

## DEDUCTION OF MELLO-ROOS TAXES

In 1982, the California Legislature enacted the Mello-Roos Community Facilities Act. The Act allows any county, city, special district, school district or joint powers authority to establish a “Community Facilities District” (CFD) which allows for the financing of public services and facilities. Among the services and facilities CFDs can provide are police and fire protection, streets, schools, parks, and libraries. A CFD is authorized to sell tax-exempt bonds to fund such local improvements and then assess a special tax (Mello-Roos tax) against property within the CFD to repay the bonds. Typically the property that is assessed is one of the properties that receive the benefits, either through use of services and facilities or increases in property value. This type of tax is distinguished from regular real property taxes where such taxes are levied for the general public welfare and at the same rates on all properties within the jurisdiction. The Mello-Roos tax is usually included on the annual County property tax bill sent to taxpayers.

California law conforms to federal law in the treatment of payments for state and local real property taxes. The law generally allows an itemized deduction for state and local real property taxes. However, a deduction is not allowed where a tax is assessed against property to fund local benefits and improvements tending to increase the value of property, unless such tax is specifically allocable to maintenance or interest expenses. Local benefits include streets, sidewalks, and other like improvements.

In order to provide taxpayers clarification on the non-deductibility of payments for Mello-Roos taxes, staff proposes to:

- Provide a discussion on the non-deductibility of Mello-Roos taxes on the Franchise Tax Board’s web site under the Frequently Asked Questions section.
- Include directions on the non-deductibility of Mello-Roos taxes in the California instructions for filing tax returns. Currently California instructions focus on where adjustments are needed due to differences between federal and state law. Since California law conforms to federal law on this issue, the deductibility of Mello-Roos taxes is not specifically addressed. Federal instructions mention similar assessments being non-deductible; however, it is questionable if taxpayers make this connection.
- Work with other state and local agencies to inform taxpayers of the non-deductibility of Mello-Roos taxes, including examining voluntary ways to provide notice to taxpayers.