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Data Sources:

California State Controller, *Financial Transactions Concerning Cities in California*, Annual Reports from various years.

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Over the last 30 years, voter-initiated propositions such as Propositions 13 and 218 have reduced local governments’ ability to raise tax revenue. In addition, in the early 1990s, Governor Wilson and the Legislature diverted a large percentage of property tax revenues from local governments to education, often called the “ERAF shift.” This loss of property tax revenues by local governments has resulted in their increasing dependence on sales tax revenues, which are more volatile. Moreover, it has increased the “fiscalization of land-use decisions” and competition between cities for retail stores. In search of sales tax revenue, cities tend to favor retail development at the expense of housing.

Property/sales tax swaps are one way to restructure local government finance in an attempt to correct some of these problems. Different swap mechanisms have been proposed over the years, most recently AB1221 (Campbell/Steinberg). In its June 2003 Options Report, the Commission on Tax Policy in the New Economy also considered whether to recommend a property/sales tax swap as a tax reform proposal.

Under AB1221, in the base fiscal year, each city and county would lose a portion of the locally-levied sales tax and gain an equal dollar amount of the property tax, diverted from the ERAF fund. The local sales and use tax rate would be reduced from one percent to 0.5 percent for cities and counties. In order to maintain revenue neutrality, the state sales tax rate would be increased from five percent to 5.5 percent, and these funds would be used to reimburse each county’s ERAF fund for the decrease in property taxes.

The AB1221 swap would be revenue neutral in the base fiscal year. Its impact in future years would depend on the differential growth rates of property and sales tax revenues in each local jurisdiction, and on changes in land use patterns. A number of recent analyses have shown that California’s major tax bases have grown at different rates over the past two decades. The chart on the following page shows the inflation-adjusted, cumulative growth of net assessed property valuation and of taxable sales for California since 1980. Net assessed property value has grown more quickly and is more stable than taxable sales. Thus, proponents of the swap argue that historical patterns and economic trends suggest that California local governments on the whole would be better off with more property tax and less sales tax.

This CRB report includes graphs for 218 individual cities showing the growth in property and sales tax bases: net assessed valuation and taxable sales. The critical comparison is

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1 “ERAF” refers to the Educational Revenue Augmentation Fund.
2 See the bill analysis for AB1221, 6/4/2003 at [http://www.leginfo.ca.gov](http://www.leginfo.ca.gov) for further details.
3 Counties also levy an additional 0.25 percent for county transportation funds.
5 Beginning in 1980-81, this chart shows the cumulative growth rate of each trend after adjusting for inflation. For net assessed value and taxable sales, the growth rates for each year shown on the graph are calculated using 1980-81 values as a base.
how these tax bases have grown over time. Similar to the statewide trends, net assessed value in most cities has grown much faster than taxable sales, and is also less volatile.

In July 2003, the State adopted a modified form of this tax swap proposal, often referred to as the “Triple Flip,” in its 2003-04 budget. According to the Legislative Analyst’s Office:

Beginning in 2004-05, the budget package temporarily redirects a share of the local sales tax (equal to ½ of one percent of taxable sales) to the state to use to repay the deficit reduction bonds. The budget package offsets local sales tax losses (almost $2.5 billion in 2004-05) by redirecting to cities and counties a commensurate amount of property taxes from the Educational Revenue Augmentation Fund (ERAF). Increased state education apportionments, in turn, will mitigate K-14 district revenue losses associated with the redirection of ERAF monies. This swap of sales for property taxes ends after the deficit reduction bonds are repaid.

A crucial difference between the Triple Flip swap as enacted in the budget and the swap as proposed by AB1221 is that in the Triple Flip swap, the additional amount of property tax revenue allocated to local governments each fiscal year equals the amount collected

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6 ABX1 7, Section 10, 1st Special Session, August 2, 2003.
from the ½ cent sales tax. This means the Triple Flip swap is revenue neutral for each city and county every year it is in effect. Under AB1221, revenue neutrality only occurs in the base year. In subsequent years, differential growth of the sales and property tax bases would determine how each city and county’s tax revenues would grow.

The Triple Flip may make AB1221’s proposed property/sales tax swap unlikely for as long as the Triple Flip remains in effect. But the question remains: After the Triple Flip ends, should local revenues revert to the arrangement that existed before the FY 2003-04 state’s budget, or should an arrangement such as the swap proposed in AB1221 be the replacement?
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

- Compton
- Concord
- Corona
El Cerrito
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

El Monte
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

El Segundo
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Escondido
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980
Huntington Park
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Industry
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Indio
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Inglewood
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980
Millbrae
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Milpitas
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Modesto
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Monrovia
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980
Palm Desert
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Palmdale
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Palo Alto
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Paramount
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980
Placentia
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Placerville
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Pleasant Hill
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Pleasanton
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980
South San Francisco
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Stanton
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Stockton
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Sunnyvale
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980
Woodland
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980

Yuba City
Cumulative Percentage Growth in Net Assessed Value and Taxable Sales
Adjusted for Inflation, Base 1980