

## Proposition 26: Stop Hidden Taxes Brief Summary

SDCTA remains **neutral** on Proposition 26. SDCTA recognizes that Proposition 26 could help prevent the passage of taxes disguised as fees. However, the Association is neutral on this measure due to its ambiguity, the potential for litigation should the measure pass, and the unintended consequences that may arise following implementation of the law.

- California Propositions 13 (1978) and 218 (1996) have placed increased restrictions on the establishment and expansion of tax revenues for the State and local governments. In response, the State and local governments have increased revenues through fees which generally have less stringent requirements for establishment than taxes. However, varied interpretations of the term fee have created disagreement about the need for some “fees” to meet Prop 13 and 218 requirements.
- The California Supreme Court’s ruling on *Sinclair Paint Company v. State Board of Equalization* provided the State and local governments’ legal authority to use fees as mitigation mechanisms. The State and local governments currently charge several mitigation fees to producers and users of products which they believe impose environmental, social, or economic harm. Examples include the Environmental Fee, Hazardous Spill Prevention Fee, Alcohol Mitigation Fee, and Covered Electronic Waste Recycling Fee. Prop 26 provides specific conditions under *which a levy must be classified as a tax*. Prop 26 also amends the provisions of Prop 13 to require a 2/3 vote of each house of the State Legislature prior to a change in law that results in increased tax liability for **any** taxpayer. The provisions of Prop 26 would be retroactive to any revenue changes made after January 1, 2010.
- Prop 26 would require increased restrictions for the passage of new mitigation fees at the State and local levels. Prop 26 would also require increased restrictions for the passage of discriminatory fees (those charged to some users but not all), repeal the “gas tax swap” pending a revote, and may increase current requirements for increasing revenues in Business Improvement Districts (BIDs).
- The LAO estimates that Prop 26 would result in a “potentially major decrease in state and local government revenue and spending.”
- Proponents are organized into a group called the Stop Hidden Taxes Coalition led by the California Chamber of Commerce and California Taxpayers Association. Opponents include the Sierra Club of California and the California Tax Reform Association.

**Prop 26 - Stop Hidden Taxes**

October 2010

**Board Recommendation:**

**NEUTRAL**

**Rationale:**

SDCTA remains **neutral** on Proposition 26. SDCTA recognizes that Proposition 26 could help prevent the passage of taxes disguised as fees. However, the Association is neutral on this measure due to its ambiguity, the potential for litigation should the measure pass, and the unintended consequences that may arise following implementation of the law.

**Title:** “*Stop Hidden Taxes*”

**Election:** November 2010 General Election

**Description:** Provides a more clear definition of the word tax, as it pertains to levies collected by state and local governments.

**Jurisdiction:** State

**Type:** Constitutional Amendment

**Vote:** Simple Majority

**Fiscal Impact:** Potentially major decrease in state and local government revenue and spending.

**Background:**

California voters have a history of supporting measures that increase the requirements necessary for state and local governments to increase taxes. Two notable propositions, Prop 13 (1978) and Prop 218 (1996), require two-thirds approval of both houses of the legislature to pass tax increases and require voter approval prior to imposition of tax increases by local governments.

***Propositions 13 and 218***

Prop 13, the “Peoples’ Initiative to Limit Property Taxation”, is a voter generated, Constitutional Amendment that limits the ability of state and local governments to increase tax revenues by (1) limiting the amount of property tax revenue that can be collected by local governments, (2) requiring two-thirds majority voter approval for new special taxes<sup>1</sup> levied by local governments and (3) requiring all increases in state taxes to be approved by two-thirds majority in both houses of the State Legislature. Prop 13 was approved by 65% of voters.

Prop 218, the “Right to Vote on Taxes Act”, focused on controlling other tools of local government revenue generation that had not been restricted by Prop 13. Among other provisions, the proposition requires simple majority voter approval prior to the imposition of general taxes<sup>2</sup>.

SDCTA opposed Prop 13 and supported Prop 218. SDCTA’s rationale for supporting Prop 218 was, “Taxes should not be raised without voter approval and limits should be put on the ways that government can raise revenue.”

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<sup>1</sup> A charge levied by a government in which revenues are used for a specific purpose.

<sup>2</sup> A charge levied by a government in which revenues can be used for any government purpose

For further discussion of Props 13 and 218 see SDCTA's analysis of these propositions, which can be found at [www.sdcta.org](http://www.sdcta.org).

### ***Taxes vs. Fees***

With specific legal restrictions placed on the creation of new taxes by Props 13 and 218, the state and local governments have turned to fees and surcharges as a means of meeting revenue demands. In most instances, governments face comparatively fewer restrictions to implement a new fee or surcharge. The California Government Code defines a fee as a charge that "should not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes." In general, taxes are levied with the primary purpose of creating revenue, while fees are levied with the primary purpose of recovering specific expenses.

The California Supreme Court's ruling in *Sinclair Paint Company v. State Board of Equalization* expanded the definition of fee by finding that state and local governments could use fees to mitigate the adverse impacts of business activity. In 1991, the California Legislature enacted the Childhood Lead Poisoning Act, which provides for monitoring and screening of children believed to be at risk for lead poisoning. The Act is paid for by a fee assessed on manufacturers believed to have contributed to environmental lead contamination. The Sinclair Paint Company filed a lawsuit against the State Board of Equalization, arguing that the fee was established for the purpose of covering the general operational costs of a government program, and therefore was actually a tax. In *Sinclair Paint Company v. State Board of Equalization* the California Supreme Court upheld the State's authority to impose the levy as a regulatory fee, stating "From the viewpoint of general police power authority, we see no reason why statutes or ordinances calling on polluters or producers of contaminating products to help in mitigation or cleanup efforts should be deemed less "regulatory" in nature than the initial permit or licensing programs that allowed them to operate. Moreover, imposition of "mitigating effects" fees in a substantial amount (Sinclair allegedly paid \$97,825.26 in 1991) also "regulates" future conduct by deterring further manufacture, distribution, or sale of dangerous products, and by stimulating research and development efforts to produce safer or alternative products."

Varied interpretations of the term fee have resulted in controversial labeling of several sources of state and local government revenues. Some examples of controversial fees include environmental fees, alcohol and tobacco mitigation fees, and insurance surcharges. The State has established a variety of fees for the purpose of funding environmental protection programs. Examples of these fees include: Environmental Fee, Covered Electronic Waste Recycling Fee, Oil Spill Response, Prevention, and Administration Fee, and Hazardous Spill Prevention Fee. Assembly Bill 1694, which was introduced to the Assembly Health Committee in March, 2010 but failed to collect enough votes, would have established the Alcohol Related Services Program to be funded by an associated alcohol mitigation fee. The funds would have been used to mitigate costs incurred by various State programs related to alcohol.

Fees levied by local governments have been more clearly defined and restricted by Props 13 and 218 than fees levied by the state. For this reason, fewer examples of controversial fees exist at the local government level. However, some examples of controversial local government fees do exist. Several local governments, such as County of Alameda<sup>3</sup> and City-County of San Francisco<sup>4</sup>, charge mitigation fees to entities who sell alcohol. The fees are used to fund the regulation of alcohol sales, inspections, training of beverage servers, and public education and outreach programs intended to alleviate the adverse effects of alcohol consumption.

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<sup>3</sup> County of Alameda, General Municipal Code 6.104

<sup>4</sup> City-County of San Francisco, Administrative Code 26.26

### **Prop 37**

In 2000, Prop 37, a voter generated Constitutional Amendment, sought to place increased restrictions on the creation of fees by requiring 2/3 approval of the Legislature prior to the establishment of a fee used to pay for monitoring, studying, or mitigating the environmental, societal or economic effects of the operations of various industries. The measure failed to pass, receiving 47.9% of the vote. SDCTA opposed the measure; however, the stated rationale was that it contained loopholes which could potentially lead to more requirements for businesses.

### **Proposal:**

The “Stop Hidden Taxes” measure is a voter generated Constitutional Amendment that would amend Section 3, Article 13A and Section 1, Article 13C of the California Constitution to provide a clear definition of the term tax, and redefine the phrase “increasing revenues”.

Section 3, Article 13A would be amended with the following definition of tax as levied by the State:

“(b) As used in this section, “tax” means any levy, charge, or exaction of any kind imposed by the State, except the following:

- (1) A charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the State of conferring the benefit or granting the privilege to the payor.
- (2) A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the State of providing the service or product to the payor.
- (3) 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.
- (4) A charge imposed for entrance to or use of state property, or the purchase, rental, or lease of state property, except charges governed by Section 15 of Article XI.
- (5) A fine, penalty, or other monetary charge imposed by the judicial branch of government of the State, as a result of a violation of law.”

Additionally, the Prop 13 clause requiring “any change in state taxes enacted for the purpose of increasing revenues collected” to be approved by 2/3 vote of each house of the State Legislature, would be amended to require 2/3 approval of “any change in state statute which results in any taxpayer paying a higher tax.”

Section 1, Article 13C would be amended with a similar definition of tax as levied by local governments, with the following additional provisions:

- “(6) A charge imposed as a condition of property development.
- (7) Assessments and property-related fees imposed in accordance with the provisions of Article XIII D.”

Any taxes established after January 1, 2010 that did not conform to the restrictions of this measure would be nullified upon the measure’s passage.

## **Policy Implications:**

### ***Revenue Neutrality***

Under the current Constitutional provisions (as established by Prop 13) changes in state tax code that result in increased total revenue are subject to 2/3 approval of both houses of the Legislature. Some changes in tax code result in an increased tax burden for some taxpayers which is offset by a decreased tax burden for other taxpayers, resulting in revenue neutrality. Such a change would not be subject to 2/3 approval of both houses of the Legislature under current law.

This measure would change this provision to require any change in the tax code that results in any taxpayer paying higher taxes be subject to 2/3 approval of both houses of the Legislature, even if the change is revenue neutral. A recent major revenue neutral change to California's tax code was known as the "gas tax swap". The gas tax swap simultaneously reduced the State's sales tax rate on motor vehicle fuels while increasing its excise tax rate on motor vehicle fuels. While this measure is projected to be revenue neutral, it provided an addition \$1 billion in revenue for the State's General Fund, as motor vehicle sales taxes are restricted to specific transportation uses while motor vehicle excise taxes are not. The gas tax swap was approved by only a simple majority of both houses of the State Legislature and would therefore become nullified under this measure unless the bill was reapproved by 2/3 majority.

### ***New Fee Restrictions***

Many new types of fees and charges would become subject to the provisions of Props 13 and 218 as a result of this initiative. This would require that a broad range of potential fees levied by the state and local governments be subject to increased approval restrictions. As a result, the ability of the state and local governments to generate revenues through these mechanisms could be restricted. The Legislative Analyst's Office (LAO) suggests that the measure will result in a "potentially major decrease in state and local government revenue and spending". Three specific types of charges affected by this measure of particular interest are discriminatory fees; regulatory and mitigation fees; and business improvement district assessments.

A discriminatory fee is a charge levied to some users of government services but not to others. An example of a discriminatory fee is an emergency response fee which is charged to non-residents, but not residents, such as in National City and Oceanside. The measure states that a levy is not a tax provided that it is charged for the provision of a benefit or service "that is not provided to those not charged". Therefore, under this measure discriminatory fees would be considered taxes and subject to increase approval restrictions. For example, emergency response fees that are charged only to non-residents would be subject to voter approval, while emergency response fees charged to all users would not. If this measure were to pass, it could potentially nullify the emergency response fees, as currently constructed, in National City and Oceanside.

The state and local governments commonly use fees as a regulatory mechanism for purpose of discouraging the present and future creation or sales of hazardous and harmful products. This measure would define regulatory and mitigation fees as taxes and require addition approval restrictions prior to their establishment. These additional restrictions could potentially limit the ability of the state and local governments to uses fees as a regulatory mechanism in the future.

Several municipalities in California have established Business Improvement Districts (BIDs) which allow business owners in a particular geographic region to self-assess a levy for the purpose of promoting business in that particular region. Levies assessed by BIDs are not defined as taxes and therefore are not subject to 2/3 majority



approval requirements associated with special taxes under Prop 13. In their analysis of the measure, the LAO suggested that, pending future legal interpretation, BID assessments could be classified as taxes and therefore subject to increased approval standards.

### ***Development Impact Fees***

Local governments commonly charge various types of development impact fees, which are charges imposed as a condition of property development. These fees are intended to mitigate the adverse effects that can be attributed to increased development such as increased traffic congestion, increased burden on local services, or decreased air and water quality. Although these fees are similar in intent and purpose to other mitigation fees, such as alcohol or hazardous material mitigation fees, they are not provided equal treatment by this measure. The measure explicitly exempts “a charge imposed as a condition of property development” from being classified as a tax. Therefore, development impact fees would not be subject to the increased restrictions provided by Props 13 and 218, whereas the other types of mitigation fees discussed would be subject to increased restrictions.

### **Proponents:**

The primary sponsor of the “Stop Hidden Taxes” measure is the Stop Hidden Taxes Coalition, a group led by the California Chamber of Commerce and California Taxpayers Association. Other members of the Coalition include Americans for Tax Reform, California Beer and Beverage Distributors, California Business Alliance, Howard Jarvis Taxpayers Association, and the Wine Institute, among others.

The Coalition argues that state and local governments have avoided the restrictions of Prop 13 by labeling taxes as fees or surcharges, allowing them to raise revenues without going through the procedures mandated by voters.

### **Opponents:**

Opponents of the measure include the Sierra Club of California and the California Tax Reform Association. Opponents argue that the measure would make it prohibitively difficult for state and local governments to use fees to regulate the production and distribution of products that are hazardous to the environment. They argue this would allow businesses and manufacturers to pollute without paying their share of the mitigation costs.