STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**2/09/01**	Bill No:	**AB 218**
Tax:	**Property**	Author:	**Dutra**
Board Position:		Related Bills:	**SB 48 (McClintock)** **AB 2288 (2000)**

BILL SUMMARY

This bill would increase the homeowners' exemption for qualified first-time homebuyers who purchase a home after January 1, 2001 and before December 31, 2006 from $7,000 to $50,000 for the first 5 years of ownership.

ANALYSIS

Current Law

Article XIII, Section 3(k) of the California Constitution exempts, from property tax, the first $7,000 of assessed value of an owner-occupied principal place of residence from property tax. This exemption is commonly referred to as the "homeowners' exemption." The Constitution authorizes the Legislature 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[1] and
2. Benefits to renters, which under current practice are granted through the renters' tax credit, are increased by a comparable amount.

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.

Proposed Law

This bill would amend Section 218 of the Revenue and Taxation Code to increase the amount of the homeowners' exemption for qualified first-time homebuyers by an additional $43,000, for a total exemption amount of $50,000 of assessed value, for up to five years if:

1. the income of the qualifying homebuyer does not exceed 150 percent of the median income for the county at the time of purchase,

2. the homebuyer has not had an ownership in residential real property in the prior three years, and

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

3. the home is purchased after January 1, 2001 and before December 31, 2006.

This bill would also require the Board to report to the Legislature the number of first-time homebuyer exemption claims made and the additional amount of subventions made for each fiscal year. It would require the California Research Bureau to report to the Legislature on the impact that this measure had on state fiscal affairs and home ownership levels.

Background

This bill is identical to AB 2288 of the 2000 legislative year, which did not pass out of the Assembly Revenue and Taxation Committee.

Over the years, numerous proposals have been before the Legislature to increase the amount of the homeowners' exemption. Those proposals used various methods, including increasing the exemption by a flat amount, indexing the exemption for inflation, and varying the exemption according to the year of purchase.

Previous legislative attempts are summarized in the following table:

Bill Number	Legislative Session	Author	Type
AB 2288	1999-2000	Dutra	Increase for 1st time homebuyers
AB 2158	1999-2000	Strickland	Increase to $8,750 for senior citizens
SCA 8	1999-2000	Johannessen	Increase to $20,000; delete renter's credit parity
AB 2060	1997-98	Granlund	Increase to $20,000
ACA 43	1997-98	Granlund	Increase to $20,000
ACA 5	1991-92	Elder	Variable according to assessed value
ACA 31	1991-92	Frizzelle	Index for inflation by California CPI
ACA 47	1991-92	Jones	25% exemption; no assessed value cap
ACA 3	1989-90	Elder	Variable depending on year acquired
ACA 9	1989-90	D. Brown	25% exemption; $250,000 assessed value cap
ACA 31	1989-90	Hannigan	15% exemption; $150,000 assessed value cap
ACA 55	1989-90	Wright	Increase to $48,000
ACA 1	1987-88	Elder	Increased to $25,000 + indexing for inflation
ACA 25	1987-88	D. Brown	25% exemption; $250,000 assessed value cap
AB 2141	1985-86	Klehs	20% exemption; $50,000 exemption cap
AB 2496	1985-86	Cortese	Increased in years with General Fund Reserves
AB 3086	1985-86	Elder	Variable depending on year acquired
AB 3982	1985-86	La Follette	Increase for 1st time home buyers
ACA 49	1985-86	Elder	Variable depending on year acquired

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author in an effort to reduce property taxes for first-time homebuyers.

2. **Provides Additional Tax Savings of $430 per Year for Five Years (Total $2,150) for Qualified First-Time Homebuyers.** The homeowners' exemption, in the amount of $7,000 of full cash value, provides annual property tax savings of about $70 at the

1% tax rate. This measure would increase the annual property tax savings to $500 for the first five years of ownership.

3. **Administrative Issues.** There would be various technical difficulties in administering this bill in its current form as noted below.

- **Tax Returns – Timeliness.** A homebuyer would provide the county assessor with a copy of their income tax return for the taxable year during which they purchased the home. However, that tax returned would not be prepared until the following year. Perhaps the most recent completed tax return should be used instead.

- **Median Income Data - Timeliness.** A qualified first-time homebuyer is defined to mean a taxpayer, who, *at the time of his or her purchase* had an annual income of less than 150% of the median income for the county. Data on median income for any particular tax year would not be known at the time of purchase (it would not be available until almost two years later).

- **Income Threshold – Multiple Owners.** The bill is drafted in a manner to address the situation where a single taxpayer purchases a home. What income threshold should be used when more than one person is title owner of the home (a married couple, partners, etc.)? If incomes are combined, should median *household* income or median *family* income be used as the basis?

- **Retroactive Effective Date.** This bill would apply to a home purchased after January 1, 2001. Thus, if this bill is enacted, many homeowners who might have qualified would have already filed a claim and received their homeowners' exemption in the amount of $7,000. Because assessors would not know which homebuyers might have qualified, and homeowners would not be aware of the higher amount made available after they filed their claim, it may be preferable to have an effective period of January 1, 2002 to December 31, 2007.

- **First-Time Homebuyer - Verification.** If the taxpayer's claim that he or she is a first-time homebuyer is sufficient, then there would be no administrative issues associated with this provision. If this is the author's intent, then the bill could be amended to require a statement under the penalty of perjury that the claimant has not owned a home in the prior three years. If some form of verification or audit is anticipated, as is currently required because of the state subvention of the homeowners' exemption, then additional administrative costs at the state level would be incurred. The Board of Equalization maintains a database of persons receiving the homeowners' exemption which is used for two purposes: 1) to prevent multiple claims of homeowners' exemptions in different counties and 2) to assist the Franchise Tax Board in verifying the eligibility of persons claiming the renter's credit on their state income taxes (the credit may not be claimed if the homeowners' exemption was claimed). The Board contracts with Stephen P. Teale Data Center to process this information. Each year the homeowners' exemption match database starts new. If the intent is to require some verification or auditing by the state, then there would be a cost to maintain this information for three years as well as a cost to query the system to verify that a person had not received a homeowners' exemption in the prior three years. Also, the current database only captures information on persons who received a homeowners' exemption in California.

- **Five Year Tracking.** Counties would incur costs in tracking the exemption for five years in order to reduce the exemption to $7,000 in year six.

4. **Exemption Amount Unchanged for 27 Years.** The homeowners' exemption was enacted in 1968 in the amount of $3,000 of full cash value and was increased in 1974 to its current level of $7,000 of full cash value. Arguments advanced against increasing the homeowners' exemption have centered on the point that Proposition 13, instituted in 1978 after the last increase in the homeowners' exemption, has provided sufficient property tax relief to all property owners, including homeowners.

5. **The $7,000 Exemption is a Minimum Amount.** The $7,000 amount specified in the Constitution sets forth the *minimum* amount of the exemption. The Constitution states that the homeowners' exemption can be increased, statutorily, as long as it is associated with an equivalent increase in the amount of the renters' credit. Presumably, it could be argued that the amount of the renter's credit for new renters should also be increased. However, the renters' credit was suspended from the 1993 through the 1997 income tax years in accordance with budget agreements. It was restored in 1998 by AB 2797, a budget trailer bill. During this suspension period homeowners continued to receive the homeowners' exemption. Thus the State effectively abandoned the constitutional parity provision for this five year period.

6. **Reporting Requirements.** While the Board would have direct access to the number of exemption claims made, data on the additional subvention amounts are reported to the State Controller's office. To furnish the subvention amount data to the Legislature, the Board would request the information from the State Controller. Alternatively, the author could require the State Controller to provide this information directly to the Legislature.

7. **Late-Filing Partial-Exemption Provisions.** Conforming amendments to Section 275 would be necessary to increase the amount of the partial exemption provided to persons who miss the February 15 deadline to file a claim for the homeowners' exemption.

8. **Related Legislation.** SB 48 (McClintock) would increase the homeowners' exemption from $7,000 to $25,000, for all homeowners, and provide for future automatic increases through an annual inflation adjustment.

COST ESTIMATE

With respect to property taxes, the Board would incur some minor absorbable costs in revising exemption claim forms, updating Assessors' Handbooks, and addressing implementation issues raised by taxpayers and tax professionals including county assessors. There would also be unknown non-absorbable data processing costs if the Legislature intends the Board to have a role in auditing or verifying taxpayer claims for the first-time homebuyers exemption. If this is the intent, then a cost estimate will be prepared.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

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 state is required to pay subventions to counties for the homeowners' exemptions to offset the resulting county property tax loss. The state reimbursement to local governments for the homeowners' exemption totaled $397.1 million in 1999-00.

Under this proposal, the homeowners' exemption for certain homebuyers would be supplemented by $43,000 for up to five years if the income of the qualifying homebuyer does not exceed 150 percent of the median income for the county and the homebuyer neither has, nor has had, an ownership in a principal residence in the prior three years. It is difficult to predict the number of homebuyers that would meet these requirements. For the purposes of this estimate, therefore, it is assumed that the annual increase in the number of homeowners' exemptions can be substituted for the number of qualifying purchases.

Since 1994, the number of homeowners' exemptions has grown from 5.0 million to 5.2 million. However, the annual increase in the number of exemptions, as shown below, has fluctuated substantially in the last seven years, ranging from the high of 123,179 in 1994 to the low of 12,067 two years later.

	Number of homeowners' exemptions	Increase from prior year	Percent change from prior year
2000	5,207,135	22,542	0.4%
1999	5,184,593	31,149	0.6
1998	5,153,444	15,758	0.3
1997	5,137,686	40,298	0.8
1996	5,097,388	12,067	0.2
1995	5,085,321	56,726	1.1
1994	5,028,595	123,179	2.5

The recent decline in the annual increase in homeowners' exemptions can be attributed, in great part, to the downward trend in housing affordability. According to the California Association of Realtors (C.A.R.), housing affordability in the state fell to 32 percent in December 2000, down 4 percentage points from December 1999. The monthly housing affordability index used by C.A.R. measures the percentage of California households that can afford to purchase a median-priced existing home, which was $249,350 in December 2000.

It is likely that the number of exemptions will grow between 12,000 and 120,000 annually and that the market value of these homes will each exceed $50,000. The latest available statewide average tax rate is 1.067 percent. The maximum increase in the subvention for the first year under this proposal is then [12,000 to 120,000] x $43,000 x 1.067%, or $5.5 million to $55.1 million.

Revenue Summary

The breakdown of the estimated maximum increase in the homeowners' exemption subvention for each of the first four years and for the fifth year and after is:

First Year	$5.5 million to $55.1 million
Second Year	$11.0 million to $110.1 million
Third Year	$16.5 million to $165.2 million
Fourth Year	$22.0 million to $220.2 million
Fifth Year and after	$27.5 million to $275.3 million

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