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CITY COUNCIL STAFF REPORT

Meeting: July 21, 2020

Subject

Resolution supporting statewide measure Proposition 15, which increases funding for public schools, community colleges and local government services by changing tax assessment of commercial and industrial property through an initiative constitutional amendment on the November 3, 2020 ballot.

Recommended Action

Adopt the Draft Resolution supporting Proposition 15, which increases funding for public schools, community colleges and local government services by changing tax assessment of commercial and industrial property through an initiative constitutional amendment.

Background

A statewide initiative measure titled The California Schools and Local Communities Funding Act of 2020 qualified for the November 3, 2020 ballot and will appear on the ballot as Proposition 15. Proposition 15 will increase funding for public schools, community colleges and local government services by changing tax assessment of commercial and industrial property through a constitutional amendment. The Legislative Analyst's Office has provided the following background information to help understand the measure.

Local Governments Levy Taxes on Property Owners. California local governments—cities, counties, schools, and special districts—levy property taxes on property owners based on the value of their property. Taxed properties include real property—land and buildings—and business personal property—machinery, computers, and office equipment. Property taxes raise around \$65 billion annually for local governments, about \$2 billion of which is attributable to business personal property. Statewide, about 60 percent of property tax revenue is allocated to cities, counties, and special districts, while the remaining 40 percent is allocated to schools and community colleges.

Counties Administer the Property Tax. County assessors determine the taxable value of property, county tax collectors bill property owners, and county auditors distribute the revenue among local governments. Statewide, county spending for property tax administration exceeds \$600 million each year.

Property Taxes Are Based on a Property's Purchase Price. Each property owner's annual property tax bill is equal to the taxable value of their property multiplied by their property tax rate. Property tax rates are capped at 1 percent plus smaller voter-approved rates to finance local infrastructure. A property's taxable value generally is based on its purchase price. When a property is purchased, the county assessor assigns a value to the property—often its purchase price. Each year thereafter, the property's taxable value increases by 2 percent or the rate of inflation, whichever is lower. This process continues until the property is sold and again is taxed at its purchase price. In most years, the market value of most properties grows faster than 2 percent per year. As a result, under this system the taxable value of most properties is less than their market value.

California Taxes Individual Income and Corporate Profits. California levies a personal income tax (PIT) on the income of state residents, as well as the income of nonresidents derived from California sources. California also levies a corporation tax on the profits of corporations.

Property Owners Can Deduct Property Tax Payments From Taxable Income. State law allows property owners to deduct property tax payments from their taxable income for the purposes of calculating PIT and corporation tax payments. This reduces their tax bills.

State Constitution Governs State Spending on Schools and Community Colleges. The State Constitution requires 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.

Proposition 15 – The Measure Proposes

Assess Commercial and Industrial Property at Market Value. The measure requires commercial and industrial properties, as well as vacant land not intended for housing, commercial agriculture, or protected open space to be taxed based on their market value, as opposed to their purchase price. A property's market value is what it could be sold for today. The measure's shift to market value assessment is phased in over a number of years beginning in 2022-23. For properties in which the majority of space is occupied by small businesses—defined as businesses that own California property and have 50 or fewer employees—the shift to market value taxation would not begin until 2025-26 or a later date set by the Legislature. Properties owned by individuals or businesses whose property holdings in the state total less than \$3 million (adjusted for inflation biannually beginning in 2025) are exempt from market value taxation. These properties would continue to be taxed based on purchase price. Similarly, residential properties would continue to be taxed based on purchase price.

Exempt Lower Value Business Personal Property. The measure exempts from taxation the first \$500,000 in value of a business's personal property. Additionally, the measure exempts from taxation all personal property of small businesses—as defined above.

Allocate New Revenues to Local Governments and Schools. The measure allocates most new revenue resulting from the measure to cities, counties, special districts, and schools. Before allocating funds to local governments, the measure requires a portion of the new revenues be allocated to (1) the state general fund to compensate for any reductions in PIT and corporation tax revenue resulting from the measure (as discussed below) and (2) counties to cover their costs of administering the measure. Of the remaining funds, roughly 60 percent is allocated to cities, counties, and special district, with each entity receiving an amount proportional to the share of property tax revenues in their county that they receive under existing law. The remaining roughly 40 percent would be allocated to schools and community colleges generally according to the same per-pupil formulas the state uses to distribute most other funding for these entities. This allocation would supplement the existing funds schools and community colleges receive under the state's constitutional minimum funding requirement.¹

Discussion

Proposition 15 increases funding for K-12 public schools, community colleges, and local governments by requiring that commercial and industrial real property be taxed based on current market value. Exempts from this change: residential properties; agricultural properties; and owners of commercial and industrial properties with combined value of \$3 million or less. Increased education funding will supplement existing school funding guarantees. Exempts small businesses from personal property tax; for other businesses, exempts \$500,000 worth of personal property.²

The Legislative Analyst and Director of Finance summarized the fiscal effects of Proposition 15 as follows: Net increase in annual property tax revenues of \$7.5 billion to \$12 billion in most years, depending on the strength of real estate markets. After backfilling state income tax losses related to the measure and paying for county administrative costs, the remaining \$6.5 billion to \$11.5 billion would be allocated to schools (40 percent) and other local governments (60 percent).

A May 4, 2020 report by Blue Sky Consulting Group, *Allocation of Revenues from Schools and Communities First for Selected Counties*, (Attachment C), estimates that the amount of additional property taxes from Proposition 15 for the City of Cupertino would be \$4,914,000 for 2021-22.

The Schools & Communities First initiative is scheduled to be considered for endorsement by The Cities Association of Santa Clara County at its August 12, 2020 meeting. The Draft Resolution (Attachment A) adopts a position of support for the Schools & Communities First initiative and endorses statewide measure Proposition 15.

Sustainability Impact

None

¹ [California the Legislative Analyst's Office, "A.G. File No. 2019-0008," February 5, 2018](#)

² [California Secretary of State, "Qualified Statewide Ballot Measures, Proposition 15 1870. \(19-0008A1\)," July 13, 2020](#)

Fiscal Impact

If Proposition 15 is adopted, the City of Cupertino could receive an estimated \$4.9 million in the first year.

Prepared by: Kirsten Squarcia, City Clerk

Reviewed by: Katy Nomura, Assistant to the City Manager

Approved for Submission by: Dianne Thompson, Assistant City Manager

Attachments:

A – Draft Resolution

B – Initiative: The California Schools and Local Communities Funding Act of 2020

C - *Allocation of Revenues from Schools and Communities First for Selected Counties*