Proposition 13

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Proposition 13, or the “People’s Initiative to Limit Property Taxation,” amended California’s Constitution in 1978 to specify the required method of property taxation throughout the state and the vote threshold needed to increase other taxes. It is noteworthy due to the profound impact it has had on the taxation of housing in California and for spurring similar statewide property tax reforms throughout the United States. The changes it specified remain in effect and many of its original provisions further expanded. To comprehend the changes in property taxation brought about by Proposition 13 to California and other states, it is necessary to understand first the basic manner of taxing property (land and buildings) in California prior to its passage.

How Came About

Preceding Proposition 13, local governments (counties, cities, and special districts) and school districts had far greater freedom to tax property within their jurisdiction to pay for the provision of local services that arguably benefitted the jurisdiction’s property owners. Using a house as an example, the annual revenue raised from such a property equaled the property tax rate levied upon it (per dollar of market value) multiplied by the market value of the house and its land. The upside of such a system is the ease of accommodating citizen demand for a greater provision of
local services within a jurisdiction. Furthermore, a clear nexus exists between having property owners within a jurisdiction pay for local government services that yield higher property values. However, this system of property taxation is not without its concerns: (1) fairness requires an accurate assessment of market value across properties and classes of property, (2) jurisdictions take in increased property tax revenue (and hence citizens get greater government services) through market value increases of property without having to explicitly ask for a property tax rate increase, and (3) it takes only a simple majority of voting residents to impose their desired level of property taxation upon others. Ultimately, these concerns were responsible for the 1978 passage of California’s Proposition 13.

The roots of Proposition 13’s passage goes back to the 1960s and widespread scandals regarding the accurate determination of the market value of California property for taxation purposes. Statewide legislation passed in 1967 (Assembly Bill 80) righted these inaccuracies, but with the consequence of raising the share of property tax payments made by residents relative to business (the direct result of a previous underassessment of residential to business property). Furthermore, the 1974 election of Governor Jerry Brown compounded this situation after he implemented his campaign promise of bringing further growth controls and environmental protections that resulted in a reduction of new home construction concurrent with continued growth in California’s population and high rates of general inflation. As a result, the nominal value of the average California home between 1974 and 1978 nearly tripled. Given the absence of local citizen movements great enough to reduce significantly the rate of property taxation through local elections, jurisdictions throughout California gained windfall increases in local property tax revenues. The payment of these windfalls fell disproportionately upon homeowners. Between 1975 and 1978, the proportion of statewide local property taxes paid by
homeowners rose from 32 to 42 percent in California. Concurrently, the State enjoyed its own revenue windfall due to inflation-based bracket creep in its highly progressive income taxes. Furthermore, in a series of three (1971, 1976, and 1977) California Supreme Court cases involving Serrano v. Priest, California’s system of public K-12 education (which relied heavily on the use of local property taxes to fund widely disparate levels in spending per pupil) was declared in violation of the State’s constitutional guarantee of equal protection in the provision of an primary and secondary education.

The mid-1970s situation that California found itself in (rapidly rising residential property tax bills, governments sitting on windfall fiscal surpluses, and growing certainty that local property taxes were no longer available for local schools) was ripe for small government/anti-tax activists Howard Jarvis and Paul Gann to declare, “We are mad as hell, and not going to take it anymore.” Proposition 13 came about as the result of over one million registered voters signing a petition in favor of bringing it to a statewide vote. Despite the California Legislature putting an alternative proposal on the June 1978 ballot (Proposition 8 – that would have reduced residential property taxation by taxing business at a higher rate through a “split role”), and the stated opposition of industry, labor, and the moderate leaders of both major political parties to Proposition 13, it received the support of 65 percent of the 69 percent of registered California voters that cast a ballot on June 6, 1978.

**What Changed**

Proposition 13 contains six provisions. The first rolled back all 1978 market value property assessments to their 1975 market value. The second discards market value assessment for a new form of “acquisition” based assessment for which taxable property value only equals market value in the year a property sold. Between sales, the value used for tax purposes increases each
year by a percentage that is the lesser of two percent or the annual rate of inflation. Proposition 13’s third provision is that property in California taxed at a percentage of assessed value can pay no more than one percent of its acquisition value. The fourth provision makes the allocation of locally collected property tax revenues a state responsibility. Finally, the fifth and sixth provisions of Proposition 13 extend beyond property taxation and require a two-thirds supermajority of each house of the state legislature for approval of any statewide revenue increase, and the same supermajority of voters for local tax increases for a designated purpose.

Proposition 13 instantly lowered property tax payments in California by six to seven billion dollars. Of course, what the taxpayer gained, California’s local governments lost – immediate 27, 40, and 50 percent respective reductions in total local revenue to cities, counties, and school districts. This citizen demanded reduction in tax payments ushered in a new era for California. Local government lost their largest revenue raising instrument and with it a commensurate ability to set a self-determined fiscal path. At the national level, Proposition 13 is the genesis of the low tax and small government political movement that yielded the “Reagan Revolution” and continues with the “Tea Party Movement.” While recent polls in California indicate that Proposition 13 enjoys the same degree of support as when it passed, and it is widely referred to as the “Third Rail of California Politics” (touch it and you will die), analysts have written extensively on the consequences that have come to California after its passage.

The “Good”

The benefit most often broadcast by the current Howard Jarvis Taxpayers Association is that the passage of Proposition 13 saved California property owners over a half trillion dollars in property tax payments between 1978 and 2010. Furthermore, the payment of these higher tax payments would have resulted in a larger, more inefficient, and more regulatory oppressive local
government. At the individual level, a California family that still lives in a home they bought in 1980 at the median price of all California homes at the time has saved over $120,000 in property tax payments. Moreover, Proposition 13 resulted in needed predictability in the tax payments made on a non-liquid asset and in the resulting revenue stream for local government. This means that fewer fixed-income (aged and/or poor) California homeowners have left their homes due to an inability to pay rising property taxes. As argued by the United States Supreme Court in its ruling that upheld Proposition 13 after a challenge based upon the United States Constitution’s Equal Protection Clause, the lower property tax payments made under acquisition value by those who live in a home longer are justified because of the immobility, and hence neighborhood stability, they promote. Finally, political conservatives cite the two-thirds supermajority vote requirements as a needed protection against the “Tyranny of a Simple Majority” that would impose their tax and spending will upon a greater than one-third minority who oppose it.

The “Bad”

A general concern raised by observers of the aftermath of Proposition 13 is that it has resulted in a more centralized provision of government in California. This is traceable to Proposition 13’s requirements that severely limited the level of local property taxation in the state, turned the ultimate distribution of the once locally controlled revenue over to the state, and forced the state to fund or provide public services once offered locally. Property tax distribution after Proposition 13 was accomplished through state legislation (Assembly Bill 8) dictating that the annual property tax revenue raised in a county remain in the county, but be distributed among jurisdictions in the county based upon a complex, state-determined formula that the state retains the right to alter. This system of local property tax distribution has been particularly difficult for California’s cities and counties who found themselves the victim of state imposed shifts in
county property tax revenues toward local school districts to meet the state’s required expenditure to schools based upon a 1988 initiative (Proposition 98). Californians have used the initiative process in 2004 (Proposition 1A) and in 2010 (Proposition 22) to freeze the intra-county tax distribution formula, but the result is still a system of property taxation that is best thought of as state controlled.

Concern over Proposition 13 has also arisen due to the pressure it put on California local government to employ increasingly arcane public financing methods as an alternate to local property taxation. This includes public-private partnerships and the issuance of debt to finance needed infrastructure if two-thirds of the landowners (based upon property value) in an assessment district approve. In addition, California jurisdictions with the ability to make land use decisions have increasingly made such decisions with an intense desire to garner additional local revenue. This has occurred in the forms of: (1) an increased use of development fees, (2) an increased use in tax increment financing, to not only spur the redevelopment of blighted areas, but to also capture the property tax revenue increment that after Proposition 13 goes for countywide distribution, and the (3) “Fiscalization of Land Use” toward high-dollar volume retail activity that generates discretionary local revenue through California’s one percent local sales tax levy, and away from affordable homes whose incremental property tax revenue is not enough to fund the increased government services provided to the residents that will occupy them.

An acquisition form of assessment also discourages desired economic mobility and generates great disparities in the local property tax payments that neighbors living in identical homes pay for identical local services. In the Los Angeles Area, if you bought your home in 1978 or earlier, you pay about one-sixth less in property taxes than a neighbor who just moved
in. In addition, acquisition value assessment discourages business relocation within California or new businesses to enter the state. This subsequently reduces the competitive advantages that such business mobility would offer to California’s consumers. Brought all the way to the United States Supreme Court as a violation of the Interstate Commerce Clause, the business (Macy’s) that filed the case dropped it before the high court could render judgment.

Finally, economists largely agree that property taxation is either a progressive tax that the rich devote a greater percentage of their income to than the poor (because high income people earn a larger percentage of their income from the property rent that is depressed because of property taxation), or a “Benefit Tax” where income incidence is irrelevant because the benefits of the additional local services provided by greater property taxation offsets the negative effect such taxation has on property value. Understanding this, a relevant concern after Proposition 13 is the increased use of sales taxation and fees at the state level to substitute for local revenue earlier raised through property taxation. Such a shift has made California’s overall revenue gathering more regressive in the form of asking the poor to devote a greater percentage of their income to it than the rich.

**Possible Reforms**

Given the revenue shortfalls currently faced by state and local governments, and the benefits that can arise from some government services being provided and financed at a more local level, it is appropriate to describe the reforms to Proposition 13 that have been proposed. The first is moving to a “split role” where non-residential property assessment returns to market value based assessment for property tax purposes, and residential property remains at acquisition based assessment. An estimate for 2010 is that this would raise six to eight billion in new revenue in California.
Another major reform is a removal of the one percent maximum rate of property taxation allowed on the assessed value of property in California after Proposition 13. Critics would point out that this allows the “Tyranny of Majority” to impose their desire for greater local government services desires, and commensurate higher rate of property taxation upon others. This is a reasonable concern that can at least be partially overcome by: (1) requiring a supermajority of citizen/property owner signatures and/or supermajority of the members of governing body to put a property tax rate increase on the local ballot, (2) requiring a supermajority to pass the proposed increase, and (3) setting an overall maximum above the current one percent that value based property taxation could rise to. A reasonable concern is that this reform would forced fixed income people out of their homes because they could no longer afford the higher property taxes that would likely result. This concern could be dealt with through the further institution of “reverse mortgages” that allow the payment of currently due property taxes with a portion of the equity in built up a property, or a public program that allows the deferment of the taxes owed on a property until it is sold or transferred to another.

A final reform, that could or could not be revenue neutral, is the full replacement of acquisition value with market value assessment. The primary reason for doing this is the greater equity it would generate in what neighbors pay in property taxes for the same local services. Doing so would raise far more than the six to eight billion in revenue estimated for this change for only non-residential property (split roll) in California, but would be paid for by an increase in everyone paying more in property taxes. However, this outcome could be eliminated for some by a commensurate “roll back” in the rate of taxation that would make the change overall revenue neutral. As an example, consider a jurisdiction that raised $1 million in annual property tax revenue through acquisition value assessment on a property tax base of $100 million and a
rate of one percent. Assume a movement to market value assessment would raise the property taxable base of this jurisdiction to $300 million. At a continued rate of one percent taxation, tax receipts rise to $300 million and the jurisdiction would enjoy a $2 million revenue windfall. However, neutralization of this occurs through a required roll back of the property tax rate from one to 0.33 percent. The overall result being a reduction in property tax payments for those who just recently bought their property and whose base under market or acquisition value assessment would be nearly the same, but now face a far lower rate. Though the likelihood of this change resulting in a rate increase rises the longer that someone has owned her property and the increase to market value assessment not being offset by the decrease in rate.

This rollback procedure would also be in place to counteract the exact scenario that caused a majority of Californians to first support Proposition 13. Moving to market value assessment, inflation in housing prices and hence market values can lead to windfall revenue increase for local governments that citizens would not have supported if asked to vote for them. To prevent this, roll back the local rate of property taxation to a rate that offset the effect of housing inflation and only allows the jurisdiction to raise the same amount of revenue (or perhaps the same amount adjusted for a rise in the consumer price index). If citizens wanted the increased revenue, they would still possess the ability to raise the rate through a vote.

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See also Property Tax, Property Rights, Residential Mobility, Residential Location, and Tax Increment Finance

Further Readings


