

PROPOSITION 40

The 2026 Billionaire Tax Act Section-by-Section Summary

Introduction to this summary. This document has been prepared by the drafters of Proposition 40, the California Billionaire Tax Act (“Prop 40”), to explain its details in plain English to voters and other interested parties, such as legislators, regulators and taxpayers. It is being submitted as public testimony and posted publicly.

This summary describes the ordinary meaning of Prop 40. California courts will use ordinary principles of constitutional and statutory interpretation, including construing the “plain and ordinary meaning,” to resolve any disputes about what Prop 40 does. Critics of Prop 40 have posted claims about the measure that differ at points with this summary. In our view these claims rest on implausible and often unreasonable efforts to twist the plain language and intent of Prop 40. California courts have rejected the use of strained, unreasonable arguments to conjure up ambiguity and thus these contrary accounts should be rejected. In the event that courts do find some Prop 40 language ambiguous, we expect they will rely in part on this summary and other interpretations offered by the drafters. California courts attempt to honor voters’ intentions, and so have generally held drafters to the claims about an initiative that they have made publicly to voters.¹ In addition, a ballot initiative that can be read and readily understood by voters cannot address every conceivable complex legal question that might arise, and so the drafters expect that some highly technical issues, such as the treatment of property held through single-member LLCs, may be resolved through further guidance from California tax regulators.

Prop 40 Overview.² The Act is a one-time wealth tax initiative for tax year 2026. Revenues from the one-time tax are committed to address an urgent and pressing fiscal emergency caused by the expected imminent loss of about \$100 billion in federal funding for health care, education, and nutrition programs. The tax portion of the Act (i) imposes a 5% excise tax on California-resident billionaires on their worldwide net worth of as of December 31, 2026, payable at once, or over 5 years with a deferral charge; (ii) defines a California-resident billionaire as a billionaire who resided in California as of January 1, 2026; (iii) allows taxpayers who do not have cash available to pay the tax to defer payment until later, with an interest charge; and (iv) further offers optional deferral accounts for qualifying taxpayers.

Structure. The measure is implemented through (A) a constitutional amendment (new Article XIII, Section 37) authorizing the tax and creating a dedicated Reserve Fund; (B) a

¹ See, for example, *Rossi v. Brown*, 9 Cal.4th 688, 700 n. 7 (1995).

² The drafters discuss the policy background for the Act and other issues here: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5996554.

Government Code article establishing Reserve Fund subaccounts and appropriation/reporting rules for that fund that will be primarily dedicated to health care, education, and nutrition programs; and (C) a new Part 27 of the Revenue and Taxation Code providing the key tax rules.

Sec. 1. Title

Provides that Prop 40 may be cited as the “2026 Billionaire Tax Act.”

Sec. 2. Findings

The findings describe urgent and pressing (and in that sense, one-time) threats to California’s health care, education, and nutrition assistance systems arising from an expected \$100 billion in federal funding cuts affecting Medi-Cal, California public schools, and CalFresh/SNAP.

Sec. 3. Purpose and Intent

The purpose of Prop 40 is to raise revenue to fund health care, K-14 education, and food assistance through levying a one-time, administrable, and fair tax on California billionaires. The billionaire taxpayers are most able to pay the tax, and also generally pay much less in taxes relative to their ability to pay compared to many other Californians. Because there are urgent and pressing threats to California’s health care, education, and nutrition assistance systems arising from an expected \$100 billion in federal funding cuts, and because a one-time tax can be set up and administered much more quickly to begin raising revenues sooner, the one-time structure of the tax is best suited to the imminent fiscal emergency.

Sec. 4. Constitutional Authorization and Dedicated Reserve Fund.

Section 4 adds Section 37 to the California Constitution, which grants constitutional authorization for the wealth tax. As described in greater detail below, it also provides for the creation of a Reserve Fund and permits facial challenges to the law to be adjudicated through a validation action proceeding.

- Use of funds. California’s constitution contains numerous complicated fiscal rules, including caps on state expenditures. Such rules and limits were not designed to account for emergencies of the type created by recent massive federal funding cuts. As a result of these cuts, California needs to significantly increase its expenditures to maintain the same baseline of services. Accordingly, this section assures that proceeds from Prop 40 will be expended to mitigate the impact of the federal cuts. Proceeds from the tax are placed in a new Reserve Fund that is permanently separate from the General Fund, with 90% committed to health care; and 10% to K-14 education and food assistance, all for the benefit of low and moderate-income families and individuals.

- Legal challenges. Generally, as a matter of California constitutional law, challenges to taxation can only be made after a tax is paid. In order to provide for more fiscal certainty for the Legislature, this section amends those rules to permit certain legal challenges to be brought immediately and to have a speedier resolution, through the California courts. The provision is based on validation actions, described more in the discussion of Operative Tax Provisions at Section 50314.

Sec. 5. Reserve Fund Implementation in the Government Code.

Section 16355

Creates the operational rules for the Reserve Fund and its two subaccounts, the Health Account and the Education and Food Assistance Account. The permitted uses of the tax revenue in the subaccounts are defined broadly.

For the Health Account, which shall receive 90% of the tax revenue, permitted uses include restoring or addressing reductions in federal funding or state appropriations; protecting and enhancing Medi-Cal and other coverage programs; supporting safety net providers; preventing or mitigating facility closures or service reductions; and other investments supporting health care access, coverage, benefits, funding, services, and provider payments.

As for the Education and Food Assistance Account, which shall receive 10% of the tax revenue, permitted uses include education spending to restore or address reductions in federal or state funding or to protect/enhance the K–14 public education system; and food assistance spending to restore or address reductions in federal or state funding or to invest in programs like CalFresh, and California’s Universal Meals Program.

This section also limits how much anticipated revenue the Legislature can spend in one year (up to \$25 billion/year) to provide for spending over a five-year period. It also forbids the Legislature from using this new revenue to replace existing state funds.

At subdivision (e), the section provides funds for tax administration. The Franchise Tax Board (“Board”) is charged with administering the tax. This section provides the Board with a start-up loan of up to \$50 million to implement Prop 40, as well as an ongoing annual reimbursement from the Reserve Fund for actual and necessary administrative and evaluation costs.

Subdivision (f) describes how the Department of Finance must report annually to the Legislature regarding the Reserve Fund, including the Fund balance, the estimated revenue to be generated for the Fund and proposed expenditures from the Fund. The Department also shall verify that moneys from the Reserve Fund are not being used to replace existing state funding. After the Director of Finance determines that all revenues from the Act have been collected and spent, under subdivision (g) the Legislature has the authority to abolish the Reserve Fund. Subdivision (h) provides definitions for this section.

Sec. 6. Operative Tax Provisions

Part. 27. 2026 Billionaire Tax Act

Chapter 1. Imposition of Tax on Personal Wealth in Excess of \$1 Billion in Net Worth

Section 50300. Short title

Provides that Part 27 is known, and may be cited, as the 2026 Billionaire Tax Act.

Section 50301. Imposition of tax; rate and phase-in; payment; filing; audit

Subdivision (a): One-time excise tax; determination dates; married couples.

This subdivision imposes, for tax year 2026, an excise tax on the “activity of sustaining excessive accumulations of wealth” by California residents with worldwide net worth of \$1 billion or more. Net worth includes all assets, whether tangible or financial, except for certain exceptions described in more detail below. Recent data suggest as much as three-quarters of current billionaire wealth is in the form of stock of publicly-traded companies. In order to prevent the misuse of trusts to avoid the tax, this subdivision also imposes tax on any trust to which a living California billionaire has transferred assets; these trusts are described in more detail in Section 50308 below.

Whether a person is a California resident is determined as of the “tax obligation date” (January 1, 2026), while the amount of net worth subject to tax is measured as of the “valuation date” (December 31, 2026). The timing for determining whether a trust is an applicable trust is discussed under Section 50308 below.

Subdivision (b): 5% tax; phase-in between \$1.0B and \$1.1B; ODA carve-out.

- **Tax rate.** This subdivision sets the tax rate at 5% of net worth for individuals with net worth in excess of \$1 billion and covered trusts. For fairness, the full rate phases in linearly for taxpayers with net worth between \$1 billion and \$1.1 billion (with respect to individuals other than trusts).
- **Deferral for illiquid taxpayers.** Allows an individual who lacks current liquid assets to pay the tax to opt to initiate an Optional Deferral Account (“ODA”) under Section 50304 to defer paying tax until the time specified by Section 50304. ODAs are discussed in greater detail in Section 50304.

Subdivision (c): Return filing and timing; installment option and deferral charge.

This subdivision provides that additional tax payable under Section 50301 (and under Section 50304 [the ODA provision], if applicable) is reported with, and due at the same time as, the taxpayer’s annual personal income tax return. A taxpayer may either pay the tax in full with the 2026 return or elect to pay in five equal annual installments beginning

in the year the tax is due. Each subsequent annual installment is subject to an annual nondeductible “deferral charge” equal to 7.5% of the remaining unpaid balance.

Subdivision (d): Filing requirement / certification.

This subdivision requires every California resident individual who files an income tax return for 2026 to either (i) make a simple declaration as part of the individual’s annual tax filings (like the checkbox declarations of a taxpayer’s filing status or dependent status) that the individual’s net assets were less than or equal to \$1 billion as of the valuation date or (ii) submit a declaration of the additional tax owed under Part 27, together with required Board forms and supporting valuation evidence (including certified appraisals where required).

Subdivision (e): Franchise Tax Board examination obligation and powers.

This subdivision directs the Board to examine all returns submitted under Part 27 and to determine the correct amount of tax owed by billionaires. The Board is not required to audit taxpayers who check the box to indicate they are not billionaires and is granted no new authority for audits generally. There are not expected to be many such returns and the FTB will be given more resources (see proposed Government Code Section 16355(e) above), and time to complete audits (see Section 50309(b)(3)). Subdivision (e)(2) specifies that the Board has discretion over the length of any such audit.

Chapter 2. Computation of Net Worth

Section 50302. Debts and liabilities

- Calculation of net worth. Prop 40 imposes a tax on a taxpayer’s *net* worth and thus the Act reduces, with certain limitations, the taxable wealth by the amount of any liability that is personally owed by the taxpayer. Legally enforceable charitable pledges entered into before October 15, 2025 also reduce net worth.
- Genuine debts and certain other liabilities reduce net worth. Debt can be used to artificially reduce taxpayer net worth to an extent that does not reflect economic reality, however. Thus, the amount of any nonrecourse or limited recourse debt that reduces net worth may not exceed the value included in the taxpayer’s net worth for the collateral securing that debt. For the same reasons, contingent liabilities, liabilities owed to related parties or otherwise not at arms’ length, and debts with an interest rate below market generally do not reduce net worth. Other liabilities entered into for the purpose of reducing tax may also be disregarded under the general anti-avoidance rules described in Section 50312, below.

Section 50303. Valuation rules; exclusions; asset-type rules

Subdivision (a): Fair market value standard.

Adopts, with certain technical modifications, the standard tax definition of fair market value: the price a willing and informed buyer would pay a willing and informed seller.

Subdivision (b): Anti-abuse rules.

Disallows certain legal structures taxpayers commonly use to reduce the taxable value of an asset. In particular, this section is intended to disallow two common techniques used by very wealthy taxpayers to reduce the valuation of an estate that would otherwise be subject to estate tax. The drafters specifically intend that prior opinions of the U.S. Tax Court upholding these techniques, which commenters generally agree were wrongly decided, should not govern interpretation of Prop 40.

Subdivision (c): Asset-type valuation rules, exclusions, and reporting requirements.

This subdivision provides default valuation methods, exclusions, and reporting requirements for specific asset types.

1. Publicly traded assets — “market trading value on the valuation date” (Section 50303(c)(1))

For all publicly traded assets, fair market value is presumed to be the asset’s market trading value on December 31, 2026. The drafters expect that assets that are not publicly traded but readily convertible to a publicly traded asset will have a value of not less than the value of the publicly traded asset.

Prop 40 uses market pricing on the valuation date of December 31, 2026 for publicly traded assets because those assets have readily ascertainable values through active markets, reducing the need for appraisal-based valuation and lowering administrative and compliance costs. Also, a taxpayer has the option of selling a portion of such assets on the valuation date to effectively lock in the market value on the valuation date. Although Prop 40 does not specify the precise convention for determining “market trading value” (for example, closing price, a volume-weighted average price, the mean of high and low prices, or a bid/ask midpoint when no trades occur), the Board may specify such conventions by regulation or other guidance, including rules for thin trading, multiple exchanges, and days on which there is no trading. In that respect, federal estate and gift tax valuation precedents for publicly traded securities (particularly Treasury Regulation §§ 20.2031-2 and 25.2512-2) provide a reasonable reference point for these valuation issues. The Board has general authority to promulgate such guidance under Section 50309(b), but is also specifically instructed to look to federal regulations in a related context at Section 50305(b).

2. Sole proprietorships (Section 50303(c)(2))

Treats assets held through a sole proprietorship as directly owned and held by the taxpayer.

3. Non-public business entity interests — “Presumed Percentage Method” and rebuttable presumptions (Section 50303(c)(3))

Governs valuation of interests in business entities (including equity, debt, and other contractual or noncontractual interests) that are not (i) interests in publicly traded

companies; or (ii) sole proprietorship assets. These default rules are designed to reduce compliance and audit costs by allowing valuation based on standardized information from financial statements. These simplified values are presumptions for administrative convenience. For assets or circumstances in which the simplified presumptive formulaic valuations would be inaccurate, however, either the taxpayer or the Board may rebut those presumptions using certified appraisals. The operation of the presumptive valuation method is detailed in Section 50303(c)(3)(A)–(E).

- Reporting inputs (Section 50303(c)(3)(A)–(B)).

In order to assess whether the presumptive formulas have been applied accurately, the taxpayer must report the relevant underlying financial information. Note that this information has been chosen to be of a type that is ordinarily produced by a business in any event. If the taxpayer lacks the information and lacks the right to obtain it, the taxpayer must submit a certified appraisal of all of the taxpayer's interests in the entity.

- Presumed Percentage Method — ownership percentage presumptions and valuation formula (Section 50303(c)(3)(C)–(E)).

Subparagraph E contains a simple formula for calculating the value of interests in non-public entities based on standard financial information. Subparagraphs C, D, and the end of E contain additional presumptions applicable to special cases of non-public entities. Taxpayers who are unsatisfied with the value determined under the formula and its presumptions may instead elect to submit an appraisal. If there is clear and convincing evidence that the appraised value is a more accurate measure of value, it will govern.

- Entity value formula (beginning of E): The fair market value of the taxpayer's interest is presumed to equal: $(\text{Entity GAAP book value at year-end} + 7.5 \times \text{average GAAP book profits}) \times (\text{taxpayer's percentage owned})$. Average book profits are computed over the current tax year and the preceding two tax years, if available. Negative average profits are treated as zero. The Board may permit consistent non-GAAP accounting methods where appropriate.
- Control-rights floor (C): For interests conferring voting or other direct control rights, the taxpayer's "percentage owned" is presumed to be at least the taxpayer's percentage of overall voting or other direct control rights. This presumption addresses a tax planning technique common in the context of the estate tax.³ It does not apply to interests in publicly traded entities.
- Relationship of presumptions to other valuation rules; the case of super-voting shares in public companies: The tax-planning techniques addressed by Section 50303(c)(3)(C) are generally employed by family-owned businesses, not large

³ For a description, see, for example, <https://www.thetaxadviser.com/issues/2022/may/freezing-stock-value-corporate-recapitalization/>.

public companies. Accordingly, because publicly-traded entities are “governed by paragraph [50303(c)](1),” the valuation presumptions in Section 50303(c)(3)—including the control-rights floor in Section 50303(c)(3)(C)—do not apply to interests in publicly traded companies, whether or not those interests themselves are publicly traded.⁴ Interests in publicly traded companies are valued at their fair market value on the valuation date, regardless of whether the shares carry enhanced voting rights. For example, an individual who holds 25% of the total vote of a public company, through their ownership of a class of non-traded shares with enhanced voting rights, would be taxed on the appraised value of those shares, not the value presumed under Section 50303(c)(3)(C).

- Profits-interest floor (D): Private equity fund managers commonly earn compensation in the form of a profits interest, or share of the realized investment returns of the fund. Some of these compensation arrangements further provide that the manager will not earn any share of profits until the fund’s profits exceed some “hurdle rate” threshold, such as an 8% overall return. The drafters intend that individuals who hold such an interest in a company should usually be regarded as likely to earn the full profits interest available. This section therefore presumes a taxpayer’s “percentage owned” to be no less than the maximum percentage of entity profits the taxpayer may earn, without regard to whether the taxpayer has yet exceeded any contractual hurdle rate or similar condition.
- Private equity entity floor (middle of E): In the case of a private equity entity, the presumed value is generally the value of the portfolio companies held by the entity, less any of the entity’s liabilities.
- Rebuttal through certified appraisals (Section 50303(c)(3)(F)).
 - Rule: The results from applying the specified formulas and the special presumptions may be rebutted if either the taxpayer or the Board can demonstrate with clear and convincing evidence that any aspect of the Presumed Percentage Method (in (C), (D) or (E) or the valuation formula in (E)) would substantially overstate or substantially understate the actual value or percentage owned. In that case, the taxable value will be the value determined through a certified appraisal. The drafters expect that the Board will promulgate guidance for the method for submitting certified appraisals, but in general the drafters’ expectation is that taxpayers who wish to rely on a certified appraisal will submit that appraisal together with a tax return in which they take the position that the Presumed Percentage Method overstates the value of an asset.
 - Practical effect: The Presumed Percentage Method is intended as a standardized starting point, not an irrebuttable rule. Taxpayers who want to argue that an asset has a different value than the formula value must support their argument with clear and convincing evidence, including a certified

⁴ For further discussion of this issue, see https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6073728.

appraisal. The Board is similarly empowered to rebut taxpayer-reported formula values when warranted. The drafters expect that a certified appraisal will routinely determine the valuation of an asset when the appraisal is based on evidence of a recent arms' length transaction. Because viable businesses regularly receive new financing or an owner can enter into a transaction for purposes of establishing valuation, the drafters expect that the certified appraisal process will be relatively predictable and uncontroversial in most cases.

4. Directly held real property (Section 50303(c)(4))

Excludes all interests in real property held directly by the taxpayer (or via a revocable trust) from net worth for purposes of calculating net worth. An applicable trust applies this exclusion to real property it directly holds in computing its own net worth. The reason for the exemption is that real estate is likely already subject to property tax—a close analogue of the wealth tax—whether in California or another jurisdiction. As a simplifying measure to avoid double taxation, and the possible need to grant credits for tax paid to other jurisdictions, Prop 40 therefore exempts real estate if held directly by the taxpayer or through a revocable trust. Real estate taxes on assets held through a business entity will generally be reflected in a lower fair market value for the entity and so do not require any special exemption.

5. Tangible personal property located outside California (Section 50303(c)(5))

Prop 40 imposes a tax on the personal property of billionaires, such as furnishings and vehicles, subject to a large exclusion. See Section 50303(c)(9) below. For administrative ease, and to comply with certain longstanding U.S. Supreme Court rulings, this provision excludes tangible personal property located outside California for at least 270 days during 2026, but denies the exclusion if the asset was relocated temporarily with a substantial purpose of avoiding tax. The drafters expect the Board to issue guidance concerning property acquired during 2026, including application of the 270-day requirement and the Act's anti-avoidance rules to short-term acquisitions or other arrangements undertaken to obtain an unintended exclusion. The exclusion applies to the tangible personal property itself and does not automatically exclude an interest in an entity that owns such property; the Board may issue guidance concerning disregarded entities and similar arrangements.

6. Trust interests and attribution rules (Section 50303(c)(6))

A trust is a legal entity with no direct owners but which may sometimes be under the direct or indirect control of the individual who funded the trust. Many billionaires aggressively employ trusts for tax avoidance purposes, and recent research finds that U.S. trusts hold trillions in dollars of untaxed wealth. The trust rules summarized below are intended to measure the real wealth of California billionaires, whether that wealth is owned directly or instead is held through trusts whose funds the billionaires can readily direct.

In summary, the rules are as follows:

- Grantor trusts (Subsection A). In federal tax law, a grantor trust is a trust whose assets are directly controlled or reclaimable by the trust's funder. Accordingly, under this subsection, an individual's net worth includes the net worth of any grantor trust of that individual.⁵
- Transfers to trusts and threshold determination (Subsection B). A funder's control over and personal benefit from trust assets is not limited to the narrow category of grantor trusts. Even if a trust is formally managed by a third party, the selection of the trust manager and the funder's power to provide instructions the manager must follow represent ongoing control over the use of the trust assets by the funder. Accordingly, for purposes of determining whether an individual meets the \$1 billion threshold and determining the applicable phase-in rate between \$1 billion and \$1.1 billion, the individual's net worth also includes, for any non-grantor trust to which the individual has transferred property, a proportional share of that trust's assets equal to the share of assets contributed by that individual. Assets held by charitable trusts and certain other trusts exempt from income tax are excluded.
- Tax-avoiding transfers to trusts (Subsection B). To address the possibility that billionaires would attempt to avoid Prop 40 by transferring funds to trusts, this subsection treats 100% of property transferred to a non-grantor, non-tax-exempt trust in 2026 and 75% of the value of property transferred in 2025 as included in the transferor's net worth for all purposes (i.e., these funds are subject to the 5% tax if the individual has net worth of at least \$1.1 billion).⁶ Thus, funds transferred to a trust prior to 2025 are used in determining whether the \$1 billion threshold is met and the applicable phase-in rate, but do not otherwise increase the tax owed by that individual.
- Beneficiaries (Subsection C): Any beneficiary of a trust is treated as the owner of any trust assets which the beneficiary is currently entitled to, even if the beneficiary has chosen to leave those assets in the trust. This is a well-defined

⁵ Determination of the status of a trust as a grantor trust would be made on the same date as all other valuation determinations, December 31, 2026. Consistent with the general tax-law treatment of changes in trust status, a grantor trust that became a non-grantor trust during the 2025 or 2026 tax years would be treated as having transferred its assets to a new, non-grantor trust. Since a transfer by a grantor trust is treated as though it were a transfer by the grantor under Section 50308, this new non-grantor trust would be taxable under Prop 40 if the grantor is a California billionaire.

⁶ As described below, Section 50303(c)(11) makes any gift of over \$1 million after Oct. 15, 2025 part of the net worth of the giver. In some cases that provision will overlap with Section 50303(c)(6)(B) and of course it is not the intention of the drafters that the same assets be twice counted in a transferor's net worth. A common tax planning technique for wealthy individuals involves so-called sales of taxpayer assets to a trust established by the taxpayer. Because the taxpayer controls both sides of this transaction, it is difficult in practice to establish whether the "sale" was made for fair market value. Accordingly, Section 50303(c)(6)(B) operates to include all "transfers," whether or not made gratuitously, in the net worth of the transferor.

concept in the California income tax. This rule does not apply if the trust is itself taxable under Prop 40, however.⁷

- Interaction with rules for taxation of trusts as separate taxpayers. As described in Section 50308(b) below, a trust that has received funds from a living California billionaire may itself be subject to tax under Prop 40. As a result, in the case of transfers to trust made in 2025 or 2026, it is possible both the transferor and the trust would be taxable on the transferred assets. Because opaque and out-of-state or offshore trusts have historically been a tool of tax avoidance for the very wealthy, and to safeguard against potential changes in federal-law limits on state taxation of trust assets, this intended redundancy is meant to reduce the possibility that trust assets will escape taxation. As further detailed in Section 50308(b), any possible double taxation can be avoided if the individual taxpayer elects to simply treat the trust assets as part of the individual's net worth. Similarly, under the rules of Subsection 50303(c)(6)(C), trusts that were not funded by living California billionaires but which have current California beneficiaries may elect to be taxable themselves in order to avoid the need for the beneficiary to include the trust assets in the beneficiary's taxable net worth. The drafters expect the Board to provide guidance regarding how taxpayers may make these elections so that trust assets do not escape taxation and unintended duplicative taxation is avoided.

Example (trust interaction rules).

Step 1—Threshold determination (Section 50303(c)(6)(B)). Individual A has \$600 million of directly held assets on December 31, 2026. In June of 2025, A transferred \$200 million to an irrevocable non-grantor trust for the benefit of A's adult child B. In 2026, A additionally transferred \$300 million to an irrevocable non-grantor trust for the benefit of A's unborn descendants. For purposes of determining whether A exceeds the \$1 billion threshold (and the \$1.1 billion phase-in endpoint), A's net worth includes the value of all property A transferred to trusts. A's threshold net worth is therefore \$1.1 billion, and A is an "applicable individual."

Step 2—Applicable trust status (Sections 50308(b) and 50301(a)). Because A is an applicable individual who transferred property to the trusts, the 2025 trust and 2026 trust are "applicable trusts" potentially subject to tax under Section 50301.

Step 3—Inclusion in net worth (Section 50303(c)(6)(B)). Because A transferred \$300 million to a trust in 2026, those funds must be included in A's net worth when the amount of A's tax liability is determined. Because A gifted \$200 million to another party (here, a trust) in 2025, 75% of that amount is part of A's net

⁷ To the extent there is any uncertainty about whether income-tax concepts apply to Prop 40, the drafters expect the Board to issue guidance clarifying when and to what extent trust assets are distributable. Where some portions of a trust are taxable and others are not, the drafters intend that phrases such as "the trust" will be understood to mean the portion of the trust that is described in the relevant statutory text.

worth. See Section 50303(c)(11) below. A will be therefore be taxable on a total of \$1.05 billion of net worth: the \$600 million held directly, the \$300 million transferred in 2026, and 75% of the \$200 million transferred to a trust in 2025. Thus, A will owe tax of 5% x \$1.05 billion, or \$52.5 million.

Step 4—Election options (Section 50308(b), last sentence). A may elect to treat one or both trusts as part of A’s own net worth. If so, the trust is not separately subject to tax under Section 50301. A will likely make this election with respect to avoid the possibility that 75% of the \$200 million and all of the \$300 million would be taxed twice. After making the election, A’s taxable net worth will be \$1.1 billion, and A’s tax will be \$55 million.

Step 5—Beneficiary attribution (Section 50303(c)(6)(C)). Because the 2025 trust is an “applicable trust,” B (as beneficiary) is not deemed the owner of the trust assets under the beneficiary attribution rule. This prevents double counting of trust assets at both the trust and beneficiary level.

7. Retirement arrangements and deferred compensation (Section 50303(c)(7))

Virtually all tax-qualified pensions and retirement arrangements are exempt from taxation under Prop 40.⁸ Exceptionally large Roth-type retirement accounts in excess of aggregate worth of \$10 million, such as the reported multi-billion-dollar Roth account of Peter Thiel, are taxable. Compensatory profits interests, supplemental executive retirement plans, and similar vested non-qualified pension and deferred compensation benefits are also taxable.

8. Receivables (Section 50303(c)(8))

This provision directs the Board to adopt regulations regarding the taxability of receivables and similar assets, including authority (subject to specified considerations) to exempt certain receivables from taxation and reporting. Pending adoption of regulations, all receivables are included in net worth.

9. “All other assets” — \$5M exclusion (Section 50303(c)(9))

Taxpayers must submit a certified appraisal of miscellaneous assets not described above, such as art, collectibles, and home furnishings, if the asset is worth more than \$1 million. To ease compliance burdens, however, each taxpayer may exclude up to \$5 million of aggregate value of miscellaneous assets from net worth and from the reporting requirements of this section. Claims that Prop 40 requires individuals to make a list of everything they own are thus inaccurate. In addition, individuals who check the box to affirm that they are not billionaires will not have to make any additional reporting under Prop 40, whether of the value of their belongings or anything else.

⁸ So-called “Malta pensions,” which have previously been identified by the IRS as an abusive tax shelter, are not exempt under this section because their unlimited contribution amount makes them not “similar in nature” to the qualified pensions described by Subsection 50303(c)(7).

10. Valuation floors: insured values and recent funding rounds (Section 50303(c)(10))

- Insurance. No asset's value may be determined to be less than the amount for which the asset is insured.
- A business entity's value may not be less than the valuation reflected in any funding round or other sale of equity occurring within two years of the valuation date, unless the taxpayer shows by clear and convincing evidence that such valuation would significantly overstate the entity's value.

11. Undervalued transfers after October 15, 2025 (Section 50303(c)(11))

To prevent tax-avoiding transfers to individuals or entities that would not be subject to Prop 40, property worth more than \$1 million transferred for less than fair market value is included in the net worth of the transferor, but only if the transfer was made after October 15, 2025. The exception for property transferred to a trust described above prevents duplicate inclusion of property already taken into account under Section 50303(c)(6)(A) or (B). A tax-exempt trust is not within this exception merely because tax-exempt trusts are referenced as an exception in paragraph (6)(B). In order to prevent double counting, property included in the transferor's net worth under this rule is not included in the transferee's net worth.

12. Dependent attribution (Section 50303(c)(12))

Assets of a person who can be claimed as a dependent are deemed assets of the taxpayer who can claim the dependent, to the extent the dependent's assets exceed \$50,000 in the aggregate.

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The following table illustrates the rules above regarding the assets that are subject to the Prop 40 tax, and those that are excluded.

Calculating Worldwide Net Worth	
<i>Included</i>	<i>Excluded</i>
All worldwide assets not excluded: cash, bank accounts, stocks, bonds, promissory notes, investments or equity in publicly traded or privately held companies or financial instruments, sole proprietorships, partnerships, contractual and noncontractual investments, indirect investments in real property through a business entity regardless of location, trust holdings, Roth IRAs over \$10 million in value, non-qualified deferred compensation that is vested as of year-end and payable in the future, and any other thing of value.	• Directly held real property (if held directly by a taxpayer or by a revocable trust), regardless of where located. • Tangible personal property held outside California for at least 270 days during 2026 (like a boat, art or jewelry), unless the property was relocated to avoid the tax • Tax-qualified retirement plans such as 401(k)s, 403(b)s, and traditional IRAs. • Foreign pensions, to the extent they are exempt from U.S. income tax under a tax treaty. • Roth IRAs and similar Roth-type retirement accounts, up to \$10 million in combined value (any amount above \$10 million counts as included wealth). • Non-qualified deferred compensation that is not yet vested as of year-end or that is actually paid before the end of the year. • \$5 million of harder to value assets (non-publicly traded financial instruments, intellectual property rights, private debts owed to the taxpayer, vehicles and other personal property). • Qualifying obligations of the United States to the extent required by federal law.

Chapter 3. Optional Deferral Accounts for Qualifying Liquidity-Constrained Taxpayers

Section 50304

Section 50304 establishes an Optional Deferral Account (“ODA”) mechanism that allows certain illiquid taxpayers to not have to immediately pay the wealth tax with respect to specified assets, instead paying a 5% tax on the value of withdrawals or effective withdrawals from the ODA at the times of such withdrawals.⁹ Section 50301 does not impose tax on ODA assets until the times set by, and in the amounts specified by, this Section 50304.

- ODA structure (subsections (a), (b), (d)). The Board shall develop an ODA contract and related forms. As part of the contract, the qualifying taxpayer must agree to (i) file annual informational returns and forms, (ii) reconcile and pay all tax liabilities arising from the ODA, and (iii) submit to personal jurisdiction in California for collection of tax, interest, and penalties associated with the ODA. The contract is binding on the taxpayer’s estate and assigns.
- Withdrawals: How an ODA is resolved (subsections (d), (e), (k), (l)). Whenever any ODA assets are sold or withdrawn in a manner that constitutes “material distribution transactions,” the taxpayer owes tax equal to five percent of the value of the amounts so withdrawn. A taxpayer may voluntarily close an ODA by treating all remaining attached assets as withdrawn and paying the resulting tax. If a taxpayer dies before the ODA is closed, the taxpayer’s estate and assigns must reconcile and close the ODA and pay the resulting tax liability.
- Who qualifies (subsections (a), (c)). An individual qualifies for an ODA if the tax due under Prop 40 exceeds the value of the individual’s publicly traded assets (including cash).

Example (qualifying taxpayer test). If an individual has \$2.0 billion of net worth (Prop 40 tax = \$100 million) and only \$40 million of publicly traded assets, the taxpayer is a qualifying taxpayer because \$100 million > \$40 million.¹⁰

- Effective withdrawals: Partial sales and “material distribution transactions” (subsections (e)-(i)). Withdrawals and certain other transactions may trigger tax under the ODA, such as the receipt of a dividend from an otherwise illiquid business. When a transaction constitutes a material distribution transaction, the taxpayer must pay tax equal to 5% of its fair market value. These “material distribution transactions” are defined to include withdrawals of money, property,

⁹ The ODA framework is based on the notional-interest approach developed in Brian Galle, David Gamage & Darien Shanske, Solving the Valuation Challenge: The ULTRA Method for Taxing Extreme Wealth, 72 Duke L.J. 1257 (2023), adapted here to the Act’s one-time wealth tax context.

¹⁰ The drafters intend the phrase “to the extent that” in Section 50304(c) to mean “if” and not as a limitation on the amount of funds an otherwise qualifying taxpayer may place in an ODA.

or other value from ODA-attached assets and certain related-party transactions that transfer asset value without transferring the ODA obligations. Ordinary and necessary transactions for maintaining or increasing the value of ODA-attached assets, that do not distribute profits/dividends or similar owner-level transfers, are not considered material distributions.

- Reporting and enforcement (subsections (d), (h), (j)). Taxpayers with an open ODA must make annual reports to the Board, whether or not the taxpayer is still a California resident. Among other details, the taxpayer must report their original and current ODA assets, any material distribution transactions during the year, and a running total of those transactions. A failure to file annual reports is a breach of the ODA contract.

Chapter 4. Certified Appraisals

Section 50305

Directs the Board to adopt regulations or publish guidance for certified appraisals and qualified appraisers, based on the federal qualified appraisal and qualified appraiser rules, already familiar to most professional appraisers, in Treasury Regulation Section 1.170A-17.

- Appraiser penalties. Authorizes the Board, in its discretion, to impose a penalty on an appraiser where an underpayment of tax is attributable to a substantial or gross overstatement or understatement of valuation in a certified appraisal. The penalty is capped at 2% of the tax understatement for a substantial misstatement and 4% for a gross misstatement, and is imposed as if the appraiser were the taxpayer for purposes of Prop 40's penalty provisions under Section 50312.

Prop 40 contains substantial penalties for gross understatements of tax liability because of the large information asymmetry between the taxpayer and Board, especially as to assets created by the taxpayer. As described more below, however, Section 50312 does not permit the Board to impose penalties in the case where a taxpayer has substantial authority for their position or where there is a reasonable basis for the taxpayer's position and the relevant facts related to the taxpayer's position are disclosed. Because of the cross-reference to Section 50312 in Section 50305, these protections also extend to appraisers. Accordingly, the drafters expect that appraisals based on recent arms' length transactions and in which all recent relevant such transactions are disclosed will not be at risk of understatement penalty except in exceptional circumstances.

Chapter 5. Apportionment and Credits

Section 50306: Reduction for New and Part-Year Residents

Prop 40 imposes a tax on taxpayers who were residents on January 1, 2026. In some cases, such as of an individual who arrived in California as a billionaire shortly before January 1, 2026, a tax on 100% of the individual's wealth may not fairly represent the

extent to which the taxpayer's excessive wealth was accumulated in, or substantially sustained by, California. This section permits taxpayers to petition the Board to reduce the portion of their wealth subject to tax, where the petitioning party proves by clear and convincing evidence that (A) their wealth did not substantially accumulate in California and (B) their wealth was not substantially sustained in California for at least 365 days in the aggregate during the 48-month period ending on the valuation date. The California apportionment percentage generally may not be reduced below 25%, unless a lower percentage is required by constitutional or other governing law.

Section 50307: Credits for taxes paid to other jurisdictions

Grants a credit against the tax imposed by this Act equal to the taxpayer's pro rata share of taxes paid to another state or jurisdiction with respect to net wealth that is also taxed under Prop 40. The pro rata share is determined based on days of residence in the other jurisdiction during the 2026 tax year (numerator = days resident in other jurisdiction; denominator = 365). In addition, and as a safety valve, subdivision (b) allows an additional credit to the extent required by the United States Constitution.

Chapter 6. General Provisions and Definitions

Section 50308: Definitions

Selected definitions include:

- Applicable individual; tax obligation date. Section 50301 taxes applicable individuals having net worth of \$1 billion or more. This section defines an "applicable individual" as a person who is a California resident (under longstanding rules applied for purposes of California's personal income tax) as of January 1, 2026. The use of an "as of" date for tax residency purposes is very common. *See District of Columbia v. Murphy*, 314 U.S. 441 (1941).¹¹
- Applicable trust; grantor trust; tax-exempt trust. Section 50301 taxes applicable trusts. This section defines an applicable trust as any trust or proportional subdivision of a trust that has received property from a California billionaire, or an entity related to that billionaire.¹² Charitable trusts (and other trusts exempt under Internal Revenue Code section 501) and grantor trusts are not applicable trusts, however. Grantor trust assets are instead taxed directly as net worth of the grantor under Section 50303. The definition of a grantor trust follows the income tax and estate tax definitions and generally means a trust whose assets are controlled or reclaimable by the person who funded the trust. A trust's tax-exempt

¹¹ For further discussion of some residency issues, see https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6987678.

¹² Courts generally presume that tax provisions do not apply to events prior to their effective date unless the statute clearly states as much. In contrast to the definition of "applicable individual," which specifies that residency is determined as of January 1, 2026, the definition of "applicable trust" does not define trust status on a date prior to the effective date of Prop 40. The drafters thus expect this determination would be made as of the valuation date, the same day other Prop 40 provisions are resolved.

status does not necessarily preclude it from also satisfying the Act's definition of a grantor trust, including because its assets would be included in the grantor's estate for federal transfer-tax purposes. Trusts may also elect to be treated as applicable trusts. The rules of Section 50303 exempt beneficiaries from tax on assets held by applicable trusts. This election therefore may be useful if the rules of Section 50303 would otherwise impose tax on the trusts' beneficiaries. Alternately, an individual may elect to treat a trust or proportional subdivision of a trust to which they have transferred assets as part of their own net worth. In that case, the applicable trust (or proportional subdivision) is exempt from separate tax on the assets taxed directly to the electing individual.

- **Net worth:** Worldwide assets and property interests taken into account for the taxpayer and spouse as of the valuation date, reduced by permitted debts and liabilities. A spouse's assets are included in the net worth of an applicable individual even if the spouse is not a California resident. Because net worth is determined as of December 31, 2026, property acquired in 2026 is included in net worth, while assets disposed of during 2026 are not, unless another section (such as the rules requiring gifted assets to be included in net worth or the rules regarding tax-avoiding transfers) requires otherwise.
- **Publicly traded asset:** Defined broadly to include assets traded on exchanges, on frequently updated secondary markets, or on platforms matching buyers and sellers, as well as other assets the Board determines have values that are readily ascertainable through similar means.
- **Valuation date.** Section 50301 imposes a 5% tax on the net worth of applicable individuals on the valuation date, which is here defined as December 31, 2026. To improve valuation accuracy, Prop 40 delays valuation until the end of the year.

Section 50309: Administration; regulations; forms; statute of limitations

Subdivision (a): Incorporation of existing administration provisions.

This subdivision states that the collection and administration of the tax imposed by Prop 40 is governed by existing state income tax administration law, unless expressly superseded.

Subdivision (b): Regulatory authority and expedited guidance.

This subdivision authorizes the Board to adopt regulations to implement, interpret, and carry out Prop 40, including regulations addressing abusive transactions.

This subdivision also extends the period for mailing notices of proposed deficiency assessment for the 2026 tax year to ten years after the return is filed.

Subdivision (c): Forms and reporting infrastructure.

This provision requires the Board to promulgate required forms within six months after passage, which would mean by May 2027, well before this tax is first due in October 2027. These forms need not be elaborate and may provide for taxpayer attachments demonstrating compliance.

Subdivision (d): Application of income tax administration rules.

This subdivision provides that, to the extent not inconsistent with Prop 40, the provisions for administration, assessment, collection, enforcement, and appeals of the personal income tax apply to the wealth tax.

Section 50310: Legislative authority to amend

Authorizes the Legislature, by two-thirds vote, to amend the statutory provisions of Prop 40, but only if those amendments are consistent with and further the purposes of the measure. The express central purpose of Prop 40 is to address an urgent and pressing fiscal emergency by “raising revenue from a *one-time* tax on *billionaire* wealth.” Section 3(a) (emphasis added). As a result, the drafters intend and expect that this provision cannot be used to make Prop 40 into a continuing tax or to extend its provisions to individuals who are not billionaires.

Authority to amend Prop 40 is included in order to allow the Legislature to make minor amendments to the law so as to advance sound tax policy. In particular, consistent with the purpose of Prop 40, the drafters understand that the measure might not have accounted for all possible scenarios. It is the drafters’ intent that all taxpayers be treated equally and fairly. California’s Constitution contains the unusual rule that the Legislature cannot amend a statute added by initiative unless that amendment is authorized in the initiative. *See* Cal. Const. Art. II, Sec. 10(c). Absent the authority provided in this Section, that Constitutional rule would prevent the Legislature from responding to unforeseen scenarios that would interfere with equal and fair treatment. It is common for statutory initiatives to permit the Legislature to amend them in limited circumstances; the courts have, appropriately, interpreted the range of such provisions narrowly. *See Shaw v. People ex rel. Chiang*, 175 Cal.App.4th 577 (2009).

In addition, Prop 40 does not amend the supermajority requirement for any increase in state taxation, Art. XIII A, Sec. 3(a). Nor does the Act impact any limitations on the taxation of real property in Prop 13; see Cal. Const. Art. XIII, Sec. 1(a).

Section 50311: Severability

This provision explicitly directs courts, should they find any portion of Prop 40 unconstitutional, to sever or reform the measure in a manner that preserves the imposition of the tax consistent with its purpose.

Section 50312: Enforcement and penalties

Subdivisions (a)–(d): Penalties for substantial/gross understatement.

To deter unlawful tax avoidance, the Act imposes a 20% penalty for a “substantial understatement” of tax and a 40% penalty for a “gross understatement.” A substantial understatement generally means the understatement exceeds the greater of \$1 million or 20% of the tax shown on a timely filed return; a gross understatement generally means the understatement exceeds the greater of \$10 million or 40% of the tax shown. California law (RTC § 19164) already follows federal law (IRC § 6662) in imposing similar substantial underpayment penalties in the personal income tax context and the drafters intend that these terms be interpreted consistently with their interpretation in those other contexts.

These penalties are in addition to other penalties.

Subdivisions (e)–(g): Limits and defenses.

The substantial and gross understatement penalties do not apply if the understatement is due to a qualifying change in law or the taxpayer’s reliance on a ruling from the chief counsel of the Board.

Subdivision (h): Reduction of penalties based on substantial authority or reasoned positions adequately disclosed.

Protects taxpayers from understatement penalties to the extent that an understatement is either 1) based on substantial authority or 2) based on positions that are reasonable *and* the position and relevant facts relating to it are adequately disclosed to the Board. As in subdivision (a), the text of this provision is drawn from existing federal law, *see* IRC § 6662(d), and the drafters intend for it to be interpreted consistently with interpretations of the source text.

Subdivision (i): Filing extensions and timing relief for 2026.

In general, California taxpayers file an income tax return on April 15 of the calendar year following the end of the filing year, but may request extensions. Some taxpayers must make estimated payments when requesting an extension and can face interest and penalties if they fail to do so. To account for the likelihood that taxpayers who owe tax under Prop 40 may need additional time to prepare their return for the 2026 tax year, and the Board may need additional time to provide forms for doing so, this subdivision grants taxpayers who may be affected by Prop 40 an additional six months to file their return. Taxpayers who take advantage of this extension are not subject to interest and penalties for any failure to make estimated payments in April of 2027.

Subdivision (j): Outside experts and counsel.

Authorizes the Board to hire and pay reasonable fees to outside experts or counsel as appropriate to administer and collect the tax. Administering the tax fairly and efficiently

might require outside expertise, especially at first. The drafters also note that it is common in valuation disputes for the public entity to find itself relatively under-resourced.

Subdivisions (k)–(m): Anti-avoidance; substance-over-form; use of income tax doctrines; no implied exemptions.

The economic substance and related doctrines already apply to California tax law. However for the removal of doubt, Prop 40 provides a general anti-avoidance rule allowing the Board to disallow or recharacterize a taxpayer’s position where transactions lack economic substance or are undertaken with a substantial purpose of obtaining an unintended tax benefit (subdivision (k)). The Board may also draw on similar principles already existing in California and federal tax law, such as the sham transaction doctrine and the step transaction doctrine (subdivisions (l), (m)). The authority granted to the Board under subdivision (k) may in some instances be more expansive than available under those familiar principles. For example, subdivision (k) authorizes the Board to set aside a transaction undertaken with a substantial tax-avoiding purpose, and is not limited to instances where tax avoidance was the sole or primary motivation for that transaction. These provisions give the Board flexibility to address avoidance strategies not specifically anticipated elsewhere in the Act, including transactions intended to shift wealth out of the tax base; to exchange taxable assets for assets exempt from taxation for a relatively short period around the valuation date; to recharacterize assets to seek more favorable valuation rules; to manufacture valuation discounts or liabilities; or to engage in debt-financed acquisitions of assets exempt from taxation where undertaken with an aim to reduce taxable net worth. A “transaction” may broadly include any step or series of steps undertaken by an individual or entity, including an individual’s actions to change their place of residence.¹³

Subdivision (n): Board authority to seek trial de novo.

Authorizes the Board to bring an action in superior court for a trial de novo if it disagrees with a decision of the Office of Tax Appeals. This provision is for the removal of doubt and does not indicate that the Board could not bring such an action under current law.

Section 50313: Construction

Directs that Prop 40 be liberally construed to effectuate its purposes.

¹³ Accordingly, the drafters expect that subsection (k) grants the Board authority to set aside standard residency rules if “a substantial purpose” of an individual’s absence from the state is to avoid tax. This authority is broader than under existing law. *Cf.* RTC § 17014(d)(4) (withholding application of a 546-day rule for residency where “*the principal purpose of the individual’s absence from the state is to avoid tax*”) (emphasis added). An absence during the period when a one-time tax is imposed, and extending through the period when residency status for that tax is being contested, is likely to constitute a substantial purpose to avoid tax.

Section 50314: Expedited review / validation action

Under current California law, there is an expedited method to establish the validity of certain actions (see Code of Civil Procedure § 860). In anticipation of certain purely legal challenges to this Act, and given the need for the revenues raised by Prop 40 to address emergency needs, the measure extends current validation law to include certain challenges made to Prop 40. Specifically, it requires a validation action challenging facial validity to be filed within 60 days after voter approval; if no action is filed, Prop 40 is deemed facially valid and no further facial challenges will be justiciable. This section further sets out guidance for the timing and venue for judicial consideration of any validation action in order that final resolution is arrived at as soon as practicable.

Section 7: Denial of deduction for net worth taxes

The tax imposed under Prop 40 is not deductible from the individual's income tax.

Section 8: Conflicts with other ballot measures

Provides that another measure appearing on the same ballot is deemed to conflict with Prop 40 if it levies a tax or affects tax rates on billionaire net worth, or provides for the use of funds from such a tax. If Prop 40 receives more affirmative votes than a conflicting measure, Prop 40 prevails and the conflicting provisions of the other measure are null and void. Of the other propositions on the November 2026 ballot, Propositions 41 and 42 are the only measures that may be in conflict with Prop 40. Each of those Propositions would arguably prohibit Prop 40 from taking effect, and if so would be in conflict with Prop 40 for purposes of Section 8. The drafters do not expect that this Section would apply to Proposition 3, because that Proposition does not tax net worth, make any rules with respect to the use of funds from a tax on net worth, or otherwise give rise to conflicts with Prop 40.

Section 9: Proponent standing and defense of Prop 40

Provides that the State, government agencies, officials, other government employers, the proponent, and (in the absence of a proponent) any citizen may defend the legality of Prop 40, including through the validation action mechanism or otherwise authorized procedures.