,853,532,000

The annual increase in the subvention starting in 2003-04 then would be at least:

$1,853,532,000 - $405,460,000 = $1,448,072,000

Under this bill, the amount of the homeowners' exemption would be adjusted annually to reflect cost of living increases. This adjustment will be based on the year-to-year increase in the California Consumer Price Index (CCPI) for all items, as of June of each year. The year-to-year changes in the CCPI for the preceding seven years have generally been modest increases, ranging from 1.556 percent in 1996 to 5.287 percent in 2001, dropping sharply to 1.474 percent in 2002. Assuming that the inflation adjustment lies in the 1 to 5 percent range, and the adjustment applies beginning with the January 1, 2004 lien date, the exemption amount in the first five years can be estimated to grow as follows:

2004-05	$32,000 x (1.01 to 1.05) = $32,320 to $33,600
2005-06	($32,320 to $33,600) x (1.01 to 1.05) = $32,643 to $35,280
2006-07	($32,643 to $35,280) x (1.01 to 1.05) = $32,969 to $37,044
2007-08	($32,969 to $37,044) x (1.01 to 1.05) = $33,299 to $38,896
2008-09	($33,299 to $38,896) x (1.01 to 1.05) = $33,632 to $40,841

Based on these exemption amounts, the increase in the subvention due to the inflation factor adjustment is estimated to be:

Estimated Annual Increase

Year	Exempt amount	Estimated total subvention	Net of $1,853,532,000
2004-05	$32,320 to $33,600	$1,872,067,000 to $1,946,208,000	$18,535,000 to $92,676,000
2005-06	$32,643 to $35,280	$1,890,776,000 to $2,043,518,000	$37,244,000 to $189,986,000
2006-07	$32,969 to $37,044	$1,909,659,000 to $2,145,694,000	$56,127,000 to $292,162,000
2007-08	$33,299 to $38,896	$1,928,773,000 to $2,252,967,000	$75,241,000 to $399,435,000
2008-09	$33,632 to $40,841	$1,948,062,000 to $2,365,627,000	$94,530,000 to $512,095,000

Revenue Summary

This bill would increase the state reimbursement for the homeowners' exemptions by at least $1.448 billion annually starting in 2003-04. In addition, it is estimated that the inflation factor adjustment proposed in this measure would further increase the reimbursement by $18.5 to $92.7 million in 2004-05, and by $94.5 to $512.0 million in 2008-09. The increases, resulting from the annual inflation factor adjustment, are expected to grow significantly over time because of the compounding effect of the adjustment.

Qualifying Remarks

This estimate assumes that the amount of the partial homeowners' exemption will be similarly increased from "the lesser of $5,600 or 80 percent of the full value of the dwelling" to "the lesser of $20,000 or 80 percent of the full value of the dwelling," and would be adjusted annually to reflect cost of living increases.

Also, it is assumed for the purposes of this estimate that the owners of owner-occupied mobilehomes will claim the homeowners' exemption, and not the renters' credit. However, it is likely that many of the mobilehomes located on rented land will not claim the $32,000 homeowners' exemption but, instead, will be granted the renters' credit, especially for those mobilehome owners that qualify for the $370 renters' credit. According to information reported by the county assessors, there were more than 220,000 mobilehomes in 2002-03.

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