

# The wrong tax reform

**I**N CALIFORNIA, prior to voter approval in 1978 of Proposition 13, the property tax relief initiative amendment to the Constitution, local agencies of government, including the public schools, were primarily financed from property tax revenues. As a consequence, it was a heavy tax burden and all property owners were very sensitive to it.

During the 1960s and 1970s, because of inflation and speculation in real estate, residential property values increased at an unusual rate and the property tax became a heavy tax burden on the homeowner.

Unfortunately, because the rising trend in real estate prices was not uniform and was more dramatic for housing, there developed a shift in the property tax burden from commercial, industrial and unused and agricultural land to residential property. For example, during 1973-76, residential property values increased by 65%; multiple residence property values increased by 25.8%, commercial and industrial property by 39% and 32% respectively, and rural property by 13.5%.

**The public response was the emergence of a populist movement in favor of property tax relief – a movement which focused primarily upon tax relief and only secondarily upon reform.**

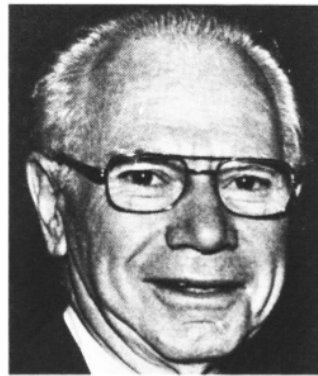
California was in a fortunate fiscal position because its revenues had become relatively elastic, increasing annually at a rate considerably greater than the rate of increase in personal incomes. As a result, state revenues exceeded expenditure and the state was able to use surplus revenues to provide local property tax relief. That goal was pursued through a greater assumption by the state of local public education costs and the enactment of a modest tax relief program for homeowners and rent relief for tenants. The tax on personal property was repealed and the tax on business inventories was partially repealed. These actions mitigated the adverse effect of the property tax burden, but they failed to reduce the public demand for tax relief.

At the same time, there was a growing concern among legislators and environmentalists over the expansion of urban areas and the negative impact upon the supply of arable land and the environment. Included among

the concerns was air pollution from the increasing dependence upon the automobile.

Legislation was enacted which mandated local governments to develop Master Plans for community development and to require Environmental Impact Reports for all proposed real estate developments. The object was to restrict urban expansion and to prevent real estate projects which were contrary to the responsible utilization of arable land and the protection of scenic areas and natural resources.

**By Albert S. Rodda**  
in Sacramento



**D**ESPITE these controversial and substantive efforts, however, it was obvious that pressures for expansion and development were powerful and that there was little incentive for the full use of areas already zoned for development which possessed the facilities essential to the land's use.

In Australia, New Zealand, the state of Pennsylvania, and the city of Johannesburg in the Republic of South Africa, where various forms of land value taxation are used to tax property, there is substantial evidence that the results are beneficial for the preservation of resources and the use of land already available for development.

**As I became more aware of the success of land value taxation, and as I reflected upon the problems confronting California, I became seriously inclined toward its implementation in this state.**

I began a dialogue, therefore, with economists in California and other

states who were favorable to the concept with the objective of determining how such a goal might be achieved. I concluded that if the existing property tax revenue base were maintained, a shift from the taxation of improvements to the taxation of land would be a responsible approach to the provision of property tax relief and reform. In addition, it would offer constructive economic incentives for property owners to utilize their land more efficiently.

After several years of study and statistical evaluation of theoretical models, it was concluded that the appropriate approach to the implementation of land value taxation was through a constitutional amendment which would provide for a complete shift of the taxation of improvements to land only over a five year transition period. During the course of that transition, however, the legislature would be authorized by a two-thirds vote in both houses to terminate the transition within three years or to lengthen the transition period.

I was aware of the fact that the plan would be vigorously opposed by real estate developers and certain members of the business community, including those engaged in agricultural production. Nevertheless, I was convinced that the action had to be initiated, if for no other reason than to educate the public as to the benefits of such a property tax reform. After an interim hearing on the concept, I introduced a constitutional amendment and presented it before the Senate Revenue and Taxation Committee in 1977. It was defeated after a lengthy and controversial hearing.

**A**LL EFFORTS to achieve responsible property tax relief and reform failed in that year and in 1978 the voters approved Proposition 13, which was a drastic constitutional amendment initiative. It had the support of residential property owners, many leader in the business community and, surprisingly, many tenants occupying residential housing.

The voters were also offered Proposition 8. The product of the legislature's action, Proposition 8 mandated a split tax roll, provided substantial property tax relief for



homeowners and renters and shifted to the state the cost of financing a number of important social programs which traditionally had been financed from the local property tax.

Out of frustration and lack of knowledge and understanding, the voters approved overwhelmingly Proposition 13 and rejected the legislature's alternative.

Proposition 13 limited the taxation of all property, land and improvements to 1% of the assessed value and allowed a maximum 2% increase in property assessments for each year, if the rate of inflation exceeded that level. It required, however, the taxation of newly-purchased or constructed property on the basis of the market value at the time of purchase or construction. All other property, constructed or purchased before 1979, was to be taxed on the basis of the assessed value for the year 1975-76.

**Today, therefore, there is a wide disparity in the tax payments made on property of the same market value. That disparity will increase over time.**

Today, newly-acquired property is taxed several times greater than property of the same value which has not experienced a transfer since 1978.

In addition, the amendment prohibited local governments from increasing the general property tax and the state of California was denied the power to tax real property. All special taxes authorized at the local level of government were required to remain at the level which then prevailed, unless an increase was approved by two-thirds of the voters.

All state tax increases were made subject to approval by a vote of two-thirds of both houses of the legislature. Renters received no direct benefit — only the hope that property owners would pass on in lower rents a portion of the property tax reduction they received.

The revenue loss from the reduction in the property tax, approximately \$7 billion out of total property tax revenues of about \$12.5 billion, was so damaging to local governments and the schools that the state had no responsible option but to use its accumulated surplus to make up the revenue deficiency.

Known as the Proposition 13 "bailout", it amounted to a \$4.4 billion transfer in 1978-79 of state revenues to local governments and the schools. All agencies of local government, especially the schools, therefore, are now more fiscally

dependent upon the state than at any time in California's history. There has been a serious loss of local government autonomy.

**C**AN CALIFORNIA'S tax structure be reformed? The only viable approach is through a constitutional amendment to repeal some of the Proposition 13 provisions. This approach, however, is controversial and has been undertaken only by groups which are strong advocates of general tax reform. So far, however, they have been unable to achieve their goals.

● An option which is being seriously considered by those involved in local government and education embodies a joint effort to gain legislative approval of a plan to earmark property tax and general sales tax revenues to provide local governments and the schools a "stable base and more local control."

Since the effort does not contemplate a tax increase, the outcome of such a plan, if implemented, will very likely result in redistribution of revenues among government agencies with a potential for "robbing Peter to pay Paul". And whether that will happen will depend upon the politics involved in the development of the formula for the distribution of the earmarked funds.

● Another approach would be legislative approval of a constitutional amendment to mandate the assessment of all property at the market value for tax purposes, a limit upon property tax payments equal to 1% of the value of the property, and the adjustment of property taxes to conform to a responsible tax revenue limit.

## SAN FRANCISCO

● In a forthcoming article **ALANNA HARTZOK** reports from San Francisco on Proposition M, the citizens' initiative on city planning which failed.

● The battle against the "Manhattanization" of San Francisco continues, but are there other models for action?

● Miss Hartzok proposes a solution which accommodates human-scale development along with a reduction in the tax burden on employees and businesses.

● Read her article in the July-August issue of *Land and Liberty*.

Such a plan, by establishing a uniform property tax base which reflected the current value of real estate, would eliminate the existing tax inequities. It would also ensure local governments and the schools a reasonable revenue source and place a cap or limit on future tax increases. The likelihood of public acceptance, however, is not favorable, since all property owners would experience an immediate property tax increase and greater tax payments in the future than are now authorized under the provisions of Proposition 13.

If such an alternative were seriously to be considered, it would be reasonable to shift the tax base from land and improvements to land alone. Under such a plan, all land would be assessed at market value, all improvements untaxed, a tax limitation of 1% of assessed value applied, and property tax revenues adjusted in the future to comply with a responsible tax revenue limit. Homeowners would experience a modest tax reduction because of the elimination of the taxation of improvements, but the same two important negatives with respect to such a transition would apply — an increase in tax payments over present taxes for all property owners and a greater rate of tax increase in future years.

**Frankly, the prospects for changes in the provisions embodied in the Constitution by Proposition 13 are not favorable.**

Today, adjustments to Proposition 13 focus almost exclusively upon a determination to provide fiscal autonomy and revenue support for various segments of local government and education. Little consideration is being given to the need for reform, whether it be the elimination of tax inequities, an enhancement in revenue, or a restoration of the ability of government at the local level to act independently and to utilize general obligation bonds to finance capital needs and community development facilities — jails, schools, libraries, roads, bridges, and so on.

California's infrastructure is in a sad condition of disrepair and Proposition 13 is contributing to that condition.

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