



# TaxNewsFlash

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## California: Property tax increase pending in November ballot initiative

A measure—Proposition 15—that would revise the rules for property taxes in California will be on the November 2020 ballot.

If approved by a majority of California’s voters, Proposition 15 would establish a “split roll” property tax regime whereby a different assessment regime would apply to commercial and industrial property, as compared to residential property.

### Background

For over four decades, California property taxes have been governed by Proposition 13—that was approved by voters in 1978. Under Proposition 13, commercial, industrial, and residential properties generally are reassessed to current market value only when there is a change in ownership or the completion of new construction. Moreover, annual valuation increases for locally assessed property are capped at the lesser of the inflation rate or 2%, and the tax rate cannot exceed 1% of the property’s assessed value.

For many years, efforts have been underway to revise Proposition 13—at least with respect to the assessment of commercial and industrial properties. Proponents of an overhaul were successful in getting a measure fully qualified for the November 2020 ballot.

### Proposition 15

Proposition 15 is officially known as “The California Schools and Local Communities Funding Act of 2020.”

If approved by voters, the California Constitution would be amended to require commercial and industrial properties be assessed based on their fair market value, rather than purchase price, at least every three years. Affected property would include commercial and industrial property, and vacant land not zoned for residential use and not used for commercial agricultural production. Residential properties, whether occupied by a homeowner or renter, would be excluded from the scope of Proposition 15.

Special rules would apply to mixed-use real property, and the legislature would be required to determine that only the portion of the property used for commercial or industrial purposes would be assessed based on fair market value.

### **KPMG observation**

There is uncertainty regarding whether Proposition 15 would apply to remote workers who use their homes as their offices.

Business owners that have commercial and industrial properties holdings in California with a fair market value of \$3 million or less would not be subject to reassessment under the revised regime. This would mean that if the owner of the property's total commercial and industrial property (in the aggregate) owned in California is valued at \$3 million or less, the property would continue to have Proposition 13's protections (i.e., initially assessed based on the value at the time of purchase price, and the assessed value each year would be subject to a maximum 2% increase).

Proposition 15 would not change the constitutional property tax rate, which is generally limited to 1% of the assessed value of the property.

### **Effective date, phased-in approach**

The change in California's property reassessment regime would generally be effective beginning with the fiscal year that runs from July 1, 2022, to June 30, 2023, although there would be a delay to the 2025-2026 fiscal year if 50% or more of the occupied square footage of a real property parcel is occupied by small businesses, as defined by Proposition 15.

Proposition 15 would require the legislature to establish a task force on property tax administration that would develop a statutory phased-in approach for reassessing a percentage of commercial and industrial real property within each county over a three-year period beginning with the 2022-2023 fiscal year. The lien date for that fiscal year would be January 1, 2022, and the first installment of property taxes for properties reassessed in the first year of the three-year phase-in would be due on November 1, 2022.

Due to the phased-in approach, there would be a few years when some property owners within a country would be obligated to pay taxes based on the new assessed value, while others would continue to pay under the Proposition 13 value. The phase-in legislation is required to provide taxpayers with a "reasonable period of time" within which to pay the increased tax due to reassessment. After the initial reassessment, commercial and industrial real property would be periodically reassessed at fair market value at least every three years.

The legislature would also be required to develop a process for hearing appeals resulting from the reassessment of such properties. This process would include switching the burden of proof regarding a property's assessed value from the assessor to the property owner and repealing the rule regarding automatic acceptance of a property owner's assessed value if the property tax appeal is not acted upon within two years.

Proposition 15 would also revise how personal property, including business equipment and fixtures, would be taxed. For certain small businesses with less than 50 annual full-time equivalent employees, all tangible personal property owned and used for business purposes would be exempt. All other businesses would have an exemption up to \$500,000 on personal property and business equipment (combined).

### **KPMG observation**

This proposed tax increase is pending the decision of California voters, and thus its fate is uncertain. Already there are court challenges concerning how Proposition 15 is titled and how the summary is written. The additional property tax revenues resulting from Proposition 15 (estimated to be \$11.4 billion by a private study) would be designated for schools and local community funding.

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