

## Proposition 26

**League Position: Oppose.** The League of California Cities is **OPPOSED** to Proposition 26, *Proposed Constitutional Amendment: State and Local Fees and Charges: Vote Requirements and Limitations*. This opposition position was taken following review by the League's Revenue and Taxation Committee and the League Board of Directors.

**Reasons for Opposition:** City officials are concerned about the many potential negative effects of this measure on local revenue raising authority.

**Text of Measure:** [http://ag.ca.gov/cms\\_attachments/initiatives/pdfs/i891\\_initiative\\_09-0093.pdf](http://ag.ca.gov/cms_attachments/initiatives/pdfs/i891_initiative_09-0093.pdf)

**Initiative Summary:** Restricts in various ways the ability of the state and local governments to adopt fees. More specifically, this initiative:

- 1) States via findings that: (A) Since the enactment of Proposition 13 in 1978, increases in state taxes require a two-thirds vote in each house of the Legislature; (B) Since the enactment of Proposition 218 in 1996, local tax increases must be approved by voters; (C) Despite these limitations rates for state income tax, sales and use tax, and state and local business taxes continue to escalate; (D) Recently, the Legislature added another \$12 billion in taxes; (E) This escalation in taxation does not account for the recent phenomenon whereby the Legislature and local governments have disguised new taxes as "fees" without having to abide by (Prop 13 and Prop. 218) voting requirements; (F) Fees that are couched as "regulatory" which exceed the reasonable costs of actual regulation, or are simply imposed to raise revenue for a new program and are not part of any licensing or permitting program, are actually taxes and should be subject to the limitations applicable to the imposition of taxes; and (G) the measure states that it defines a "tax" for state and local purposes so that neither the Legislature nor local governments can circumvent these restrictions by simply defining new or expanded taxes as "fees."
- 2) Changes applicable to the **STATE**:
  - Amends Section 3 of Article XIII A to delete language that requires a two-thirds vote of both houses of the Legislature for "*any change to state taxes enacted for the purpose of increasing revenues collected thereto, whether by increased rates or changes in computation*" and instead substitutes a new standard which requires a two-thirds vote of both houses of the Legislature for "**Any change in state statute which results in any taxpayer paying a higher tax.**" *This changed standard appears designed to eliminate recent legislative interpretations of the existing phrase "purpose of increasing revenues" that allow, via majority vote, one tax to be increased if another tax is lowered by an equivalent amount.*
  - Creates a definition of a "tax" to include any levy, charge or exaction of any kind imposed by the state except for:
    - a. A charge imposed for a specific benefit conferred or privilege granted directly to the payor that: (1) is not provided to those not charged, and (2) does not exceed

the reasonable costs to the state of conferring the benefit or granting the privilege.

- b. A charge imposed for a specific governmental service or product provided directly to the payor that: (1) is not provided to those not charged, and (2) does not exceed the reasonable costs to the state of providing the product or service.
  - c. A charge imposed for the reasonable regulatory costs to the state “*incident to*” issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof.
  - d. A charge imposed for entrance or use of state property, or its purchase rental or lease, except for Article XI, Section 15 (The Constitutional reference to Vehicle License Fees VLF). *While this reference to the VLF is awkwardly located in this measure, in a clause that otherwise relates to state property, it presumably reflects that VLF charges are already considered taxes at the state level).*
  - e. A fine, penalty, or other monetary charge imposed by the judicial branch or the State as the result of a violation of law.
- Applies the above changes to any state statute tax adopted after January 1, 2010. Declares any tax adopted prior to the effective date of the Act that is not in compliance with the above requirements and definitions is void 12 months after the effective date, unless the tax is reenacted by the Legislature and signed by the Governor in conformance with its provisions.

3) Changes applicable to **Local Governments:**

- Amends Section 1 of Article XIII C to add to definitions applicable to local taxation authority a definition of “tax” that is virtually identical to the definition applicable to the state outlined above (See Paragraph #2), with the following “additions” (added to the local definition) and “exceptions” (included in the state definition, but missing from the local definition):
  - a. Additions: There are two additional items-- that are only applicable to local governments -- that are added to the list of exceptions from the definition of “tax,” described in paragraph #2, they are: (1) a charge imposed as a condition of property development, and (2) assessments and property-related fees imposed in accordance with the provisions of Article XIII D, adopted by Proposition 218 in 1996.
  - b. Exceptions: While language used in the definition of “tax” applicable to state and local government is very similar, in several instances the wording in the local government section is slightly different. The reason to point this out is that these differences may lead to future different legal interpretations: (1) the term “*to the payor*” is dropped from the end of two provisions describing an exception to a tax applicable to (A) benefits conferred or a privilege granted, and (B) a specific governmental service or product provided; (2) the term “*for*” is used in the language related to licenses and permits applicable to local government, as opposed to the potentially broader “*incident to*” in language applicable to the state; and (3) the exception related to Vehicle License Fees included in the state definition is missing from the local definition. *This omission may or may not be designed to reflect that in some instances local governments have levied a local “fee” on VLF registrations, such as in San Mateo which imposes a local vehicle registration fee (a regulatory fee) for various congestion management relief and storm water cleanup programs. That said, other provisions of this measure may capture the San Mateo type “fee” as a “tax.”*

- 4) Changes applicable to both **State and Local Governments**:
  - Requires both the state and local governments to bear the burden of proof by a “preponderance of the evidence” that a levy, charge or exaction is: (1) not a tax; (2) that the amount is no more than necessary to cover reasonable costs of the governmental activity; and (3) that the manner in which those costs are allocated to a payor bear a fair and reasonable relationship to the payor’s burdens on, or benefits received from, the governmental activity. (*This is currently the standard recognized by the California Supreme Court.*)
- 5) Includes a “conflicting measures” provision stating that should another measure appear on the same ballot relating to the legislative or local votes required to enact taxes or fees that the provision of this measure shall prevail in its entirety should it receive a greater number of affirmative votes, and the conflicting measure be deemed null and void. The measure also contains a “severability clause” which permits any provisions that are not held to be invalid or unconstitutional to remain in effect.

**Background:**

This initiative is fueled, in part, by recent legislative budgetary battles where the business community has become concerned with proposals put forth by Legislative Democrats which include the following:

- A budget package sent to the Governor in December of 2008 which proposed to repeal all taxes on gasoline and replace it with an equivalent fee.
- A legal interpretation proffered by Legislative Democrats, and supported by Legislative Counsel, that the Prop 13 two-thirds legislative vote requirements do not apply to a measure which decreases a state tax then enacts a replacement tax by an equivalent amount because it is not a “*change to state taxes enacted for the purpose of increasing revenues.*” The recent “gas tax swap” is an example of this concept. Earlier versions of the gas tax swap, which were not adopted, also included a proposal to allow regions to levy their own “fees” on gas to pay for transit and other services.
- A concern that legislators are seeking to save General Fund dollars whenever possible by enacting new fees.

Other features of this initiative (*through the narrow and precise exceptions to the new definition of “tax”*) seek to address longstanding concerns in the business community with the decision in *Sinclair Paint v. State Board of Equalization (1997)*. In the *Sinclair Paint* case, the Court upheld a fee imposed exclusively on paint manufacturers that had used lead in the production of paint to mitigate health effects of lead on children. The fee supported a program that provided evaluation, screening, and medically necessary follow-up services for children who were potential victims of lead poisoning. In upholding the fee, the Court found that the fee was a mechanism to require manufacturers and other persons whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating the adverse health effects their products created in the community.<sup>[2]</sup>

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<sup>[2]</sup> The Court referred to the following valid regulatory fees: regulatory fee imposed on A.B.C. licensees to support pilot project to abate nuisances associated with sale of alcoholic beverages; landfill fee based on land use to reduce illegal waste disposal; waste disposal surcharge imposed on waste haulers; fee to support emissions-based formula for recovering direct and indirect costs of pollution emission permit programs.

Under current law, a “regulatory fee,” may not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and may not be levied for unrelated revenue purposes. To demonstrate that a regulatory fee is not a special tax, the government must prove (1) the estimated costs of the service or regulatory activity; and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on or benefits from the regulatory activity. Whether the fees collected exceed the cost of the regulatory program need not be proved on an individual basis. Rather, the agency is allowed to employ a flexible assessment of proportionality within a broad range of reasonableness in setting fees.

Recently another regulatory fee was upheld in a case called *California Building Industry Association v. San Joaquin Valley Air District* (2009) 178 Cal.App.4<sup>th</sup> 120. The CBIA challenged the District’s indirect source review (ISR) rules which are intended to encourage developers to reduce indirect pollution (mobile source emissions, caused by new development projects). Under the ISR, the developer can reduce emissions by incorporating pollution-reducing features in the project, or paying a fee to fund off-site projects that will reduce emissions, or a combination of the two. The Court upheld the ISR (fee) as a valid regulatory fee which may be charged to cover the reasonable cost of a service or program connected to a particular activity; which may not exceed the amount required to carry out the purposes and provisions of the regulation; and which bear a reasonable relationship to the fee payor’s burdens on or benefits from the regulatory system.

**Fiscal Impact:**

The analysis by the Legislative Analyst and Director of Finance finds “Potentially major decrease in state and local revenues and spending, depending upon future actions of the Legislature, local governing bodies, and local voters.”

**Existing League Policy:**

As an initial reference point, the League adopted an Oppose position to both Proposition 13 in 1978, and Proposition 218 in 1996, due to their significant limitations on local revenue raising authority. Based upon the stated findings, this initiative measure is designed to “*ensure the effectiveness of these constitutional limitations.*”

The League also opposed a similar measure, Proposition 37 of 2000. Prop. 37 required a two-thirds vote of State Legislature, or either majority or two-thirds of local electorate, to impose on any activity fees used to pay for monitoring, studying, or mitigating the environmental, societal or economic effects of that activity when the fees impose no regulatory obligation upon the payor. The measure also sought to redefine various fees as taxes, and contained exclusions for certain real property related fees, assessments and development fees, and damages, penalties, or expenses recoverable from a specific event. It also contained a provision that stated it did not apply to fees enacted before July 1, 1999, or increased fees due to inflation or greater workload, as specified. Prop. 37 failed with a narrow 48% Yes, and 52% “No” vote at the November, 2000, election.

While there are no adopted League policies that encompass all aspects of this measure, here are three related policy reference points:

- League’s 2010 Strategic Goals. One of the three strategic priorities adopted by the League Board and leadership for 2010 is to: “**Protect Local Control and Funding for Vital Local Services.** Use statewide ballot measure and legislative and legal advocacy to achieve reforms that protect local control and abolish the power of the state to borrow,

divert or impose restrictions on the use of all local revenue sources, including locally imposed or levied taxes, the local shares of all transportation tax revenues (including public transit funding), the redevelopment tax increment, and any other local revenue source used to fund vital local services.”

- The most applicable League’ Revenue and Taxation policy is under the subject of “Additional Revenue” and reads: "Additional revenue is required in the state/local revenue structure. There is not enough money generated by the current system or allocated to the local level by the current system to meet the requirements of a growing population and deteriorating services and facilities. (Note: the underlined wording above was added to League policy at the Committee’s previous meeting)
- League policy from the Housing, Community and Economic Development Committee reads: “The League supports providing local discretion in the assessment, collection and usage of development fees. The state should provide infrastructure funding to help local communities meet California’s growth demands and to increase housing affordability. The League opposes limiting the ability of cities to levy fees to provide for infrastructure or services.”

#### **Comments:**

1) **Sponsor’s Intent:** The “Stop Hidden Taxes” initiative is sponsored by the California Chamber of Commerce and California Taxpayers’ Association, with coalition of taxpayers, employers and small businesses. In their view, passing this measure would restrict what they describe as “loopholes in the law,” which allow taxes to be raised on products and services because they are called “fees.” Another objective of this coalition is to oppose initiative #09-0057, the “On Time Budget Act of 2010,” an initiative proposal which would allow legislative budgets to be adopted with a majority vote, and is a potential target of the “conflicting measures” clause included in this initiative.

2) **Definition of “Tax”:** The word “tax” is not now defined either in the Constitution or in the state statutes.<sup>[1]</sup> This initiative defines a tax to include “any levy, charge, or exaction of any kind” with certain enumerated exceptions. Included within the list of exceptions for local government are:

- User fees or charges for a specific government service or product.
- Charge for entrance to or use of government property (e.g. park).
- A fine, penalty or other charge imposed for violating the law.
- Charge imposed for a specific benefit conferred or privilege granted.
- Charge imposed for reasonable regulatory costs incident to issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders
- A charge imposed as a condition of property development.
- Assessments and property–related fees imposed in accordance with Proposition 218.

If this measure is approved by the voters, the true interpretation of how it will apply will likely take years of litigation. Local agencies will need to individually examine local fees charged to

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<sup>[1]</sup> The Courts have said that “tax” has “no fixed meaning;” that it is a legal issue for the courts to decide based upon an independent review of the facts. Government Code section 50076 defines what is not a tax (“a fee that exceeds the reasonable costs of providing a service”) but does not define what a tax is.

determine how the specific definitions used in this measure may affect an existing fee. As an example, the following are examples of fees that appear to be excluded from the list of exceptions and, therefore, would be “taxes” under the new definition:

- A fee imposed to mitigate the significant environmental impacts of a project.
- An assessment to abate a nuisance.
- A charge for a specific government service or product which is not paid by all persons receiving the service or product (e.g. could not give a senior or low-income exception).
- A charge imposed for a regulatory program designed to mitigate the social or economic burdens created by the operations of the fee payers. This means that, for example, the following two fees would be taxes: the ARB’s fee imposed on sources of greenhouse gas emissions to pay for implementation of the AB 32 program; and the proposed “transportation fee” that was originally included in the Democrats’ gas tax swap proposal.
- A charge imposed by Fish & Game to review Environmental Impact Reports.

**3) Burden of Proof:** Under existing law, the government has the burden of proving that a fee or charge is not a tax; that the amount is no more than is necessary to cover the reasonable costs of the governmental activity; and that the manner in which the costs are allocated to a payor are proportional to the payor’s burdens on, or benefits received from the governmental activity. The initiative incorporates this rule into the Constitution. City attorney’s report that there are three basic legal tests of the burden of proof: preponderance of evidence (lowest); clear and convincing evidence (mid-range); and beyond reasonable doubt (highest).

**4) Application to Existing Fees:** It is unclear how this measure will be construed to apply to existing fees that have been adopted by state or local governments. The section that applies to the state would void non conforming statutes enacted between January 1, 2010, and before the effective date of the Act. No specific date is mentioned for the provisions that apply to local government. Both state and local existing fees could become subject to challenge that they are “unconstitutional.”

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**NOTE:** The “Stop Hidden Taxes” coalition produced a list of the following (*verbatim*) examples of fees that presumably could be viewed as “taxes” if the measure passes. While this list does not represent a legal conclusion on any of these “fees,” it provides some context for the types of fees the sponsors desire to capture. Also, depending on the specific circumstances, changes could be made to narrow the scope, use or application of a fee to fit the exceptions provided in the measure.

### ***SPECIFIC INDUSTRY EXAMPLES***

#### ***Restaurants***

- *Fees on alcohol to litigate public nuisance associated with sale or consumption*
- *Fees on canned beverages to mitigate waste/recycling*
- *Fees on soda to mitigate obesity and other negative health effects*
- *Fees on unhealthy foods, fats, sugar to mitigate negative health effects*
- *Health inspection/monitoring fees*
- *Traffic impact fees*

- *Parking impact fees*
- *Air quality impact fees*
- *Water quality impact fees*
- *Fees on waste production*
- *Energy use surcharges and fees*
- *Fees on snack food*
- *Fees on food packaging for takeout orders*
- *Public safety cost mitigation fees*

#### **Public Utilities**

- *Trenching fees for diminution in durability or longevity of roads, traffic congestion mitigation, mitigate potential damage to existing infrastructure*
- *Alternative energy fees*
- *Fossil fuel consumption fees*
- *Eco-impairment fees for hydro-facilities*

#### **Alcohol**

- *Mitigation fees to address public nuisances associated with sale or consumption*
- *Mitigation fees to pay for health services provided by government (mental and physical) for alcoholics or those injured or otherwise affected by alcoholics*
- *Fees to fund public programs to prevent illegal consumption by minors or discourage abuse by adults through education, research into causes and possible cures for alcoholism*

#### **Oil**

- *Carbon consumption fees for pollution mitigation (injuries related to effects of pollution)*
- *Eco-Impairment fees (effects of drilling, storage, or consumption on habitat or parks and recreation areas)*
- *Carbon consumption fees to discourage consumption and encourage use of alternative fuel sources. Additionally, fuel consumption as a means for measuring "road damage fees"*
- *Oil severance fee to mitigate oil spill clean-up, and build larger response and enforcement capabilities*
- *Hazardous waste fees to support general hazardous waste/substances programs.*
- *An Air District might impose a refinery gate fee to mitigate harm from diesel exhaust emissions. A city or county might impose pipeline fee to enhance public safety to respond to pipeline accidents*
- *A state or local agency may impose gasoline fee at the pump for clean-up and mitigation of MTBE contamination at service stations or in lakes and groundwater.*
- *A local or regional agency might impose a gasoline fee at the pump for mass transit. (Note: fees could still be assessed if connected to a specific regulation, problem or liability identifiable to the fee payer.)*

#### **Tobacco**

- *Mitigation fees: Fees for mitigating the adverse health effects of tobacco products (including evaluation, screening, and necessary follow-up services who are deemed potential victims of tobacco related injuries)*
- *Deterrence fees: Fees to discourage consumption (by increasing cost of product) and/or to educate the general public on the consequences of tobacco consumption. Fees to prevent illegal consumption by minors*

### **Telecommunications**

- *Cellular: Fees to reduce the impacts of DWTs (Driving While Talking), burdens on the 911 system, potential future effects of close proximity radio frequency exposure*
- *Trenching fees for diminution in durability of roads, traffic congestion mitigation mitigate potential damage to existing infrastructure*

### **Technology Companies**

- *Fees to mitigate the Digital Divide*
- *Ergonomic and repetitive motion injury mitigation*
- *Site location fees for traffic mitigation and growth impacts*
- *Youth and video game violence prevention fee*
- *Hardware disposal fees*
- *Toxic/Waste fees*

### **Agriculture**

- *Chemical/gene/hormone and other "altered food" products fees (a perceived threat for "altered food" could result in fees being levied for research, screening, testing and treatment should adverse consequences materialize or simply as a means of discouraging their use out of perceived negative externalities)*
- *Spoiled/infected food mitigation fees*
- *Insecticide abatement fees*

### **Food (Retailers/Grocers/Malls)**

- *Traffic impact fees (malls and Big Box retailers)*
- *Public safety impact fees (added security necessary because of increase concentration of people)*

### **Fast Food**

- *Traffic impact fees (where traffic backs-up at the drive-through)*
- *Litter abatement fees*
- *Fees to fund education, outreach, screening and treatment for obesity (fast foods having high concentrations of fat) or similar programs to discover, measure and treat the adverse health consequences of high cholesterol or caffeine*

## **TAXES**

### **Entertainment**

- *Arenas/promoters/sports teams: Traffic impact fees. Public safety cost mitigation fees*
- *Television/movies: Location mitigation fees (relating to traffic impacts, clean-up, public safety and emergency services). Fees on television and movie programming to mitigate effects of violence on youth or similar anti-social consequences linked to programming*

### **Non-Indian Gaming**

- *Public safety mitigation fees (for expenses associated with a perceived increase in a criminal element associated with activity-including increase police presence, specialized investigation units)*
- *Fees to mitigate effects on compulsive gamblers or other associated addictive consequences including screening, education, and treatment*



### **Pharmaceuticals**

- *Mitigation for subsequently discovered health risks potentially associated with a particular drug product*
- *Fees to fund drug education*
- *Fees related to health research*
- *Fees to fund health treatment*
- *Emergency care fees*
- *Fees covering the cost of the uninsured or underinsured*
- *Pharmaceutical cost fees to cover the poor and/or elderly*
- *Fees related to covering immunizations for children*

### **Railroads**

*Generally protected by the federal "4-R Act" enacted by Congress to protect railroads from discriminatory local taxes. However, the 4-R Act applies to "taxes" and not fees or assessments. So long as the exaction does not contribute to the general fund of the government, it may not be considered a "tax" under the 4-R Act. See *Wheeling & Lake Erie Railway Co. v. Public Utility Commission, et. al.*, Nos. 96-3703, 3704 (1998)*

- *Consequently, fees to mitigate railroad-crossing accidents are potential*
- *Eco-impairment fees for effects of train traffic on ecosystems or potential effects of rail accidents*
- *Pollution abatement fees (whether for emissions or sound)*
- *Carbon consumption fees*

### **Airlines**

- *Pollution abatement fees*
- *Noise abatement fees (also affected by any carbon consumption fees)*
- *Crash mitigation fees (reimbursing local governments for costs of search and rescue, recovery or salvage and investigation)*
- *Runway maintenance fees*
- *Ground traffic congestion/mitigation fees*

### **Truckers**

- *Road damage fees to mitigate damage to streets and highways caused by heavy truck traffic/spills*
- *Fees to mitigate the adverse effects of long haul trucking and or fund programs to research evaluate and reduce potential of trucking accidents. Fees to mitigate health costs related to injuries of truck drivers or increased risk of traffic fatalities due to size of trucks used (SUV plus mitigation fee). Could be affected by carbon fuel consumption fees or pollution mitigation fees*

### **Auto Manufacturing**

- *Carbon fuel consumption fees. Road damage fees based on size of vehicle*
- *Accident fees (for costs of responding to and treating victims) based on size/safety rating of vehicle.*
- *A deterrence fee based on fuel efficiency to fund mass transit*
- *Tire disposal fees to mitigate costs and hazards of tire disposal*
- *Off-road mitigation fee on 4-wheel drive and all-terrain vehicles to offset eco-damage of off-*

*road automobile use*

***Chemicals***

- *Most closely related to Sinclair paint circumstance where a product is deemed hazardous, its use discontinued, and then after the fact businesses are pursued for mitigation fees*
- *Mitigation fees to offset adverse health effects of a chemical or chemical by-product*
- *Accident/hazard mitigation fees (educating public on proper usage, storage and disposal of household chemicals; offset health costs in responding to accidents relating to household chemical accidents)*

***General Business***

- *Fees on businesses to fund indoor air quality maintenance and investigation programs*
- *Hazardous waste fees to support general hazardous waste/substances programs*

***Insurance***

- *Fees on property casualty insurers for firefighting, earthquake and flood mitigation/preparation, uninsured drivers and auto case court costs, among many others*
- *Fees on health insurers for such things as premium assistance for lower income consumers and those who lack coverage, cover costs of certain medical procedures and tests and fees for consumer protection/intervention services against insurers”*

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