

[Senate Bill 364](#) (Stone)

Date: June 18, 2019 (Amended)

Program: Property Taxes

Sponsor: Author

Revenue and Taxation Code Sections 51 and 5813

Effective: Upon chaptering, but operative for January 1, 2020 lien date

Mark Durham (Chief) 916.319.9220

Glenna Schultz (Analyst) 916.274.3362

Chris Butler (Revenue) 916.323.3800

Summary: This bill eliminates, for a 10-year period, the annual inflation factor-related assessed value increase on homes and manufactured homes owned by income-qualifying veterans 65 years and older. This bill also requires the Board of Equalization (BOE) to annually review and report to the Legislature on the effectiveness of the tax benefits of this bill.

Summary of Amendments: Since our last analysis, this bill was amended to (1) provide that the inflation factor freeze is for a 10-year period beginning January 1, 2020, and (2) require the BOE to annually review and report to the Legislature on the effectiveness of the tax benefits of this bill.

Fiscal Impact Summary: Eliminating the inflation factor applied to a qualifying veteran's home would result in a potential annual revenue loss of \$27.2 million.

Existing Law: The California Constitution¹ provides that all property is taxable unless explicitly exempted by either the Constitution or federal law. The California Constitution provides a *veterans' exemption* that applies to any property owned by a person who serves or has served in the military. However, this exemption has become effectively obsolete because for any veteran who owns a home, the homeowners' exemption provides greater tax savings.² Veterans who do not own homes, but own other taxable property (i.e., a boat or business personal property) are disqualified from the veterans' exemption if they own property worth more than \$5,000 (if single) or \$10,000 (if married). For purposes of this exemption, all property owned in California is cumulated to meet the asset limitation.³ Thus, only one veteran in California currently qualifies under this exemption.

The Constitution also (1) limits the maximum amount of any ad valorem tax on real property at one percent of full cash value, plus any locally-authorized bonded indebtedness, and (2) provides that assessors can only reappraise property whenever it is purchased, newly constructed, or when ownership changes (Proposition 13, 1978).⁴ Proposition 13 also places limits on the inflationary growth of real property value to two percent per year.

The law requires the assessor to establish a "base year value" for real property at its 1975 market value and thereafter reset the value to current market value every time the property changes ownership or new construction is completed.⁵ The base year value must be compounded annually by an inflation factor not to exceed 2 percent.⁶ The inflation-adjusted value is called the "factored base year value." Generally,

¹ California Constitution [article XIII](#), section [1](#).

² The veterans' exemption is \$4,000, and the homeowners' exemption is \$7,000. A homeowner may receive one exemption, not both.

³ See Property Tax Rule [464](#) and Property Tax Annotation [865.0010](#).

⁴ [Article XIII A](#).

⁵ Revenue and Taxation Code (RTC) section [110.1](#)(a) and (b).

⁶ RTC section 110.1(f) and section [51](#).

This staff analysis is provided to address various administrative, cost, revenue, and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

every year the law requires a property's assessed value to be based on its factored base year value or its current market value, whichever is lower.⁷

Manufactured homes that are not licensed and not placed on permanent foundations are considered personal property and assessed under the Manufactured Home Property Tax Law.⁸ However, for property tax assessment purposes, manufactured homes are treated similar to real property in that existing law provides that for each lien date, the taxable value of a manufactured home is the lesser of (1) its factored base year value, or (2) its current market value.⁹

Relevant to this bill, the California Constitution¹⁰ specifies that a property's base year value *may* reflect from year to year the inflationary rate not to exceed 2 percent for any given year.

Proposed Law: Beginning January 1, 2020, this bill eliminates future inflation factor increases for qualified veteran homeowners. To qualify, all of the following must apply:

- **Honorable Discharge.** The veteran must have been honorably discharged from military service.
- **Principal place of residence.** The inflation factor limitation only applies to a veteran's principal place of residence, including so much of the land surrounding it as is reasonably necessary for use of the dwelling as a home. A principal place of residence includes a manufactured home that is assessed on the property tax roll.
- **Age.** The veteran must be at least age 65 on the lien date (January 1).
- **Income Qualifications.** The veteran must have an annual household income of less than:
 - \$50,000 if single, or
 - \$100,000 if married.

Filing. This bill requires a claimant to provide information and answer all questions contained in an affidavit furnished by the assessor to determine that the claimant is a qualified veteran.

Effective Date. As a tax levy, this bill is effective immediately upon enactment. However, the bill provides that this inflation factoring exception first applies for any assessment year commencing on or after January 1, 2020. Generally, property taxes for the 2020-21 fiscal year are based on the assessed value set for the January 1, 2020 lien date.

Review of Tax Benefits. This bill requires the BOE, on an annual basis beginning January 1, 2021, to review the effectiveness of the tax benefits allowed under SB 364. The review is to include, but is not limited to, an analysis of the demand for the tax benefits, the economic impact of the tax benefits, and the performance indicators, which are the number of properties receiving the tax benefits and the assessed value of property claiming the tax benefits. County assessors are required to provide any data for this review as requested by the BOE. This bill requires the BOE to submit a report of their review to the Legislature.

In General: Property Tax System. Voters changed California's property tax system through Proposition 13, which replaced a current market value-based system with an acquisition value-based system.

⁷ RTC section 51(a)(1).

⁸ RTC sections [5800 through 5842](#).

⁹ RTC section [5813](#).

¹⁰ Article XIII A, [section 2](#)(b).

Specifically, under Proposition 13, real property assessed values were rolled back to 1975 market value levels and future assessed value increases were limited to the inflation rate, not to exceed 2 percent, for as long as the property's ownership remains unchanged and the property is not substantially improved (i.e., new construction). Thus, regardless of future real estate value increases, the 2 percent maximum inflation adjustment ensures limited assessed value increases.

Base Year Values. The "base year value" of real property is the Proposition 13 protected value of a property. Under existing law, once the base year value of real property is established, it subsequently must be annually adjusted by an inflation factor of no more than 2 percent, based on the annual percentage change in the October California Consumer Price Index.

Specifically, RTC section 110.1 provides that the "full cash value" of real property means its fair market value as of the date on which a purchase or change in ownership occurs or new construction is completed. RTC section 110.1(b) provides that this value is to be known as the "base year value," while section 110.1(f) requires that the base year value annually be adjusted by an inflation factor, as specified in RTC section 51(a).

Background: Veterans' Exemption. At its peak, from 1956 through 1962, over one million persons received the veterans' exemption. Currently, only one person receives the exemption. This table reflects the number of persons who have been granted the veterans' exemption in the past six years.

ROLL YEAR	REGULAR VETERANS' EXEMPTION
2013-14	6
2014-15	4
2015-16	2
2016-17	6
2017-18	0
2018-19	1

Usage of the veterans' exemption declined for two reasons. First, in 1974, home-owning veterans transitioned to the homeowners' exemption when that exemption amount increased and provided greater tax savings. Second, the strict wealth limitations fixed in the California Constitution (\$5,000 if single and \$10,000 if married) make most veterans ineligible. For purposes of this limitation, all property owned in California is counted.¹¹

Service Discharge. There are five different types of discharges from active duty: Honorable, General (under honorable conditions), Other Than Honorable conditions (OTH), Bad Conduct, or Dishonorable. Generally, to receive disability compensation benefits from the USDVA requires an Honorable or a General (under honorable conditions) discharge. But, it is possible for a person with an OTH and Bad Conduct discharge to receive disability compensation if, after an investigation by the USDVA, which administers veteran benefits, the USDVA finds that the OTH or Bad Conduct discharge was not "under conditions other than dishonorable" and authorizes disability compensation benefits.

¹¹ See Property Tax Rule [464](#) and Property Tax Annotation [865.0010](#).

[SB 1458](#) (Stats. 2016, ch. 871) expanded the disabled veterans' exemption¹² to include persons who were discharged from military service under "other than dishonorable" conditions. The Senate Committee on Veterans Affairs [legislative analysis](#) for SB 1458 explains these issues in detail, a portion of which is excerpted below:

Types of Military Discharges. The military separates its personnel from active service by formally discharging them. Discharges may be either administrative or punitive. Each of the five different discharge statuses is determined by the characterization of an individual's service. The character of service slides along a scale with "honorable" at the high end and "dishonorable" at the low end.

The types of discharges fall under one of two categories: "administrative" or "punitive." Punitive discharges are reserved for the most negative cases and imposed only by special and general courts martial. Administrative separations cannot be awarded by a court-martial and are not punitive in nature. Enlisted personnel may be administratively separated with a characterization of service or a description of separation. Administrative discharges include:

- 1) *Honorable.* This is the most common discharge status. It presumes creditable service and good behavior. All service members will earn an Honorable Discharge unless they experience significant problems and receive a lower type of discharge.
- 2) *General (under honorable conditions).* Sometimes referred to as a "General Discharge," it is granted if an individual's commander determines that the service has been generally honest and faithful, even if the person ran into some trouble. General Discharges are given for a variety of reasons, including failure to progress in training; failure to maintain military standards in appearance, weight, or fitness; or for disciplinary infractions, including drug or alcohol abuse.
- 3) *Other than Honorable.* An "OTH" discharge usually is given when an individual's service represents a broader pattern of departure from the conduct and performance expected of all military members. It can result from notable drug or alcohol problems, but also can be based on other misconduct, such as abuse of authority, fraternization, or a pattern of continue misconduct. OTH discharges bar the individual from reenlisting into any component of the armed forces, including the military reserves and National Guard.

Punitive discharges are authorized punishments of courts-martial and can only be imposed as an approved court-martial sentence following an individual's conviction for violating the Uniform Code of Military Justice. There are two types of punitive discharges:

- 1) *Bad Conduct Discharge.* This can be imposed by both special and general courts-martial. This discharge is usually given for convictions of crimes such as absent without leave, drunk on duty, driving while under the influence, adultery, writing bad checks, and disorderly conduct.
- 2) *Dishonorable Discharge.* This is the worst type of military discharge a service member can receive, and can be imposed only by a general court-martial. In most cases, a Dishonorable Discharge also involves being sentenced to serve time in a military prison.

¹² RTC section [205.5](#).

Legislative History. Proposals to modify the veterans' exemption have included:

YEAR	BILL	DESCRIPTION
2017	SB 404 (Stone)	CPI-elimination for Income Qualified Senior Veterans. Held in Senate Appropriations Committee. (Identical to this bill)
2016	SB 690 (Stone)	CPI-elimination for Income Qualified Senior Veterans. Held in Assembly Appropriations Committee. (Identical to this bill)
2016	SB 1104 (Stone)	CPI-elimination for Income Qualified Senior Veterans. Held in Senate Appropriations Committee. (Identical to this bill)
2005	SCA 14 (Morrow)	Create a Military and Veterans homeowners' exemption that is 10% greater than the homeowners' exemption for active military and veterans. Held in Senate Revenue and Taxation Committee.
1997	ACA 9/AB 551 (Morrissey and House)	Increase the Veterans' Exemption to \$7,700 and eliminate the wealth cap. Held in Assembly Appropriations.
1996	ACA 39/AB 2790 (Morrissey)	Increase the Veterans' Exemption to \$7,700 and eliminate the wealth cap. Failed in the Senate.

Senior Provisions. Various age-based property tax benefits are available generally. This includes base year value transfers for persons at least age 55 that buy a qualifying home and a state program that allows income-qualified persons at least age 62 to postpone property taxes with interest.

Commentary:

1. **Author's Statement.** Many veterans who are, or will soon become, senior citizens served America during the Vietnam and Korean wars, a time when our nation often did not show these men and women the respect they deserved. As these men and women become senior citizens, the least we can do is offer them the financial stability to allow them to stay in their homes that this legislation provides.
2. **Summary of Amendments.** The **June 18, 2019** amendment (1) provides that the inflation factor freeze is for a 10-year period beginning January 1, 2020, and (2) requires the BOE to annually review and report to the Legislature on the effectiveness of the tax benefits of this bill. The **May 17, 2019** amendment eliminated the expansion of the disabled veterans' exemption to a 100 percent exemption.
3. **Provides financial relief to income and age qualifying home-owning veterans.** According to the author, capping the property tax assessment of veterans age 65 or older will help lower income veterans afford to stay in their own home and avoid homelessness. The author notes that homelessness is a significant issue for veterans.
4. **Freezes assessed values for income qualifying veterans at least age 65 for 10 years.** For a 10-year period, this bill freezes the assessed values for income and age qualifying veterans at the home's factored base year value for the 2020-21 fiscal year, which is the factored base year value for the January 1, 2020 lien date. In addition, as other qualified veterans reach the age of 65, their home's assessed value will also be frozen. Beginning with the January 1, 2030 lien date, factoring will once again resume for these qualifying veterans.
5. **Historically, the inflation factor has applied equally to all property types and all property owners.** The Constitutional provision specific to "full cash value base" inflation adjustments does not appear to prohibit the Legislature from enacting a law that makes the inflation factor optional

to a certain class of taxpayer. The Constitution is silent on differential application of the inflation factor to the "full cash value base." Section 2(b) of article XIII A of the Constitution reads:

The full cash value base *may reflect* from year to year the inflationary rate not to exceed 2 percent for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction, or may be reduced to reflect substantial damage, destruction or other factors causing a decline in value.

Section 1 of article XIII of the Constitution provides that:

All property . . . shall be assessed at the same percentage of fair market value. When a value standard other than fair market value is prescribed by this Constitution or by statute authorized by this Constitution, the same percentage shall be applied to determine the assessed value. The value to which the percentage is applied, whether it is to be the fair market value or not, shall be known for property tax purposes as the full value.

Article XIII, section 1 uses the terms "assessed value" and "full value." It is unclear if the amendment to section 51 prohibiting the application of an inflation adjustment to a limited class of properties could be interpreted to be contrary to section 1's requirement that all property be assessed at the same percentage.

6. **Assessment uniformity.** Assessed values lack uniformity under California's acquisition value-based system. However, the acquisition value-based standard is authorized by the Constitution and has been upheld by the courts. Adding an income-based element expands non-uniform assessment and complicates administration of the tax. This bill contains three qualifications (military service, age, and income) that the Constitution does not expressly authorize.
7. **The property tax is an ad valorem tax based on a property's assessed value.** Historically, the imposition of the property tax has not varied based on income. Property tax law does provide certain constitutionally-authorized exemptions to be applied to a property's assessed value (disabled veterans' exemption and welfare exemption low income rental housing) and age-based exclusions from the definition of change in ownership (Propositions 60 and 90 base year value transfers).
8. **Annual income requirement.** One of the requirements for the inflation factoring freeze is that the veteran must have an income, as specified, of less than \$50,000 if single or \$100,000 if married. Unlike the disabled veterans' exemption, which provides for annual inflationary adjustment of the income limit, this bill does not provide for any inflationary adjustments.
9. **Honorable discharge requirement.** One of the requirements for this factoring freeze is that the veteran be honorably discharged. This is unlike the disabled veterans' exemption for which "other than dishonorable" veterans are eligible. The disabled veterans' exemption requirement for the character of discharge from military service was changed in 2016 from "honorable" conditions to a lower threshold of "other than dishonorable" conditions.¹³

¹³ [Senate Bill 1458](#) (Stats. 2016, ch. 871).

10. **Annual income verification.** Should it become common to enact property tax laws that base assessed values on the property owner's income, independent verification of income eligibility would become increasingly important. Thus, assessors would need to delve into taxpayers' private financial matters unrelated to property value. Assessors will need to establish a procedure to verify continued income eligibility specific to this bill's provisions. To this end, the bill allows the assessor to request additional proof of eligibility.
11. **Qualifying veterans will need to take action.** Assessors do not have information about homeowners' veteran status, age, or income. The bill specifies a basic claim-filing requirement to request this tax benefit. As annual income may change from year to year, claimants may have to annually file income information to verify qualification.
12. **Excess land.** This bill expressly provides that the inflation factor limitation does not apply to land in excess of what is reasonably necessary for use of the property as a home. This is consistent with other property tax law provisions in which a "residential dwelling" means a dwelling occupied by the claimant as the principal place of residence, and so much of the land surrounding it as is reasonably necessary for use of the dwelling as a home. For example, for a home located on a parcel of land that is a large farm, the inflation factoring limitation would be limited to the home and the home site.
13. **Report to Legislature.** This bill requires the BOE to, from January 1, 2021 until January 1, 2031, annually review the effectiveness of the tax benefits of this base year value inflation factoring freeze. The review is to include, but not be limited to, an analysis of the demand for the tax benefits, the economic impact of the tax benefits, and the performance indicators (specified as the number of properties receiving the tax benefits and the assessed value of property claiming the tax benefits). With additional, appropriate staffing, the BOE would be able to perform a revenue impact analysis, not an economic impact analysis.
14. **Related Legislation.** [Senate Bill 562](#) (Morrell) proposes to increase the existing exemption limits for disabled veterans.

Costs: Costs to create forms and modify publications and website materials are absorbable. However, BOE would incur costs to request data from assessors, analyze the data for revenue impact, and annually report on the effectiveness of the tax benefits under this bill; an analysis of the cost for staff needed to complete this review is pending.

Revenue Impact: Background, Methodology, and Assumptions. Generally, a property's sale price is the assessed value (called the base year value), and annual increases to that value are limited to the rate of inflation, not to exceed 2 percent (called the factored base year value). This bill eliminates the annual inflation factor increase applied to the base year value of an age and income qualified veteran's home.

Age. According to U.S. Census data, California veterans 65 and older account for 15 percent of all Californians 65 and over. Among this age group, there are roughly 2.2 million owner-occupied homes in the state. While specific data does not exist, we can estimate the number of homes owned by veterans 65 and older as follows:

$$2.2 \text{ million homes} \times 15\% = 330,000 \text{ homes}$$

Income. Based on a review of available data, we estimate that about 80 percent of veteran-owned homes will qualify given the income limits of \$50,000, if single, and \$100,000, if married.

330,000 homes x 80% = 264,000 homes

For fiscal year 2018-19, the average assessed value of homes receiving the homeowners' exemption was \$412,000. Eliminating the inflation factor for qualified veterans 65 and older results in annual revenue loss at the basic 1 percent property tax rate calculated as follows:

Average Home Assessed Value	Inflation Factor	Assessed Value Increase Avoided	Tax Rate	Tax Savings Per Home	Income Qualifying Veteran 65+ Homes	Revenue Loss
\$412,000	2%	\$8,240	1%	\$82.40	330,000	\$27.2 Million

Revenue Summary. By eliminating the inflation factor applied to a qualifying veteran's home, this bill would result in a potential annual revenue loss of \$27.2 million.

Qualifying Remarks. This estimate assumes (1) a similar rate of homeownership for veterans 65 and over as for all Californians 65 and over; and (2) a similar level of income for veterans 65 and over as for all Californians 65 and over. This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.