

California's Parcel Tax

Jon Sonstelie

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Abstract

Because of limitations on property tax revenue, many local governments in California levy a parcel tax. Like the property tax, a parcel tax is imposed on parcels of real property. Unlike the property tax, however, a parcel tax is not based on the value of real property. The simplest parcel tax is a flat tax, a tax that does not vary with the size, improvements, or use of a parcel.

This paper reviews the origins of the parcel tax and the use of that tax by California cities, school districts, and special districts. It also considers conditions on the structure of a parcel tax that would make it a reasonable source of local revenue.

Keywords: Property Taxation, Henry George

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A Not-So-Bad Parcel Tax

Introduction

In most states, the property tax is a discretionary source of local government revenue. Cities, counties, school districts, and other special districts levy taxes on the value of real property. In contrast, California counties levy a 1 percent tax on real property and allocate the revenue from that tax among other local governments according to a formula established by the state legislature. The revenue received by local governments is not related in any obvious way to the demands of residents for public services. As a consequence, some local governments have resorted to less common sources of revenue. One of those sources is the parcel tax.

Like the property tax, a parcel tax is levied on parcels of real property. Unlike the property tax, the parcel tax is not based on the value of the property. The simplest parcel tax is a flat amount per parcel, the same tax regardless of the value, size, or use of the parcel, but a parcel tax can also be based on the size of the parcel, the improvements on the parcel, and the use of the parcel.

This paper reviews the origins of the parcel tax and its use by local governments in California. With that background, the paper addresses the question of whether the parcel tax is a good choice to play its current role as a supplement to the property tax revenue allocated to local governments. The answer is generally affirmative, although the tax in its current form has three key shortcomings. These shortcomings could be ameliorated through specific government policies.

A Shameful History

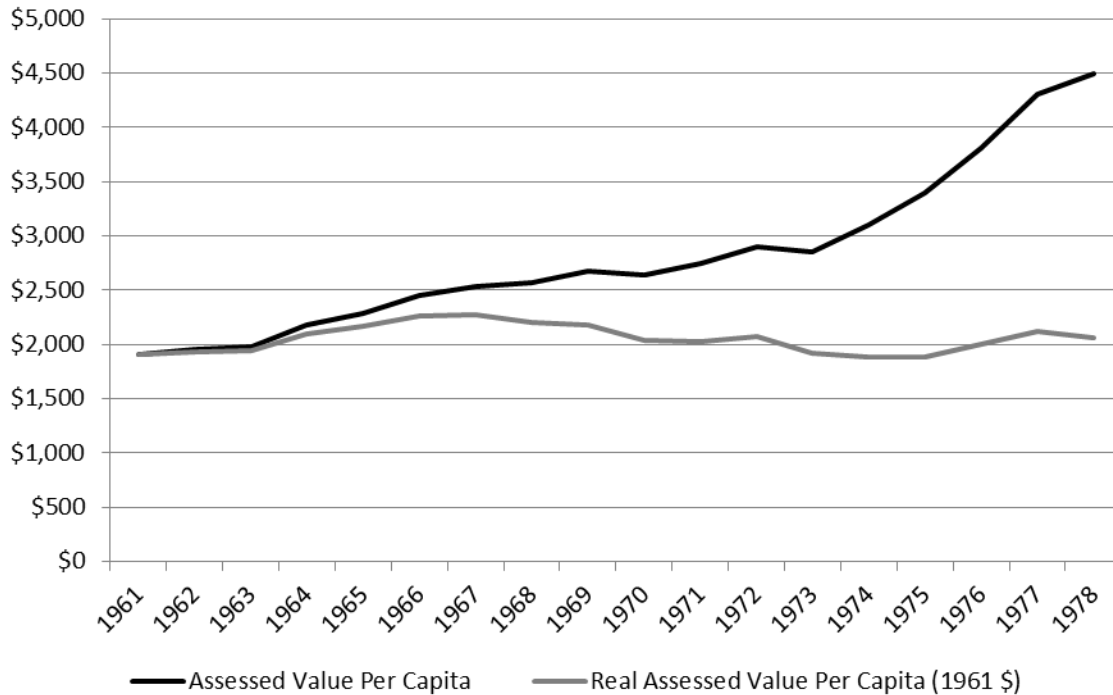
How did California get to this place? How did it get to a place where local governments search for uncommon sources of revenue? The answer is Proposition 13, the 1978 voter initiative that radically transformed the property tax in California. The authors of that Proposition, Howard Jarvis and Paul Gann, surely did not envision that their creation would lead to the parcel tax. It did, however, through a complex series of court rulings, popular initiatives, and legislative action. In the words of Jon Coupal, president of the Howard Jarvis Taxpayers Association, the torturous path from the intentions of Jarvis and Gann to this end is “the shameful history of parcel taxes” (Coupal, 2013).

Limitations on Property Tax Revenue

Proposition 13 set the stage by sharply reducing property tax revenue in California. The reduction was due to two provisions. The first limited the property tax rate to 1 percent, a rate less than half the average in the state at the time. The second capped the growth in assessed value. From a base determined by the purchase price of a property, assessed value can grow no faster than either the inflation rate or 2 percent per year, whichever is lower. The Legislative Analyst’s Office (2012) provides a fuller description of California’s property tax system.

Fox (2003) describes the environment that led to Proposition 13, identifying two key factors. The first is the large increases in assessed value and thus higher property taxes experienced by many homeowners during the 1970s. The second is the illiquid nature of housing equity. Yes, an increase in assessed value may reflect an increase in wealth, but “you can’t pay taxes with paper profits based on the increased value of real property” (Fox 2003, 42).

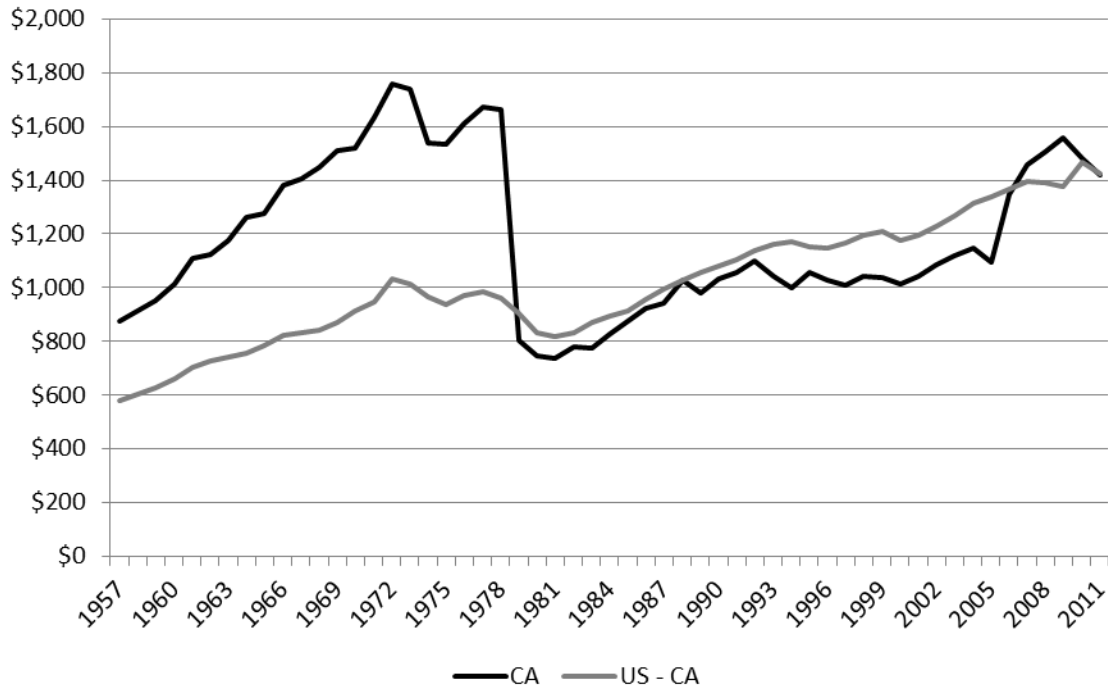
Figure 1: Assessed Value Per Capita in California



Source: California State Board of Equalization, Annual Reports, 1960-61 to 1977-78.

As Figure 1 demonstrates, the rise in assessed value was dramatic in California during the 1970s. From 1973 to 1978, assessed value per capita grew by 50 percent. Prices of goods and services were also increasing rapidly during that period. Adjusting for inflation, assessed value per capita changed very little during the 1960s and 1970s.

Figure 2: Property Tax Revenue Per Capita (2011 \$)



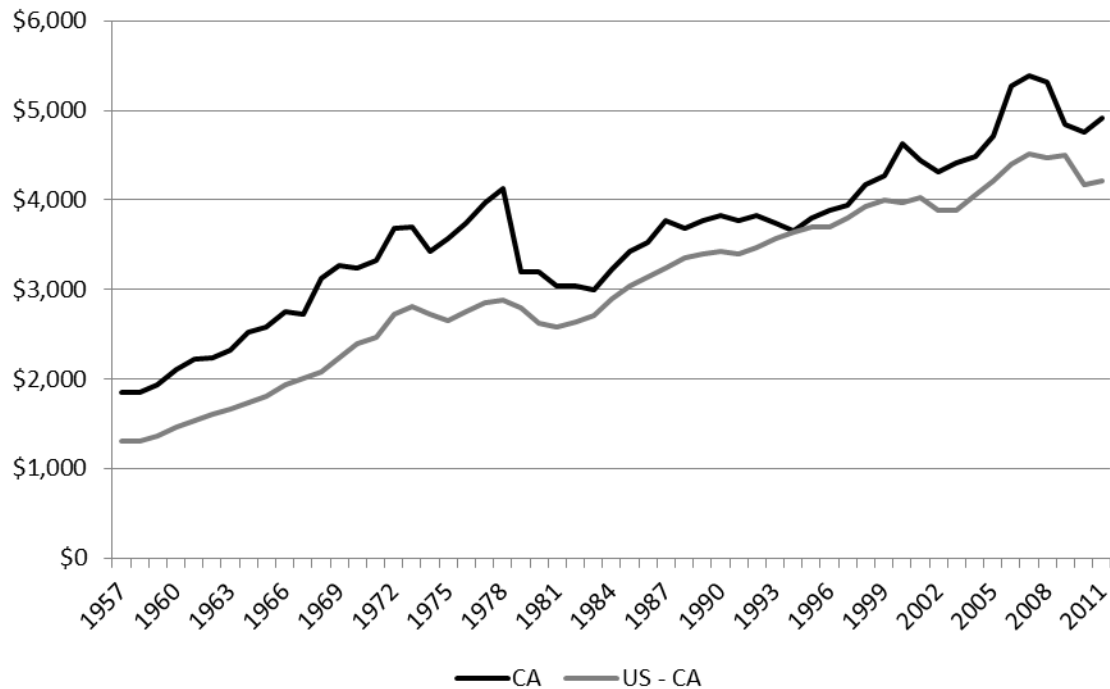
Source: U.S. Census Bureau, Annual Survey of State and Local Government Finances and Census of Governments, 1957 to 2011.

As Figure 2 shows, however, real property tax revenue did rise considerably in the 1960s. The rise was caused by an increase in property tax rates, which grew from a statewide average of 7.42 percent in 1960 to 9.92 percent in 1969. At that time, the ratio of assessed value to market value was 25 percent, so these rates translate to 1.85 percent and 2.48 percent of market value. Much of the growth in tax rates was due to the increased rates levied by school districts. The statewide average for school districts was 3.39 percent in 1960 and 5.07 percent in 1969, an increase of 1.68 percentage points. Rising school enrollments account for at least some of this increase, and school districts had to secure voter approval to increase tax rates.

During this period, property tax revenue per capita was much higher in California than in the rest of the country (Figure 2). In 1957, property tax revenue per capita was 50 percent higher in California. This ratio grew to 73 percent by 1969.

As described in Doerr (2000), there were numerous attempts, through both legislative action and popular initiative, to limit the growth in property tax revenue during this period. None of these attempts was successful until Proposition 13 in 1978. Revenue per capita fell immediately to the level of other states and since then has grown at roughly the same rate as the rest of the country.

Figure 3: Total State and Local Tax Revenue Per Capita (2011 \$)



Source: U.S. Census Bureau, Annual Survey of State and Local Government Finances and Census of Governments, 1957 to 2011.

Immediately after Proposition 13, the state ameliorated much of the revenue loss local governments experienced through state aid, program shifts, and other forms of assistance. This aid has been greatly reduced for most local governments, but continues for schools, funded by high state income and sales tax rates. Overall, considering tax revenue of all types and combining state and local governments, California continues to have revenue per capita that is greater than revenue per capita in other states. As Figure 3 shows, the gap between California and other states was wider before Proposition 13 than after it.

The Allocation of Property Tax Revenue

On the issue of how revenue from the 1 percent property tax rate would be allocated among local governments, the authors of Proposition 13 punted to the state legislature. The legislature responded by creating a formula that allocates the revenue from each parcel to local jurisdictions in proportion to the revenue they received from that parcel before Proposition 13.

Because of the legislature's response to the ruling of the California Supreme Court in *Serrano v. Priest* 5 Cal.3d 584 [1971], the state has insulated most California school districts from the vagaries of this formula. The Court ruled that the existing system of school finance violated the equal protection clauses of the state and federal constitutions. Under that system, school districts levied their own tax rates, and the state provided aid to districts to offset differences in assessed value per pupil across districts. Despite the efforts of the state, variations in revenue per pupil

among districts were related to variations in assessed value per pupil. School districts with low tax bases had less revenue, which the Court determined to be a violation of equal protection. To comply with this ruling, the legislature established a system of revenue limits. Each district was assigned a limit, and the state provided aid to make up the difference between this limit and the property tax revenue a district receives. Except for the 10 percent or so of districts in which property tax revenue exceeds the limit, the total revenue a district receives is unaffected by its property tax revenue. The new local control funding formula, enacted in 2013, modified revenue limits to account for need, but did not change the basic situation with respect to property tax revenue. A district that receives more property tax revenue receives less state aid, dollar for dollar.

Table 1: Property Tax Revenue in Ten Largest Counties, 2009-2010

County	Per Capita Property Tax Revenue	Percentage of Property Tax Revenue for Schools	Per Capita Property Tax Revenue for Other Local Governments
Santa Clara	\$1,714	43	\$ 974
Contra Costa	1,404	31	966
Orange	1,396	41	827
Alameda	1,310	23	1,011
San Diego	1,274	37	804
Los Angeles	1,095	19	887
Riverside	983	27	717
Sacramento	890	27	645
San Bernardino	855	16	717
Fresno	654	29	465

Source: California State Board of Equalization, Annual Report 2008-2009, and California Department of Education, Standardized Account Code Structure unaudited actuals (SACS), 2009-2010.

Note: Property tax revenue is 1 percent of taxable assessed valuation. School revenue is from SACS, 2009-2010.

The allocation of property tax revenue among cities, counties, and special districts is complex (Legislative Analyst’s Office (2000)). Table 1 demonstrates two issues. First, property tax revenue per capita varies considerably among counties. In Contra Costa County, the 1 percent rate raised \$1,404 per capita in 2009-2010 as opposed to only \$654 in Fresno County. In both counties, about 30 percent of that revenue goes to schools, leaving only \$465 per capita for other local governments in Fresno County as opposed to \$966 per capita in Contra Costa County.

The second issue is that the percentage of property tax revenue going to schools also varies considerably among counties. Los Angeles County has about \$300 less per capita in property tax revenue than Orange County, but only 19 percent of that revenue goes to schools as opposed to 41 percent in Orange County. As a result, other local governments in Orange County have less property tax revenue than their counterparts in Los Angeles County.

Table 2: Property Tax Revenue in Full-Service Cities in Los Angeles County, 2009-2010

City	Per Capita Property Tax Revenue	Percentile Among Cities in Per Capita Property Tax Revenue
Pomona	\$ 85	11
Alhambra	93	19
Santa Fe Springs	117	31
Arcadia	150	42
Long Beach	178	50
Burbank	238	61
Los Angeles	243	65
Pasadena	262	73
Redondo Beach	283	80
San Marino	721	92

Source: California State Controller's Office, Cities Annual Report, 2009-2010.

Even within the same county, the allocation of property tax revenue can be very uneven. Table 2 shows per capita property tax revenue of 10 cities in Los Angeles County in 2009-2010. All 10 are full-service cities, meaning they provide police and fire protection, libraries, and parks. The last column lists the percentile of each city in the distribution of property tax revenue per capita among the 26 full-service cities in the County. Pomona, in the 11th percentile, receives property tax revenue of \$85 per capita, whereas San Marino in the 92nd percentile receives \$721 per capita.

This brief overview points to one broad conclusion. Judging by the standards of other states, state and local governments in California have ample tax revenue. The issue is the distribution of that revenue among governments. The Legislative Analyst's Office (2000) has proposed several alternatives to the current allocation of property tax revenue, but none of those alternatives has been adopted.

Special Taxes

Because of the reduction in property tax revenue due to Proposition 13 and the uneven distribution of that revenue, local governments turned to other sources of tax revenue. Foreseeing this eventuality, the authors of Proposition 13 sought to limit these sources. The limit is provided in Section 4 of the Proposition.

Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district.

In the year following the passage of that Proposition, the legislature authorized local governments to levy special taxes without specifying the nature of those taxes (Government

Code 50075). The same year it enacted a specific statute allowing local governments providing police and fire protection to levy a tax on “parcels, a class of improvements to property, or use of property basis...” (Government Code 53978). Specific legislation for school districts and community colleges was added in 1987 (Government Code 50079) and for public libraries in 1988 (Government Code 53717). The legislation for schools, colleges, and libraries included the important condition that the tax be applied “uniformly to all taxpayers or all real property”. School districts were allowed to exempt persons who are sixty-five years old or more and persons receiving certain kinds of disability income. Community college districts were allowed to tax unimproved property at a lower rate.

While this legislation allowed parcel taxes if approved by two-thirds of voters, neither Proposition 13 nor the legislature defined the class of taxes that are “special” and thus need the approval of two-thirds of votes. Doerr (2000) suggests three possible definitions. The first is that special taxes means all taxes except the property tax. Local governments could not raise the property tax, and they would have to secure the approval of two-thirds of voters to raise any other tax. The second possibility is that a special tax is a tax levied on a particular group of taxpayers or a particular class of transactions. In that interpretation, a tax on business receipts or the use of utilities is a special tax as opposed to a general income or sales tax. The third possibility is that special taxes are taxes earmarked for particular purposes, such as hiring more police, as opposed to general taxes, whose revenue can be used for any legitimate purpose.

In *City and County of San Francisco v. Farrell*, 32 Cal. 3d 47 [1982], the California Supreme Court opted for the third possibility. It ruled that a payroll and gross receipts tax levied by San Francisco was a general tax because its proceeds were deposited in the city’s general fund. Because it was a general tax, it did not have to be approved by two-thirds of voters. In his dissent, Justice Otto Kaus noted the “perversity” of the ruling. If a city detailed what it proposes to do with the proceeds of a new tax, it must secure voter approval. If it doesn’t detail its intentions, voter approval isn’t needed.

This ruling led quickly to a second popular initiative. In 1984, the Howard Jarvis Taxpayers Association placed Proposition 36 on the ballot, which tested voter support for another definition of special taxes. Proposition 36 would have required the approval of two-thirds of voters for any increase in taxes. The Proposition failed.

Taxpayer organizations responded with a second initiative in 1986, Proposition 62, which accepted the Supreme Court’s definition of special versus general taxes, but placed new restrictions on general taxes. Special taxes would continue to require the approval of two-thirds of voters, but general taxes would now require majority approval. The Proposition passed, enacting a modified version of the perversity that Justice Klaus had seen in the *Farrell* decision. If a government explains what it intends to do with the proceeds of a new tax, it needs the approval of two-thirds of voters. Without an explanation, a majority will do.

For the parcel tax, the courts gave this distinction between special and general taxes a unique interpretation. In 1988, Oakland put a parcel tax measure on the ballot with “the sole purpose of raising revenue which would be deposited in the City’s General Fund”. (*City of Oakland v. Digre*, 205 Cal.App.3d 99 [1988]) The measure was approved by a majority of voters, but not by

two-thirds of them. The city maintained that its parcel tax was a general tax because its proceeds were not earmarked and thus only required approval by a majority of voters. The California Appeals Court reached a different conclusion. It found that, according to the California Constitution, any general tax on property must be based on the value of that property and thus subject to the 1 percent limit under Proposition 13. The Oakland parcel tax could not be a general tax because it would exceed that limit. A tax on property not based on value could be a special tax, the court ruled, but imposing that tax required support by two-thirds of voters. In essence, all parcel taxes require a two-thirds vote.

Proposition 62 was challenged in court, leading finally to Proposition 218, which passed in 1996 and has resolved this issue for now. As with Proposition 62, special taxes require approval by two-thirds of voters, but general taxes require only a majority. Following the Appeals Court ruling in *Digre*, Proposition 218 specifically requires the approval of two-thirds of voters for a parcel tax. Furthermore, all taxes levied by school districts and special districts must be special taxes. The only special tax the legislature has authorized for these districts is the parcel tax.

Proposition 218 also limited special assessments, another method for collecting revenue from property owners. Special assessments have a long history in California, dating back to the early years of the twentieth century. In general, special assessments are charges to property owners for the cost of public facilities or services that specifically benefit those properties. The common rationale is that property owners throughout a community should not have to pay for benefits conferred on only a few owners. Assessments require approval of a majority of the landowners. Votes in these mail-in ballots are weighted by the charges levied on each property.

Immediately after Proposition 13, a number of special assessments were challenged on the grounds that they were really parcel taxes and thus required the approval of two-thirds of voters. This issue reached the California Supreme Court in *Knox v. City of Orland* 4 Cal. 4th 132 [1992]. In this case, a special assessment district was formed to pay for park maintenance. Each parcel in the district was assessed a tax of \$23 per dwelling unit. In its ruling, the court made a clear distinction between assessments and taxes. Assessments are based on the benefits a property derives from a public expenditure. Taxes on a property are not tied to any notion of benefit. Because the benefits of a park are shared quite generally in a community, this distinction would seem to rule against the Orland assessment. The Court reached the opposite decision, however. It found that park maintenance had often been financed by assessments in the past, and it cited a U.S. Supreme Court decision supporting park assessments (*Wilson v. Lambert* 168 U.S. 611 [1898]). In that instance, the Court saw the higher property values resulting from a new park in Washington, D.C., as a rationale for a special assessment on property owners in the city. Conceivable this broadly, a special assessment is a way around the two-thirds requirement for a parcel tax.

Mindful of this possibility, the authors of Proposition 218 included more stringent conditions for levying special assessments. The most important is the distinction between general benefits and special benefits. Local agencies levying a special assessment must first separate the general benefits of the public facility or service from the special benefits conferred on particular parcels of property and can only assess those parcels for the cost of special benefits. To illustrate the effect of this distinction on parcel taxes, suppose a community intends to finance a public service

through a tax on parcel owners. It determines that 50 percent of the benefits of that public service are general and that 50 percent are special benefits shared equally among parcel owners. Suppose that the cost of the public service works out to \$100 per parcel. With the approval of at least half of parcel owners, the community may levy a special assessment of \$50 per parcel for the special benefits conferred on parcel owners. With the approval of at least two-thirds of voters, it can finance the general benefits with a special tax of \$50 per parcel. Special benefits are financed through a special assessment, and general benefits are financed through a special tax. As a practical matter, the assessment and the tax look the same to the parcel owner, a payment of \$50 for each. The only difference is that the first \$50 requires majority approval, but the second requires approval of two-thirds of voters. Faced with this odd construction, a reasonable community may opt to finance the entire cost with a special tax of \$100 per parcel.

This scenario assumes that the community can clearly separate general benefits from special benefits. In fact, Proposition 218 is not clear about the difference between the two, leaving this issue to the courts. The Proposition defines special benefit this way.

“Special benefit” means a particular and distinct benefit over and above general benefits conferred on real property located in the district or to the public at large. General enhancement of property value does not constitute “special benefit.”

The Proposition does not define general benefit. The distinction between general and special benefit was tested in 2001 by the Santa Clara County Open Space Authority. The Authority, whose boundaries include almost all of Santa Clara County, proposed a special assessment of \$20 per year for all single-family homes within its boundaries to purchase and maintain open space. The Authority claimed that the benefits of open space would be shared equally among residents of the county and that these benefits constitute the special benefit of the district. The general benefit of open space, it claimed, is the benefit of open space in Santa Clara County conferred on people who are not residents of the County. It estimated that these general benefits constituted 10 percent of total benefit, leaving 90 percent for special benefit.

On a mail-in ballot, the assessment was supported by 66.8 percent of respondents. Weighted by the assessment on each parcel, 50.9 percent of voters supported the assessment. This outcome was challenged on several grounds, eventually reaching the California Supreme Court in *Silicon Valley Taxpayers’ Association v. Santa Clara County Open Space Authority*, 44 Cal. 4th 431 [2008]. The Court found fault with the Authority’s calculation of general benefit, mainly because it was based on one segment of the “public at large,” visitors to the County. The Court suggested that other residents of the County should be included in this larger public and that special benefits might be tied to proximity to open space, begging the question of where special benefits end and general benefits begin. Overall, the Court offered little guidance on this issue, declared its intent to exercise its “independent judgment,” and invited other courts to do the same.

Other courts have accepted this invitation. In one case, the Town of Tiburon formed a special assessment district to pay for the cost of burying overhead utility lines. An engineering firm hired by the Town established a numerical metric of the special benefit of underground lines for each parcel. The cost of burying the lines varied across areas of the district, however, so the assessment reflected not only benefits, but costs. In *Town of Tiburon v. Jimmie D. Bonander*,

Cal. App. 3rd [2009], an appeals court ruled that the assessment could only be based on benefits, essentially requiring property owners in one area to subsidize the provision of services to owners in another area. The Court's ruling clearly follows the language of Proposition 218, but it also illustrates how the Proposition has limited what was previously a common use of special assessments.

Proposition 218 and its broad interpretation by the courts erected new hurdles for special assessments. Despite this, local governments maintain substantial ability to levy taxes targeted for particular neighborhoods. Under the Mello-Roos Act of 1982, a local government can establish a community facility district to finance schools, parks, roads, or other public capital in the district through a tax on landowners in the district. Public services can also be financed through this tax. To form a district and levy the tax, two-thirds of voters in the district must approve. The community facility district is essentially a mechanism for levying a parcel tax on land in a particular area of a county, city, or district. In that respect, it is similar to an assessment for public services provided to specific parcels. It requires approval by two-thirds of voters and can therefore pass as a special tax, which does not require a separation of general and specific benefits.

The history of the parcel tax is even more complex than this brief account. For the purposes of this paper, this history comes down to three broad points.

- In practice, taxes on real property (other than the ad valorem property tax) require approval by two-thirds of voters. A special assessment requires only a majority of landowners, but it may be difficult to establish the basis for such an assessment.
- For cities, a parcel tax is not the most attractive source of discretionary revenue. A parcel tax requires approval by two-thirds of voters, but other taxes (utility users' tax, business license tax, sales tax) require only a majority.
- For school districts and special districts, the parcel tax is the only real source of discretionary revenue. School districts and special districts can only levy special taxes, which require approval by two-thirds of voters. So far, the parcel tax is the only tax the legislature has authorized districts to levy. It could authorize districts to levy other taxes, but these would require two-thirds approval. A parcel tax would still be an attractive option.

The Legislative Analyst's Office (2014) provides a more detailed description of voter requirements for local taxes.

The Parcel Tax in Practice

Though cities, school districts, and special districts have enacted parcel taxes, governments of each type operate in different fiscal environments. Cities have more sources of discretionary revenue than school districts and special districts, and school districts have more state aid than special districts. This section reviews the fiscal environment for each government type and the use of the parcel tax by each. Because the focus of the paper is on broad-based taxes for general public services, the parcel taxes reviewed in this section are those levied by cities, school districts and special districts, not the taxes levied by community facility districts created by these other governments. Much of this material was covered in an earlier and more comprehensive study by Rueben and Cerdan (2003). This section is largely a selective update.

Cities

Cities have several revenue sources. The most important is the property tax, which in 2009-2010 varied from \$95 per capita in the 20th percentile of full-service cities to \$380 per capita in the 80th percentile (Table 3). Full-service cities are the 110 cities that provide fire and police protection, libraries, and parks. California has 336 other cities that provide only a subset of those services, depending on special districts and counties to provide the services they don't provide.

Table 3: General Revenue Per Capita, Full-Service Cities, 2009-2010

	Average	Percentile		
		20 th	50 th	80 th
Property tax	\$208	\$ 95	\$191	\$ 380
Sales and use tax	139	99	147	231
Utility users' tax	101	0	0	124
Vehicle license fee	76	71	78	83
Business license tax	55	8	18	40
Transient lodging tax	38	6	18	87
Franchises	27	15	32	50
Real property transfer tax	15	2	4	13
All other taxes	4	0	0	12
Total	\$663	\$409	\$630	\$1,037

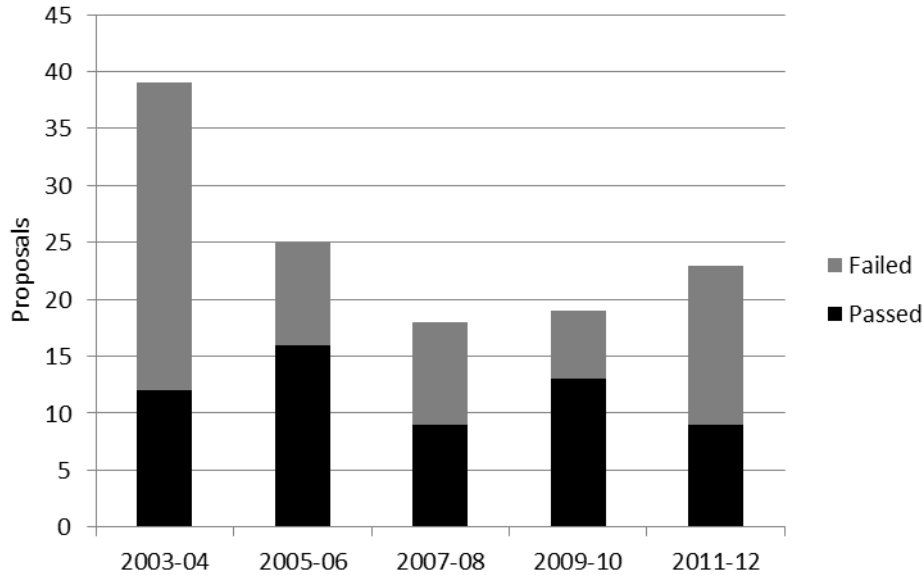
Source: California State Controller's Office, Cities Annual Report, 2009-2010.

Note: Averages are weighted by city population.

Property tax revenue was allocated to cities by a state formula, as was revenue from the vehicle license fee and most of the sales tax revenue. Cities no longer receive revenue from the vehicle license fee. The most important sources of discretionary revenue are the utility users' tax, the business license tax, and the transient lodging tax. All three are almost always imposed as general taxes (Coleman, 2014). The utility tax is a tax on the use of utilities such as gas, electricity, telephone, and cable television; the business license tax is commonly levied on the

gross receipts of businesses; and the lodging tax is levied on persons staying temporarily in hotels, motels, or other lodging facilities.

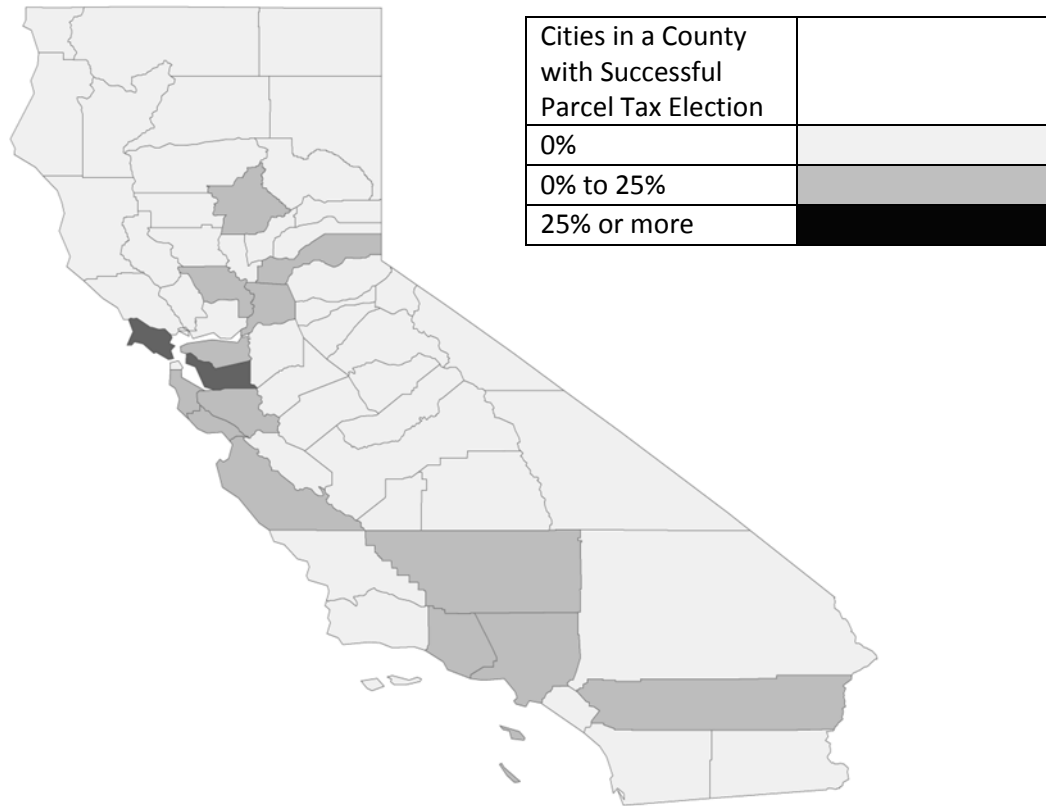
Figure 4: Parcel Tax Elections, Cities, 2003-2012



Source: Michael Coleman, Votes on Local Taxes and Other Revenue Measures, www.CaliforniaCityFinance.com.

The revenue data for Table 3 comes from a survey of cities by the State Controller’s Office. The survey does not ask cities to report parcel tax revenue separately, but Michael Coleman has kept data on local tax elections since 2002. From 2003 through 2012, cities have placed 124 parcel tax proposals on the ballot, and 59 of those proposals have received the required support from at least two-thirds of voters (Figure 4). Cities placed an unusually large number of proposals on the ballot in 2004. Ten came from a group of cities in Los Angeles County, each of which proposed a tax of \$25.26 per parcel for libraries. All of the proposals failed.

Figure 5: Successful Parcel Tax Election, Cities, 2003-2012



Source: Michael Coleman, Votes on Local Taxes and Other Revenue Measures, www.CaliforniaCityFinance.com.

Cities in the San Francisco Bay Area are more likely to have passed a parcel tax than cities in other areas (Figure 5). Seven of the eleven cities in Marin County passed a parcel tax between 2003 and 2012, as did five of the fourteen cities in Alameda County. Seven cities in Los Angeles County passed a parcel tax during this period, but this is only 8 percent of all cities in the County. Eleven counties had only one city with a parcel tax, and forty-one counties had no city with a parcel tax.

Of the 106 proposals for which information on tax rates is readily available, 51 had a flat tax applied to all properties. The lowest was an annual tax of \$12 per parcel for animal control in Paradise, and the highest was \$950 for public safety in Ross. Twenty-nine proposals had a tax of \$30 per parcel or less, and sixteen had a tax of \$100 per parcel or more. The median rate was \$60 per parcel. Proposals without a flat rate often involved a flat rate for residential parcels or dwelling units, and a different rate for non-residential properties.

The most complicated rate structure was the one enacted by the City of Huntington Park in 2004. The tax had 17 different rates depending on the use of a parcel. The lowest rate was \$20.24 per year for unimproved lots, and the highest was \$629.14 per year for hotels, motels, department

stores, mobile home parks, and supermarkets. The tax was \$78.64 for parcels with one single-family residence, \$147.18 for parcels with two dwelling units, and so on. The tax had its origins in a special assessment for a lighting and landscaping district. The ordinance proposing the parcel tax also repealed the special assessment previously levied by the district. In his analysis of the proposal for voters, the City Attorney wrote that these assessments, which were based on street frontage, fell more heavily on single-family than on multi-family residences and that the proposed parcel tax would rectify this inequity. The proposal secured the support of 69 percent of Huntington Park voters in the November 2004 general election.

Desert Hot Springs provided another example of a parcel tax proposal in which the tax burden falls more heavily on some uses than on others. The City first passed a “public safety parcel tax” in 2000 with 79 percent of voters approving. It renewed the tax in 2010 with 83 percent approving. For the June 2014 election, the City placed on the ballot a proposal to amend its parcel tax by increasing the tax rate on vacant land from \$30 per acre to \$372 per acre. The increase would have had a particularly large impact on a Canadian company that owned 1,600 acres of vacant land in the city. Overall, the tax increase was projected to add \$3.8 million per year (Ramseth 2014). The proposal received a positive vote from 61 percent of voters, 5 percent short of the required two-thirds.

Table 4: Parcel Tax Base, Cities, 2009-2010

	Average	20 th	Percentile	
			50 th	80 th
Parcels per capita	0.29	0.25	0.32	0.42
Residential parcels per capita	0.25	0.21	0.27	0.34
Residential parcels/total parcels	0.87	0.76	0.87	0.92

Source: DataQuick.

Note: Averages are weighted by city population.

The revenue cities raise from these tax rates depends on the number of parcels taxed. On average, a California city has 0.29 parcels per capita (Table 4). For the average city, a tax of \$100 per parcel raises about \$29 per capita. Eighty-seven percent of parcels are residential, so a flat parcel tax is borne mainly by owners of homes and apartments.

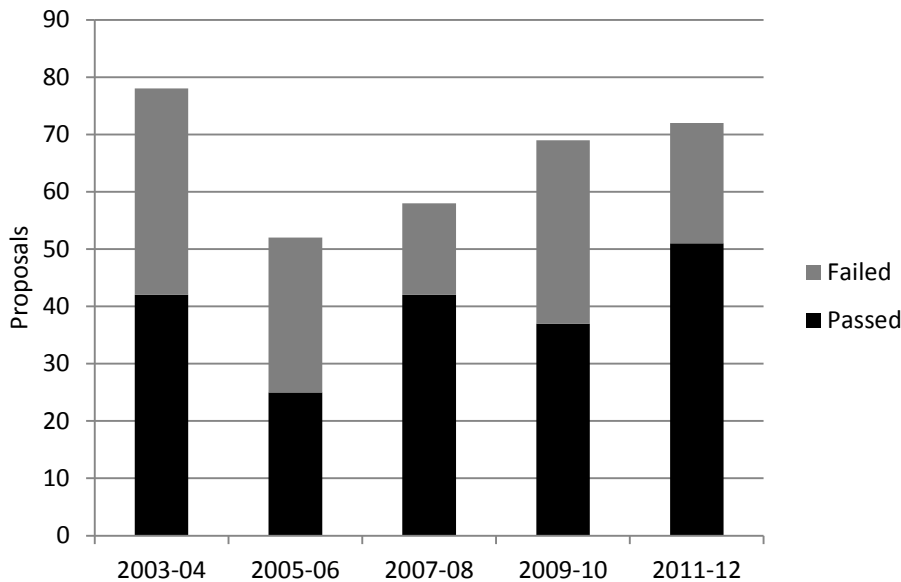
No single data source has parcel tax revenue for all cities, but 40 cities posted parcel tax revenue on their websites. Among these cities, median revenue per capita was \$33 in 2009-2010. In the 20th percentile, revenue was \$12 per capita. In the 80th, it was \$104 per capita.

School Districts

School districts have fewer revenue sources than cities. In 2009-2010, California had 963 school districts. Average revenue per pupil was \$8,801. On average, districts received \$2,210 per pupil in property tax revenue, well short of most revenue limits. State aid made up the difference between the two amounts. This aid averaged \$3,114 per pupil. In addition, the state allocated an average of \$1,865 per pupil to districts in the form of other aid, such as K-3 class size reduction and special education. School districts also received federal aid, an average of \$1,042 per pupil. A variety of other local revenue sources, such as interest, rental income, and various interagency transfers added another \$570 per pupil.

In this breakdown, parcel tax revenue is included in the category of “other local revenue.” Parcel tax revenue averaged \$53 per student in 2009-2010. Though parcel tax revenue is derived from a tax on real property, it does not count as local revenue in the state’s revenue limit calculations. Therefore, an increase in parcel tax revenue does not reduce state aid as in the case of an increase in property tax revenue.

Figure 6: Parcel Tax Elections, School Districts, 2003-2012

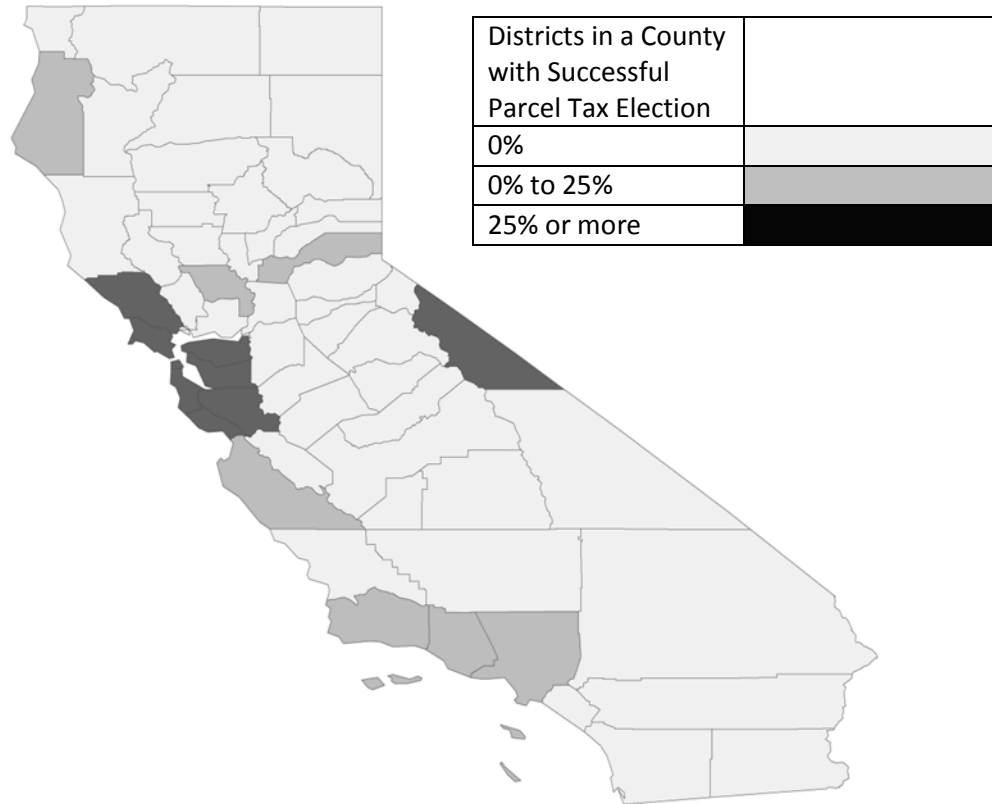


Source: EdSource.

Between 2003 and 2012, school districts placed 329 parcel tax proposals on the ballot (Figure 6). Sixty percent of those proposals passed. Most proposals included a sunset provision, usually four to ten years, but many districts renew or increase their parcel taxes when they expire. Though 197 proposals passed from 2003 to 2012, 83 were renewals or increases. Only 114 districts had at least one successful parcel tax election during this period. As Figure 7 shows, those districts were concentrated in the San Francisco Bay Area. In Marin County, 79 percent of districts passed a parcel tax. For the other Bay Area counties, the percentages were 74 for Santa Clara, 70 for San Mateo, 61 for Alameda, and 50 for Contra Costa. For the state as a whole, only 12

percent of districts passed a parcel tax between 2003 and 2012. Chavez and Freedberg (2013) and McGhee and Weston (2013) provide a more complete description of parcel taxes levied by school districts.

Figure 7: Successful Parcel Tax Elections, School Districts, 2003-2012



Source: EdSource.

Of the 389 parcel taxes proposed by school districts during this period, 86 percent were flat rate taxes. The average tax rate was \$134 per parcel, and the median was \$96. In the 80th percentile of proposals, the tax rate was \$195 per parcel. It was \$59 per parcel in the 20th percentile. The proposals that were not flat rate were mostly based on the square footage of the parcel or the improvements on the parcel. Several of these proposals had different tax rates for residential and non-residential parcels. A 2008 proposal of that type was challenged in court and overturned by the California Court of Appeals (*George J. Borikas v. Alameda Unified School District*, Cal. App. 4th [2013]). In the decision, the Court ruled that taxing different classes of property at different rates violated legislation authorizing school districts to levy parcel taxes that “apply uniformly to all taxpayers or all real property.” The California Supreme Court subsequently denied a motion to review that decision, and the legislature is now considering a statute that would allow school districts to tax residential and non-residential property at different rates.

Table 5: Parcel Tax Base, Unified School Districts, 2009-2010

	Average	20 th	Percentile 50 th	80 th
Parcels per capita	0.33	0.29	0.39	0.81
Residential parcels per capita	0.27	0.23	0.29	0.38
Residential parcels/total parcels	0.80	0.47	0.78	0.89

Source: DataQuick.

Note: Averages are weighted by district enrollment.

The tax base for flat rate parcel taxes is unevenly distributed among school districts (Table 5). The average unified school district (K-12) in California has 0.33 parcels per capita. A tax of \$100 per parcel would raise \$33 per capita. In terms of services, the relevant divisor for schools is pupils, not residents, and the ratio of pupils to total population in California was 0.12 in 2009-2010. For the average district, a tax of \$100 per parcel would raise \$275 per pupil. Because parcels per capita vary considerably across districts, so too will the yield from a tax of \$100 per parcel. In a school district with 0.89 parcels per capita, the 80th percentile among districts, that tax would raise \$741 per pupil, more than twice as much as the average district.

As Lang and Sonstelie (2014) find, districts with relatively high ratios for parcels per capita are more likely to levy parcel taxes than other districts. Accordingly, even though the average parcel tax rate was \$194 per parcel, average revenue among districts with a parcel tax was \$588 per pupil. Among those parcel tax districts, parcel tax revenue was \$213 per pupil in the 20th percentile, \$577 in the 50th percentile, and \$1,222 in the 80th percentile.

Special Districts

Special districts are local governments that provide a limited number of services. Examples are fire protection districts, parks and recreation districts, and library districts. Special districts have governing boards and taxing authority, but they typically do not have the full range of police powers possessed by cities and counties (Mizany and Manatt 2002).

Table 6: Parcel Tax Proposals for Special Districts, 2003-2012

District type	Number of Districts	Proposals	Proposals Per District	Percent Passed
Fire	436	123	0.28	50
Police	305	11	0.04	45
Parks and recreation	256	31	0.12	39
Cemetery	254	3	0.01	33
Water	187	7	0.04	57
Library	99	10	0.10	50
Hospital	94	12	0.13	83
Flood control	44	5	0.11	20
Streets	36	29	0.81	21

Source: Michael Coleman, Votes on Local Taxes and Other Revenue Measures, www.CaliforniaCityFinance.com and State Controller's Office, Special Districts Annual Report, 2009-2010.

From 2003 through 2012, special districts placed 239 parcel tax proposals on the ballot. Almost half of those proposals came from fire districts (Table 6). In addition to the proposals listed in Table 6, there was one proposal from an airport district, one from a memorial district, one from a vector control district, two from transit districts, and two from community service districts providing a range of services. Three of these seven proposals passed.

Among the 192 proposals from special districts for which tax rate information was available, 144 proposed a flat rate for all parcels, 44 proposed to tax different land uses at different rates, and 6 proposed a tax on square footage. The median flat rate was \$68 per parcel, \$42 at the 20th percentile, and \$148 at the 80th percentile.

Though cities, school districts, and special districts are different in many ways, their experiences with the parcel tax are very similar. First, the frequency of parcel tax elections is roughly the same for the three types of governments. From 2003 to 2012, cities placed 124 parcel tax proposals on the ballot. California has 446 cities, so the ratio of proposals to cities was 0.28. For school districts, that ratio was 0.34. For special districts, the ratio was 0.14. Second, within each type, the passage rate for parcel tax proposals was similar. The rate was 48 percent for cities, 60 percent for school districts, and 45 percent for special districts. Local governments do not place parcel tax proposals on the ballot without a reasonable chance of passage. Third, most parcel taxes are flat rate taxes. Of the 389 taxes proposed by school districts from 2002 to 2012, 86 percent were flat rate taxes. For cities, flat rate taxes were 51 percent of the total. For special districts, 75 percent were flat rate proposals. Lastly, most flat rate taxes were relatively small. The median rate was \$60 per parcel for cities, \$96 per parcel for school districts, and \$68 per parcel for special districts.

The Parcel Tax in Theory

In the case of the parcel tax, practice has run well ahead of theory. Many local governments have levied parcels taxes to supplement revenue from other sources, but relatively little attention has been given to whether this is a good idea. This section addresses that question.

When it comes to taxes, public policy discussions center on two key issues: neutrality and equity. A tax is neutral if it does not distort market outcomes. Governments should minimize distortions because distortions create a social loss. A simple example demonstrates this idea. Consider a community with 100 individuals. Fifty are willing to work for \$60 per day or more and another 50 are willing to work for \$80 per day or more. There are many potential employers, all of whom are willing to pay as much as \$100 per day. Competition among employers drives the market wage to \$100 per day, and all 100 workers are employed. The workers willing to work for \$60 per day earn a surplus of \$40 per day, and the workers willing to work for \$80 per day earn a surplus of \$20 per day.

Now suppose the community levies a tax of \$30 per day on workers. Workers willing to work for \$60 per day now demand \$90 per day. Workers willing to work for \$80 per day now demand \$110. The competitive market wage is still \$100 per day, but now the only employed workers are those willing to work for \$60 per day. They earn a surplus of \$10 a day after taxes. The surplus they earned without the tax, \$40 per day, has been reduced by \$30, the amount of the tax. The surplus they earned without the tax has been redistributed to the government to finance government services. There is no social loss from this redistribution, assuming, of course, that the services are valuable to the community.

The story is different for the workers willing to work for \$80 per day. They now demand \$110 and are no longer employed. The surplus they earned without the tax disappears, and there is no tax revenue to offset this loss. It is a loss to the community as a whole, a deadweight loss in the parlance of economics. The total deadweight loss is \$1,000, a loss of \$20 per worker for 50 workers.

This deadweight loss occurs because the tax drives a wedge between the amount employers are willing to pay and the amount for which individuals are willing to work. The difference between those amounts creates a surplus when an individual is employed. Without the tax, the surplus goes to the worker because, by construction, they are the short side of the market. A tax on work takes some of that surplus. If the tax is less than the surplus, as in the case of the workers willing to work for \$60 per day, the loss in surplus is equal to the tax. Work continues and there is no deadweight loss. If the tax is greater than the surplus, however, as in the case of the workers willing to work for \$80 per day, workers no longer find it worthwhile to work, the surplus disappears, but no tax revenue results.

Deadweight loss occurs when the demand or supply of a resource, good, or service is responsive to price. For a given tax, excess burden increases with the responsiveness of supply and demand. In the example, a tax rate of \$30 would have no deadweight loss if all workers were willing to work for \$60. All 100 workers would be employed with the tax, the tax would raise \$3,000, and

the loss in surplus would also be \$3,000. The deadweight loss is zero because the tax does not reduce employment. The tax is neutral.

The primary example of neutrality is a tax on land (Oates and Schwab 2009). Because land is fixed in supply, a tax on land does not create an excess burden. Though this idea has a long history, it is most commonly associated with Henry George. A land tax is a good tax, George argued, because it will not discourage the production of wealth. The essence of his argument is captured by this sentence:

Taxation which falls upon labor *as* it is exerted, wealth *as* it is used as capital, land *as* it is cultivated, will manifestly tend to discourage production much more powerfully than taxation to the same amount levied upon laborers, whether they work or play, upon wealth whether used productively or unproductively, or upon land whether cultivated or left waste. (George 1897, 409).

A tax on laborers, “whether they work or play,” is commonly called a head tax and raises questions about the ability of individuals to pay the tax. On the other hand, taxing according to the ability to pay inevitably leads to taxes such as the income tax or sales tax, which can create a substantial deadweight loss. Similarly, a property tax is partly a tax on the improvements to a parcel of land. It is a tax on “wealth as it is used as capital,” which creates a deadweight loss. Because capital is very responsive to rates of return, this deadweight loss can be large.

A tax on land is not neutral if it varies with the use of land. A tax that is heavier on improved land than unimproved will discourage improvements, causing a deadweight loss. George proposed to tax the value of land, its value in its highest and best use. A tax on land value is neutral because it does not change as the use changes.

Because of the limit on ad valorem taxes, a tax on the value of land is not an option for California, but the ideas that George developed have immediate implications for the parcel tax. A parcel tax is neutral as long as it does not depend on the use of land.

George’s argument for a tax on land was not only about neutrality. He also argued that a land tax would be fair and equitable. Living in San Francisco as it grew from a small town to a major city, George saw that the great wealth created by this growth went primarily to owners of land. In a fable illustrating his observations, George imagines a conversation with “some hard-headed business man, who has no theories, but knows how to make money.” George asks him to imagine that in ten years a little village will become a major city. The business man tells him to “get a piece of ground, and hold possession.” And, if you take his advice,

You may sit down and smoke your pipe; you may lie around like the lazzaroni of Naples or the leperos of Mexico; you may go up in a balloon, or down a hole in the ground; and without doing one stroke of work, without adding one iota to the wealth of the community, in ten years you will be rich! (George 1879, 294)

Landowners become wealthy as a city grows because they own a fixed factor of production. As the demand for land rises, its supply does not respond, so its price must rise. In contrast, as the

demand for labor and capital rises, supplies increase, so prices do not. Workers move to the growing city from other regions, keeping wages from rising. Capital flows in from around the world, keeping its return competitive with returns in other areas.

In addition, because land is fixed in supply, a tax on landowners is not passed on to others such as residents of rental housing or business customers. A tax on suppliers of a factor is passed forward to consumers of the goods and services produced by that factor only if the tax reduces supply. The reduction in supply increases the price of the factor, which increases the cost of the good or service, passing on some of the tax to consumers of that good or service. But, land is fixed in supply. A tax on land, applied equally to all uses of land, is borne by landowners only.

Though the context for the parcel tax is different from the context that concerned George, the same ideas are relevant. If a community imposes a parcel tax to enhance public services, it makes itself more desirable for potential residents, increasing the demand for housing in the community. If zoning regulations permit, this increased demand will also increase the supply of housing. Over the long run, however, that increase is limited by the supply of land, so enhancing the public services in a community will tend to increase land values. This increase will occur in both residential and non-residential areas, because non-residential uses must compete with residential for land.

The taxes to finance the expansion in public services will have the opposite effect. They will tend to decrease the value of land. For landowners, therefore, the question is whether the benefits of public services exceed their costs. This is the difficult question they must ponder when asked to vote on a parcel tax. Whether they can answer this question with surety or not, it seems just that the landowners in a community, who stand to gain from enhanced public services, should pay the cost of those enhancements. In that sense, a parcel tax is fair and equitable.

In addition to the advantages of neutrality and equity, a parcel tax has four other positive characteristics. First, it is not costly to administer. The structure necessary for the property tax is sufficient for the parcel tax. Second, because it is a tax based on physical characteristics that do not change, a parcel tax is stable from the perspective of both taxpayers and governments. Third, because it is based on easily measured characteristics, a parcel tax is transparent. Finally, the tax is difficult to evade.

There are three potential shortcomings of a parcel tax, however. The first concerns very small parcels. The process of subdivision inevitably creates a few parcels that are too small to be developed by themselves. These parcels are often possessed by the owners of an adjacent parcel and treated as part of the larger parcel. In the case of a flat tax, the owner would pay a tax for both parcels. With a tax on parcel size, the total tax for the two parcels would be the same as if the parcels were one. A tax on land area would also remove a distortion inherent in a flat parcel tax. The flat tax penalizes subdivision, which may discourage residential development.

The second shortcoming concerns parcels with little value even though they are large. The slope of a parcel may be too steep for development, or the parcel may not have any reasonable prospect of hooking up to the local water supply. In such cases, the stream of future tax payments from a parcel tax may exceed any reasonable expectation of future income from the

land. The application of a parcel tax in this case amounts to confiscating land. The appropriate policy for such parcels is to exempt them from taxation.

The third shortcoming concerns the distribution of non-residential property among school districts. Non-residential property serves as a subsidy for educational spending. In the simple case of a flat tax, the cost of increasing spending per pupil by \$1 is the number of students per parcel in the district. This cost will be very small in school districts with many non-residential properties, implying that residents of those districts are more likely to support parcel tax increases. Lang and Sonstelie (2014) find empirical support for that proposition.

Subsidies for education spending may be an appropriate public policy. Education is a benefit to not only the recipient, but also to other members of the community. But, as Table 5 shows, that subsidy varies considerably from district to district. If education is to be subsidized, why should the subsidy vary according to the extent of non-residential property in districts?

Variations in the percentage of non-residential property may also raise constitutional concerns. In *Serrano*, the California Supreme Court objected to variations in revenue per pupil related to variations in assessed value per pupil. The variations in assessed value were at least partly related to the distribution of commercial and industrial property across districts. Under the property tax system, commercial and industrial property was subsidizing school expenditures, and the subsidy varied from district to district.

A simple response to this concern is to count parcel tax revenue from non-residential property as local revenue, like the property tax, in calculating state aid. The parcel tax revenue from non-residential property would then reduce state aid, dollar for dollar, removing the non-residential subsidy for educational spending. The parcel tax revenue from non-residential property would reduce the state's obligation under the state aid formula. The state could use those funds to increase aid to all school districts, thus redistributing parcel tax revenue from non-residential property in any one district evenly among all districts.

Conclusion

For the authors of Proposition 13 and their many supporters, the parcel tax falls into that well-populated category of unintended consequences. Howard Jarvis and Paul Gann surely did not intend to limit property taxes and then create another form of taxation for real property. Yet, on reflection, this creation is not such a bad idea.

Proposition 13 capped property tax revenue, which was arguably excessive, but it also closed off the main avenue through which local governments could address the demands of their constituents. The state has devised a formula for allocating property tax revenue among local governments, but no centralized formula can be expected to respond to the diverse demands of constituents in a large and complicated state like California. Some form of local, discretionary revenue is needed to supplement the property tax revenue allocated to each government.

The parcel tax has assumed that role for school districts and special districts. It also plays that role for cities, although cities have other sources of discretionary revenue. According to the standard principles of taxation, the parcel tax is a very good option for the role it is playing. Consideration of those principles leads to four recommendations about the structure of the parcel tax:

- The parcel tax should be based on land area, a tax per square foot.
- The rate of taxation should be the same for all land uses.
- Parcels that cannot be developed and have little value should be exempt from taxation.
- Revenue from parcel taxes levied by school districts on non-residential properties should reduce state aid to those districts dollar for dollar.

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