SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Anna M. Caballero, Chair
2023 - 2024 Regular

Bill No:	SCA 4	**Hearing Date:**	5/10/23
Author:	Seyarto	**Tax Levy:**	
Version:	4/19/23	**Fiscal:**	Yes
Consultant:	Grinnell		

PROPERTY TAXATION: PRINCIPAL RESIDENCE AND FAMILY HOME TRANSFERS

Reinstates Proposition 58 and 193 change in ownership exclusions for intergenerational transfers that were limited or repealed by Proposition 19 (2020).

Background

Article XIII of the California Constitution provides that all property is taxable unless explicitly exempted by the Constitution or federal law. Article XIIIA of the Constitution limits the maximum amount of any ad valorem tax on real property at 1% of full cash value, and directs assessors to set assessed values at 1975 market value levels and only reappraise property thereafter if there is a change in ownership (Proposition 13, 1978).

Base year value transfers. State law implementing Proposition 13 generally sets a property's value as its sales price when purchased or, when there is no sales price, at its fair market value when ownership changes (base year value). Thereafter, the law requires an annual inflation adjustment to that value that cannot exceed 2% (factored base year value). An acquisition-value based system like California's can cause a reduction in mobility, known as a "moving penalty" or 'lock-in effect,' because property owners must pay tax based on any new residence's full market value that can be much higher than the factored base year value of their current home.

In response, voters have approved base year value transfers as exceptions to Proposition 13's requirement to reassess property upon change of ownership in the following cases:

- In June 1986, voters enacted Proposition 50 to allow a taxpayer to transfer their base year value when their property is damaged by a major misfortune or calamity and located in an area the Governor declared to be in a state of disaster.
- In November 1986, voters approved Proposition 60 to let a homeowner over the age of 55 transfer their base year value to a replacement home of equal or lesser value within the same county under specified circumstances.
- In November 1988, voters expanded base year value transfer availability to allow transfers to counties that adopt ordinances allowing the transfer (intercounty transfers).
- In June 1990, voters approved Proposition 110 to allow disabled individuals regardless of age to transfer base year values to a purchased or newly constructed replacement property.
- In November 1998, voters approved Proposition 1, which allows a base year value transfer for qualified contaminated property to a replacement or newly constructed property of equal or lesser value than the value of the contaminated property if that property was not contaminated.

Base year value transfers allow a taxpayer to continue to pay property taxes at the factored base year value of their previous home (or other property types where the law allows) and not on the value of their newly purchased or constructed home, often resulting in tax savings. For example, a taxpayer who purchased their residence for $100,000 in 1975 now has a base year value under Proposition 13 that cannot exceed $259,000 under the 2% cap in annual inflationary growth, regardless of its market value. If that taxpayer sold their residence for $500,000 and purchased a new one for the same amount, a base year value transfer allows them to continue to pay property taxes based on the $259,000 value, not $500,000, which at the 1% rate results in $2,410 in annual tax savings ($500,000 - $259,000 = $241,000 x 1% = $2,410).

Change in ownership exclusions. A change in ownership exclusion allows the new owners of a property to continue paying property based on its factored base year value, and stall any reassessment to fair market value until the property is purchased in a transaction where an exclusion does not apply. The Legislature enacted, and voters approved, two changes in ownership exclusions for transfers of property from one generation to the next. Proposition 58 (1986) exempted from change in ownership transfers of property from parents to children (ACA 2, Hannigan), which voters extended to grandchildren ten years later, so long as the grandparent is deceased (Proposition 193, 1996; ACA 17, Knowles). These exclusions applied to all inherited primary residences, regardless of value or number of transfers. They also applied to up to $1 million in aggregate value of all other types of property, such as second homes or business properties.

ACA 11/Proposition 19. In 2020, the Legislature placed on the ballot, and voters approved as Proposition 19, the Home Protection for Seniors, Severely Disabled, Families, and Victims of Wildfire or Natural Disasters Act (ACA 11, Mullin). Among other provisions, the Act created a new section of the California Constitution to allow base year value transfers for disabled taxpayers and those over the age of 55, as well as a victim of a wildfire or other natural disaster. Proposition 19 allowed taxpayers to transfer base year values to properties of greater value and across county lines regardless of whether the accepting county enacted an ordinance, so long as the replacement property is purchased or constructed within two years of the date the original property is sold, or damaged or destroyed by a disaster.

To implement its base year value transfer provisions, the measure:

- Provides that if the replacement property is of equal or lesser value of the original property, its taxable value is equal to that of the original property.
- States that if the replacement property is of greater value of the original property, its taxable value is equal to that of the replacement property, plus the difference in value between the sales price of the original property and the sales price of the replacement property is subsequently added to the base year value. For example, if the original property has a base year value of $230,000 sells for $500,000, and the taxpayer purchases a $750,000 replacement property, its new base year value is $480,000 ($750,000 – $500,000 = $250,000 + $230,000 = $480,000).
- Allows disabled taxpayers or those over 55 three transfers.
- Requires taxpayers to file an application with the assessor to claim a transfer with contents identical to the application for current transfers.
- Applies beginning April 1, 2021.

To offset potential property tax revenue losses resulting from its new base year value transfer benefits, the Act created a new section of the California Constitution to limit the parent-child and grandparent-grandchild exclusion from change in ownership of a principal residence only if the property continues as the primary residence of the transferee. The Act further repeals the parent-child, grandparent-grandchild exclusion for up to $1 million in aggregate value of all other types of property that is not the principal residence entirely. The new section also:

- Provides that even if the property continues as the primary residence of the transferee, the exclusion can only reduce assessed value by $1 million.
- Directs the State Board of Equalization (BOE) to adjust the $1 million exclusion amount annually for inflation beginning on February 16, 2023.
- Provides that the capped exclusion applies to family farms, as defined.
- Requires the transferee to claim the homeowners' or disabled veterans' exemption at the time of transfer to apply the exclusion. However, a transferee can file a claim to apply the exclusion up to one year after the purchase or transfer, and receive a refund of previous taxes paid or owed between the transfer date and the date they file the claim.
- Applies to transfers beginning February 15, 2021.

Additionally, the Act created a new section of the California Constitution to allocate any additional revenues or savings to the state to the California Fire Response Fund and the County Revenue Protection Fund, and continuously appropriate moneys to those purposes, as specified. The new section implements these provisions by:

- Requiring the Director of Finance to calculate additional revenues and net savings to the state resulting from the measure during the preceding fiscal year each September 1st between 2022 and 2027 using the best data or available estimates if data is not available.
- Directing the Controller to transfer 75% of the amount certified by the Director of Finance for the applicable year to the California Fire Response Fund.
- Directing the Controller to transfer 15% of the amount to the County Revenue Protection Fund to reimburse counties with "negative gain."
- Specifying that funds in the California Fire Response Fund are subject to appropriation by the Legislature according to a specified methodology, which states funds must be used to expand fire suppression staffing in underfunded special districts that provide fire suppression staffing, and must not supplant existing state or local funds utilized for those purposes, and further:
    - Allocates 20% to the Department of Forestry and Fire Protection to fund fire suppression staffing.
    - Sends 80% to the Special District Fire Response Fund, for districts that provide fire protection services according to specified criteria.

The Act added four new sections to the California Constitution, but was not accompanied by a legislative bill that set forth the statutory guidance necessary for the BOE and assessors to implement its provisions uniformly across the state. Many of the Act's terms and requirements were unclear, or conflicted with other parts of state law. In response, the BOE initiated a process to provide guidance and initiate rulemaking, resulting in several letters to assessors, new and updated property tax rules, and chief counsel memos to advise taxpayers and promote uniform implementation of Proposition 19's changes. The Legislature also enacted SB 539 (Hertzberg), which created two new sections of the Revenue and Taxation Code that provided further statutory detail to guide assessors and taxpayers claiming base year value transfers of change in ownership exclusions.

As noted above, Proposition 19 enacted some of the most significant and complex changes to California property taxes since Proposition 13. The initiative's provisions also went into effect quickly, especially its limitation and elimination of parent-child, and grandparent-grandchild exclusions, which became effective on February 15th 2021, catching many taxpayers unaware. Arguing that voters may want to revisit Proposition 19's changes to the exclusions, the author wants to place a constitutional amendment before voters reenacting them.

Proposed Law

Senate Constitutional Amendment 4 places a measure before voters that repeals Proposition 19's limitation on the parent-child and grandparent-grandchild exclusion from change in ownership of a principal residence to apply only if the property continues as the primary residence of the transferee. SCA 4 also reinstates the parent-child, grandparent-grandchild exclusion for up to $1 million in aggregate value of all other types of property that is not the principal residence. Under the measure, both changes become effective on January 1, 2025, if approved by voters.

SCA 4 directs the Legislature to provide in statute that the end date for the operation of its repeal of Proposition 19's changes, and reinstatement of the exclusions as they existed before Proposition 19 became effective, are publicized and that the publicity is ensured to reach minority communities. The measure states that every statute, regulation, and judicial interpretation of its changes must be consistent with a liberal interpretation, and with a broad application of the tax benefit. The measure also includes a severability clause.

State Revenue Impact

According to BOE, the revenue impact of SCA 4 is indeterminable.

Comments

1. Purpose of the bill. According to the author, "California's median home value is now passing $716,000 and expected to only climb. Family ranches, businesses, and homes are quickly surpassing the million dollar cap, forcing the younger generations to sell their family homes and businesses due to the reevaluation and increased tax base for their childhood homes. Families whose greatest potential for economic mobility is only achieved through home ownership. SCA 4 would allow voters to decide on the ballot to reinstate Proposition 58 and Proposition 193, restoring what was recently taken away through the hidden provisions in Prop 19: the constitutional exclusion from reassessment when certain property is transferred between parents and children or grandparents and grandchildren."

2. Good deal. The combination of the Proposition 13 method of property taxation and the grandparent-grandchild/parent-child exclusion can be highly financially beneficial. The exclusion can be applied to the same property an infinite number of times, providing a tax benefit that increases the more the value of the property grows and the longer the same family holds it, which reduces the tax burden on accrued lineal wealth. While Proposition 19 eliminated the intergenerational transfer exclusion for up to $1 million in property that isn't the transferee's principal place of residence, it continued the exclusion for principal residences, but only when the transferee continues to reside in the family home. Proposition 19 meant that many children

or grandchildren had to leave or sell their current home and take up residence in their parents' or grandparents' old one to maintain its factored base year value. If not, they could either sell the parents' or grandparents' home, or pay taxes based on its fair market value as of the date of transfer. SCA 4 would restore the tax incentive for families to rent out these residences, at the cost of incremental property tax revenues, and any increase in supply of homes on the sales market resulting from Proposition 19. The Committee may wish to consider the fairness of restoring intergenerational transfers, and whether doing so would affect the supply of homes for sale in the state.

3. Bad deal. SCA 4 proponents argue that Proposition 19's significant changes and effective dates only months after voters approved the initiative caught many taxpayers unaware, upset estate planning, and forced many taxpayers to sell homes. Many affected taxpayers only became aware of Proposition 19's changes while grieving the death of a parent or grandparent that resulted in an inheritance of property. Proponents add that voters approved the initiative narrowly (51.1% to 48.9%), based on a campaign that emphasized the initiative's benefits to seniors, wildfire victims, and disabled homeowners. SCA 4 gives voters the opportunity to reinstate tax benefits that had been in place for many years before limited or eliminated by Proposition 19. However, even if the Legislature enacts and voters approve SCA 4's changes, its reinstated tax benefits would only apply to transfers beginning on January 1, 2025; transfers before that date but after February 15, 2021, would still be subject to Proposition 19's rules.

4. LAO Review. In 2017, the Legislative Analyst's Office (LAO) published "the Property Tax Inheritance Exclusion," which reviewed the intergenerational transfers before they were amended by Proposition 19. The report states:

- Each year, the exclusion applied to between 60,000 and 80,000 inherited properties statewide, and around 650,000 properties—roughly 5 percent of all properties in the state—in the last decade.
- The vast majority of properties receiving the inheritance exclusion are single-family homes.
- The longer a home is owned, the higher the property tax increase at the time of a transfer. As a result, the tax break provided to children by allowing them to avoid reassessment often is large. The typical home inherited in Los Angeles County during the past decade reduced the child's property tax bill by $3,000 to $4,000 per year.
- Parent-to-child exclusions reduced statewide property tax revenues by around $1.5 billion from what they would be in the absence of the exclusion, about 2.5 percent of total statewide property tax revenue. This share is higher in some counties, such as Mendocino (9 percent), San Luis Obispo (7 percent), El Dorado (6 percent), Sonoma (6 percent), and Santa Barbara (5 percent).
- Inheritance exclusions appear to be encouraging children to hold on to their parents' homes to use as rentals or other purposes instead of putting them on the for sale market. Before inheritance, about 70 percent of homes in Los Angeles County in the last ten years claimed the homeowner's exemption, compared to about 40 percent after inheritance.
- The conversion of inherited properties from primary residences to other uses could be exacerbating challenges for home buyers created by the state's tight housing markets, but could put downward pressure on rents, although the shift of homes from the for-sale market to the rental market likely results in fewer Californians being homeowners and more being renters.

5. Dry well. Proposition 19 added provisions to the Constitution that required the Department of Finance (DOF) to calculate additional revenues and net savings to the state resulting from the measure. The measure identified reductions in the state's funding obligation under Proposition 98 due to increased local property tax revenues resulting from limiting or eliminating intergenerational transfer exclusions as one possible source. ACA 11 then directed 75% of any revenues and savings calculated by DOF to the California Fire Response Fund, which the Legislature would appropriate for various firefighting purposes, and 15% to the County Revenue Protection Fund, to potentially reimburse counties for revenue losses resulting from the measure. However, on September 2, 2022, the DOF wrote to legislative leaders and the State Controller that there were no additional revenues or savings to the state, so the Controller would not transfer any moneys to either fund in 2021-22. DOF stated that local property tax revenue will increase as a result of Proposition 19, but so would income tax deductions for local property taxes paid, resulting in no additional state revenue. DOF added that any changes in local funding from property tax revenue do not affect the state's required contribution to the minimum funding guarantee because Test 1 of Proposition 98 was operative in 2021-22.

6. Double-referred. The Senate Rules Committee ordered a double referral for SCA 4, first to the Committee on Governance and Finance, and second to the Committee on Elections and Constitutional Amendments.

Support and Opposition (5/5/2023)

Support:
Honorable Jeff Prang, Los Angeles County Office of The Assessor
Alameda County Taxpayers' Association, INC.
Apartment Owners Association of California Inc.
California Contractors Coalition
California Realtors Coalition
California Taxpayer Protection Committee
California Taxpayers Association
Californians for Better Government
Central Coast Taxpayers Association
Central Valley BizFed
Central Valley Taxpayers Association
Coalition of Labor Agriculture and Business Santa Barbara County
Coalition of Sensible Taxpayers
Contra Costa Taxpayers Association
Family Business Association of California
Glendora Chamber of Commerce
Howard Jarvis Taxpayers Association (HJTA)
Libertarian Party of Santa Clara County
Mission Street Neighbors
Monterey County Farm Bureau
Northeast Neighbors of Santa Monica
Orange County Taxpayers Association
Placer County Taxpayers Association
Pro Small Biz California
San Francisco Taxpayers Association

San Luis Obispo County Farm Bureau
Silicon Valley Taxpayers Association
Solano County Taxpayers Association
Ventura County Taxpayers Association
Western Manufactured Housing Communities Association
Wilshire Montana Neighborhood Coalition
2047 Individuals

Opposition:
American Federation of State, County and Municipal Employees
California Association of Realtors
California Professional Firefighters
California Teachers Association
Common Ground California

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