California’s Reliance on Personal Property Taxation: An Economist’s View from Sacramento

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I provide a California-based perspective on Reducing Reliance on the Property Tax: Pros and Cons. I do this by offering a brief history of personal property taxation in the state, pertinent state-specific definitions and rules, data-based figures on personal property reliance in California, and specific concerns. I then discuss the issue of personal property tax reform in California by exploring its reduction or outright elimination. Key to this exploration is a consideration of feasible forms of replacement revenue. I rely upon the other five presentations in this session to provide a general background on the economic and administrative reasons for considering personal property tax reform, and for what is happening regarding this throughout the United States.

California’s state and local governments tax all forms of property unless prohibited by the state constitution or federal law. Proposition 13 (1978) limited the statewide ad valorem tax rate on personal property to one percent, but market value assessment of this classification of property still remains (acquisition value only applied to real property).

When considering all state and local government revenue collected in California, the local property tax raises slightly more revenue than the state personal income tax or the state/local sales tax. Two-thirds of California’s property tax revenues go to K-14 public schools and counties.

Personal property in California is all property besides real property (land, minerals, timber, improvements). The California Legislature (with a two-thirds vote of each house), may provide for differential exclusion of forms of personal property from the one-percent statewide rate. Current major exemptions include: business inventories, application software, licensed motor vehicles, household items, all personal property owned by banks/financial/insurance companies, $50K of each employee’s owned tools, and personal property with market value less than $10K owned by a business.

The intent of personal property assessment is its market value as of January 1 of each year derived through business-provided data. In FY 2013-14, personal property consisted of only about four percent of California’s total property tax base (down from about 5.5 percent in the early 2000s). But wide variation in this reliance occurred across the state’s 58 counties (Marin and Siskiyou Counties at around 1.6 percent, Santa Clara and Siskiyou at around 6.6 percent, and Glen County leading at 11.4 percent). A correlation coefficient of +0.59, between the percentage of a county’s property tax base that is classified as personal and the percentage acres devoted to agriculture production, offers a potential reason for this variation. Santa Clara County (Silicon Valley), exhibits the greatest reliance on personal property tax revenue of any urban county in California. However, this is not a growing concern as this reliance has halved over the last decade. California’s reliance on the personal property tax at $53 per capita in state and local revenue derived from personal property taxes, and 0.77 percent of state and local own-source

1
revenue earned from personal property tax, in FY 2009-10, was far below the respective U.S. weighted averages of $112 and 1.95 percent. Furthermore, these values for California were very near or below that observed in neighboring states, and far below the values observed in the competitor states of Texas, Utah, and Arizona.

Concerns raised in California regarding the taxation of personal property arise due to its uniqueness and mobility. The uniqueness of business personal property, and the requirement that it be assessed at market value every year, resulted in the California Taxpayer’s Association (2001) concluding that “valuation is the most controversial and contentious aspect of the personal property tax.”1 Besides an administrative cost that is five times greater than for real property, personal property concerns include difficulty in valuing high tech equipment, actual obsolescence faster than allowed, findings of entirely obsolete equipment still valued at 20 percent of the original market price and double assessment through double counting of personal as real property also. Within broad California Board of Equalization statutes, elected county appraisers are free to use any method to get the fair market value for personal property assessment.

By its very definition, personal property is detached from land and therefore potentially mobile. Concerns have arisen over the appropriateness of taxing something that can relocate to a jurisdiction that does not tax it. Some California businesses people, and their lobbyists, cite California’s onerous regulatory and tax burdens – including the taxation of personal business property – as driving firms out of the state and repelling business relocations from other states. Evidence of this include polls of business decision makers and specific anecdotes, but a data-based study by the Public Policy Institute of California (PPIC, 2007) showed the state only loses only about 0.1 percent (124,000) of its employment to interstate mobility in a typical year.2 Over 95 percent of California’s business mobility is within state. These findings – combined with the fact that California is not out of line with neighbor and competitor states in its reliance on personal property taxation – suggests that the state’s taxation of personal property is likely not a concern regarding interstate business mobility. None the less, differences in the way that the state’s counties assess personal property could be a contributing factor to the high degree of intrastate mobility of business activity in California found in the PPIC study.

In conclusion, I weigh in on the suggestions to reduce or eliminate California’s taxation of personal property. Important to this question is the realization that only about 0.6 percent of California’s state and local government revenue comes from personal property taxation. Even so, given California’s barely balanced state and local budgets, the statewide elimination of personal property taxation would likely require replacement of the $2.2 B raised from it in FY 2013-14. A split property tax role, where real business property goes back to market value assessment, is a possibility. But, how would this be more business friendly than personal property taxation? Perhaps a more politically viable option is the imposition of an oil extraction severance tax. Legislative proposals exist to do this, but not one of them with the suggestion that new revenues supplant the revenue lost from the elimination of personal property taxation. Thus, the only reform I suggest worthy of consideration is the allowance of a local option to exempt all or a portion of a jurisdiction’s personal property from taxation. It is conceivable that a local jurisdiction could actually see an increase in real property tax revenues if its administration of the personal property tax was previously driving it out. Even if such a Laffer Curve is non-existent exist for a locality (as there is strong evidence that it does not exist for the state as a whole), a jurisdiction may still justify a personal property exemption by the increased local economic activity it generates. However, a concern with the granting of local autonomy to exempt personal property from taxation is the likelihood of it degrading into a near statewide elimination of personal property taxation in California.