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Parcel Taxes as a Local Revenue Source in California


ISTOCK

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SUMMARY

A movement is under way in California to transfer authority from the state government to local governments. Public Safety Realignment and the Local Control Funding Formula have shifted some of the responsibility for corrections and school funding to local authorities. These initiatives are consistent with public opinion, which favors transferring many obligations from the state to localities. However, a stronger local public sector requires not only more responsibility but also adequate revenue, a concern since the passage of Proposition 13 in 1978. That initiative limited property tax increases and replaced locally determined rates with a statewide rate, thereby constraining local government finances.

In many cases, local governments have responded by turning to another source of revenue—the parcel tax. The parcel tax is a tax on parcels of real property collected as part of a property tax bill. Unlike the property tax, the parcel tax cannot be based on property value. Typically, it is a flat tax that does not vary with the size or characteristics of a parcel. To impose a parcel tax, governments must win support from two-thirds of voters. From 2002 to 2012, California cities, school districts, and special districts placed almost 700 parcel tax proposals on the ballot, of which more than half passed.

This report evaluates the parcel tax based on standard principles of taxation, including neutrality, equity, stability, simplicity, transparency, integrity, and growth. It finds that a well-designed parcel tax can be a worthwhile fiscal institution for California. Statewide, aggregate property tax revenue may be adequate. But the state's formula for allocating that revenue is

not aligned with the specific public services that community residents demand and are willing to pay for. The parcel tax can strengthen the link between local governments and community residents, promoting government efficiency and realistic expectations about what the local public sector can achieve.

Because the parcel tax is essentially a tax on land, it has several advantages. Other taxes, such as the sales and income taxes, can distort economic activity by discouraging work or consumption. But land is immobile and limited in supply. A properly designed tax on land tends to be more neutral in its effect on the economy. To promote equity, a parcel tax should ideally be based on land value. However, Proposition 13 prohibits taxes based on land value. For that reason, it is preferable that parcel taxes not be flat but instead be based on parcel size. A well-designed parcel tax is a levy per square foot applied uniformly to all land uses. Such a tax has one major shortcoming though: a parcel tax based on parcel size can make ownership of large tracts of vacant land uneconomical. A lower tax rate for these parcels may be the solution, but that would violate uniformity. Thus, large tracts of vacant land with little value represent a challenge for the parcel tax.

Other states do not levy parcel taxes. California turned to it only because of Proposition 13's limits on the property tax. Yet in this large and complex state, the parcel tax plays a useful role, helping California's diverse localities tailor public services to the needs and desires of their communities. It is vital then that California make the best possible use of this tax to promote government efficiency and help ensure that residents get the services they are willing to pay for.

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