



## **Analysis of SB 1021 (Wolk): Split-Roll Parcel Taxes**

### **CalTax Position: Oppose**

#### **WHAT THE BILL DOES**

SB 1021 (Wolk), as introduced February 14, 2014, authorizes more than 1,000 California school districts to impose unlimited tax increases on select property owners by allowing the imposition of nonuniform parcel taxes, further complicating an already complicated tax regime. Under the bill, school districts could split parcel tax assessments within a district based on the square footage of a parcel, the square footage of improvements on a parcel, and/or the use of a parcel (but the same tax must be levied on all properties that have the same use).

The bill also allows school districts to impose a different tax rate on unimproved parcels; and to treat multiple parcels as one — for purposes of a parcel tax — where the parcels are contiguous, under common ownership, and constitute one economic unit (they must have “the same primary purpose and are not separate and distinct properties that may be independently developed and sold”).

#### **BACKGROUND**

Under state law, school districts that impose parcel taxes must apply them “uniformly to all taxpayers or real property within the school district.” State law does not allow school districts to impose parcel taxes “on a particular class of property or taxpayers.” There are exemptions for seniors who are 65 years of age or older and certain disabled persons (Government Code Section 50079).

The California Constitution, Art. XIII, Sec. 1(a) states, “All property is taxable and shall be assessed at the same percentage of fair market value.” This addresses the *ad valorem*, or acquisition-value, property tax assessments. That section goes on to say: “When a value standard other than fair market value is prescribed by this Constitution or by statute authorized by this Constitution, the same percentage shall be applied to determine the assessed value.” Art. XIII A, Section 4 authorizes cities, counties and special districts, by a two-thirds vote of the electorate, to impose special taxes within the district, “except *ad valorem* taxes on real property or a transaction tax or sales tax on the sales of real property within such City, County or special district.”

Some local governments currently are in violation of state law, because they are imposing nonuniform parcel taxes. For example, some school districts impose parcel taxes at a higher rate on commercial and industrial parcels than they do on residential parcels. In *Borikas v. Alameda Unified School District*, the First District Court of Appeal

ruled on December 6, 2012, that the school district's imposition of nonuniform parcel taxes violated Government Code Section 50079. The Alameda Unified School District taxed commercial parcels larger than 2,000 square feet at a higher rate (up to \$9,500 per year) than residential and small commercial properties. The court concluded that the school district's property classifications and differential tax burdens exceeded the district's taxing authority, and the property owner won the case. AB 59 (Bonta), introduced January 7, 2013, attempted to overturn the *Borikas* decision retroactively before the California Supreme Court denied the petition for review. However, CalTax was successful in leading a coalition that blocked that bill from being heard in its first policy committee.

## ANALYSIS

SB 1021 overturns the *Borikas* decision on a prospective basis by allowing approximately 1,043 school districts to impose nonuniform parcel taxes. In other words, the bill would allow school districts to tax select types of property at a higher rate than other types of property. For example, a school district may choose to tax hospitals, hotels and motels, ski resorts, wineries and breweries, storage facilities, and assisted-living facilities at a higher rate than residential parcels.

SB 1021 would further complicate an already complex local tax structure. The options to tax parcels would be unlimited under SB 1021. As an example, a school district may decide to impose a parcel tax at a rate of \$5,000 on residential homes that are 2,500 square feet or more; \$500 on residential homes that are less than 2,500 square feet; and \$1 per square foot on commercial and industrial property (with an exception of gas stations); and a flat \$100,000 on all property used as a gas station. The combinations to tax are endless under SB 1021.

Further complicating the tax structure, SB 1021 allows school districts to treat multiple parcels as one under certain conditions. If a developer owns an office building on one parcel, and a to-be-developed, but currently unimproved adjacent parcel, SB 1021 would give the taxing authority the ability to collapse the two parcels into a single taxable site, and apply a parcel tax on the unimproved site at a much higher rate.

## KEY POLICY CONCERNS

**Property Owners Could Face Higher State and Federal Income Taxes.** To be deductible for both state and federal income tax purposes, real property taxes must be levied for the general public welfare "at a like rate against all property" in the taxing authority's jurisdiction under Treas. Regs. Sec. 1.164-4(a). [IRS Information Letter 2012-0018A](#) (March 30, 2012) states that non-*ad valorem* assessments may be deductible under certain circumstances: Real estate taxes that are not based on value are deductible only if they are "are levied for the general public welfare by a proper taxing authority at a like rate on owners of all properties in the taxing authority's jurisdiction, and if the assessments are not for local benefits (unless for maintenance or interest charges)." A school district that imposes a higher parcel tax rate on commercial

and industrial property than on residential property, for example, could cause all property owners, including homeowners, in the district to lose their income tax deduction for the parcel tax. Likewise, a school district that bases a parcel tax on a flat amount for residential property, on square footage for commercial, and on use for industrial property, triggers the nondeductibility rule for both state and federal income tax purposes.

**Further Weakens Low-Wealth School Districts.** School districts that impose higher parcel taxes raise equity issues reminiscent of the *Serrano* decisions, and may put California's system of public school finance back on trial. In 1971, the California Supreme Court held in the first *Serrano v. Priest* decision that school revenue based on *ad valorem* taxes was unconstitutional, stating: "So long as the assessed value within a district's boundaries is a major determinant of how much it can spend for its schools, only a district with a large tax base will be truly able to decide how much it really cares about education. The poor district cannot freely choose to tax itself into excellence which its tax rolls cannot provide." In 1977, in a second *Serrano v. Priest* decision, the California Supreme Court again ruled against a property-tax-based school finance system. An attempt by the Legislature to address the court decision was headed to court in 1978, when Proposition 13 solved the problem by limiting the property tax to 1 percent and by not allowing school districts to have *ad valorem* property tax overrides. Because low-wealth school districts are less likely to get voter approval to increase taxes, *Serrano* and Proposition 13 brought equity to California's school financing system through equalization of per-pupil spending. Nonuniform parcel taxes would undermine the *Serrano* decisions, as low-wealth districts only would be able to raise a fraction of the money that high-wealth districts would be able to raise.

**Deteriorates Proposition 13's Protections for Homeowners.** All of the numerous "add-ons" to property tax bills that homeowners receive each year, including add-ons for parcel taxes, erode the property tax relief provided by Proposition 13. For example, some homeowners may find themselves paying more in parcel taxes than their basic one percent property tax under Proposition 13.

**Potentially Higher Taxes on Businesses.** Nonuniform parcel taxes would target both small and large businesses, and would adversely impact them. Small businesses and minority-owned businesses would be hit hardest because they would not be able to absorb higher lease costs that would result from higher property taxes. Lease payments on commercial buildings, shopping centers, business parks, and warehouses, to name a few, would increase to reflect increased parcel taxes, as most commercial leases allow for such increases to be passed through to lessees.

**Discriminatory.** The touchstone of discriminatory taxes is their detrimental economic effects. A school district that exempts from tax a particular type of parcel, but taxes another type of parcel — maybe even a similar type of parcel — sets up a discriminatory tax system. Manipulation of the components of a parcel tax — its rates, property classifications, methods of assessment, and exemptions — can produce substantial discriminatory effects. The problems created by discriminatory property

taxes are no different from those created by discriminatory non-property taxes, namely, certain taxpayers would be forced to pay more than other similarly situated taxpayers; and some businesses would be forced to pay more than their competitors, thus putting them at an economic disadvantage.

Moreover, school districts may have incentives to discriminate against certain property owners, and favor others. A sporting goods store, for example, in a district that taxes its 20,000-square-foot store at \$1 per square foot would pay \$20,000 a year in parcel taxes, while a book store down the street might pay a \$30 flat-rate-parcel tax. Class-action suits were filed in February 2014 challenging New York City's and New York State's real estate taxes, claiming they discriminate against African-American and Hispanic renters. SB 1021 is headed in this direction, as it would set up a tax system similar to New York City's property tax classification system. That system has "a disparate and adverse impact upon the City's African-American and Hispanic residents, and denies such residents their statutorily and constitutionally protected rights to due process and equal protection," according to the suit. Because of the property tax classifications, the property tax system illegally burdens African-American and Hispanic New Yorkers who live in big rental buildings, as compared to predominantly white-owned condos and co-ops, and predominantly white- and Asian-owned homes, according to the suit. Taxing certain classes of property, as SB 1021 authorizes, certainly would lead to similar litigation (see [\*Ernest Robinson and Rosa Rodriguez v. City of New York and State of New York in the New York Supreme Court\*](#)).

**Property Owners Are Singled Out.** Parcel taxes single out property owners to pay for programs and services that benefit the community at large, such as for fire prevention and public safety. Many residents of a school district that imposes a nonuniform parcel tax would benefit from such services without bearing the financial burden of paying the tax.

## CONCLUSION

Allowing school districts to further complicate parcel taxes by allowing a free-for-all system is ill-advised. The Legislature should equalize parcel tax rates by continuing to require uniform parcel taxes imposed by school districts, and by adopting a uniform rate structure for all types of parcel taxes. Parcel taxes have the potential to generate wide funding disparities among school districts, raising a number of equal protection issues. The California Supreme Court ruled in 1971 that California's system of funding public schools through local property taxes was unconstitutional because it unfairly discriminated against children who live in low-wealth school districts, and nonuniform parcel taxes move the state back in time toward that unconstitutional and discriminatory system of school funding.