



PROPOSITION 26: SHOULD THE STATE AND LOCAL GOVERNMENTS BE REQUIRED TO MEET HIGHER VOTING THRESHOLDS TO RAISE REVENUES?

Proposition 26, which will appear on the November 2, 2010 ballot, would amend the state's Constitution to require a two-thirds vote of the Legislature to enact or increase many types of fees that can currently be approved by a majority vote.

Proposition 26 would also require two-thirds of the state Legislature to approve any measure that would increase taxes for any single taxpayer in California, even if that measure does not result in an overall increase in state tax revenues. This *Budget Brief* provides an overview of Proposition 26 and the policy issues it raises.

What Would Proposition 26 Do?

Proposition 26 would amend the state's Constitution to reclassify certain fees as taxes, thereby requiring two-thirds, rather than a majority, of the Legislature to impose or increase these charges. At the local level, a vote of the people, rather than a majority of the local governing body, would be required to enact or increase certain charges. Specifically, Proposition 26 defines "tax" as "any levy, charge, or exaction of any kind imposed by" the state or a local government *except*:

- Charges where the fee-payer receives a service, product, benefit, or privilege that non-payers do not receive. The amount of the fee may not exceed the "reasonable costs" to the state or local governments of providing the service, product, benefit, or privilege.
- Charges imposed for entrance, use, purchase, or lease of state or local government property.
- Penalties, fines, or other monetary charges resulting from a violation of the law and imposed by the courts, the state, or a local government.
- Charges imposed for "reasonable regulatory costs" related to issuing a license or permit; performing investigations, inspections, and audits; and related enforcement activities.

- Charges imposed by local governments as a condition of property development, so-called developer fees.
- Assessments and property-related fees as defined in the state's Constitution.¹

Taxpayers challenging a charge would no longer bear the burden of proving whether a new or increased charge is invalid. Instead, the burden of defending the charge would fall to the state or local government proposing the charge. The public body would be required to prove that the amounts levied are no more than necessary to cover the reasonable costs of the governmental activity, and are related to the payer's "burdens on, or benefits received from" the governmental activity.

Proposition 26 would also require two-thirds of the Legislature to approve "any change in state statute which results in any taxpayer paying a higher tax." If enacted, this change could represent a significant shift from current law, which states that "any changes in state taxes enacted for the purpose of increasing revenues" must be approved by a two-thirds vote of the Legislature.² Current language has been interpreted to allow a measure that includes some provisions that increase revenues, and others that decrease revenues, to be adopted by a majority vote of the Legislature if the overall measure does not increase the amount of taxes owed.³

If approved, Proposition 26 would apply retroactively to any measures passed on or after January 1, 2010.

What Policy Issues Are Raised by Proposition 26?

By reclassifying certain fees as taxes, Proposition 26 would limit the ability of the state and local governments to impose or increase fees, and consequently limit the options available to governments to respond to budget shortfalls. Proposition 26 would also limit state and local governments' ability to shift the cost of programs and services from taxpayers as a whole, to specific individuals, businesses, or industries that are responsible for the cost of public services.

What Is a Tax? What Is a Fee? Why Does It Matter?

In California, "tax" has never been precisely defined, and instead the distinctions between taxes and fees have evolved through a series of initiatives and subsequent court decisions. Prior to Proposition 13 of 1978, the distinction was essentially meaningless since both taxes and fees could be imposed or increased by a majority vote of the Legislature. Since 1978, however, limitations on the authority of the state and local governments to impose taxes have increased the importance of differentiating fees from taxes (Table 1). Proposition 13 imposed

a two-thirds majority approval requirement for measures that increase state tax revenues. In contrast, the state can impose or enact fees by a majority vote of the Legislature. At the local level, Proposition 218 of 1996 required local general purpose taxes to be approved by a majority of voters and special taxes to be approved by two-thirds of voters. Meanwhile, local fees may be imposed by the governing body of a jurisdiction – such as a city council or board of supervisors – without a vote of the people (Table 2).

The courts have recognized that the difference between a "fee" and "tax" is frequently "blurred."⁴ In general, however, taxes support the general operations of government, while fees are related to a particular use or benefit. Taxpayers pay into a system that funds a variety of public services, such as schools, prisons, and health inspectors. The broad benefits funded by taxes need not bear direct relation to any individual taxpayer's relative benefit from tax-supported services. In contrast, fees are paid in return for a specific service provided, benefit conferred, privilege granted, or regulatory activity required.⁵ In other words, an individual can opt out of paying a fee by not engaging in an activity or accessing certain services or benefits, such as visiting state parks.

In general, fees are charges imposed to recover the cost of providing a service to the fee payer. The charges "reasonably" reflect the value of the government's cost to administer the program and the benefits the feepayer receives in exchange. In

Table 1: Tax and Fee Vote Requirements and the Initiative Process

Proposition 13 (June 1978)	<ul style="list-style-type: none"> Limited property tax rates to 1 percent, except for rates for voter-approved debt. Allowed reassessment of property to market value only upon change of ownership. Transferred responsibility for allocating property tax revenues to the Legislature. Required two-thirds voter approval for cities, counties, and special districts to impose "special" taxes. Required measures changing state taxes "for the purpose of increasing revenues" to be approved by a two-thirds vote of each house of the Legislature.
Proposition 62 (November 1986)	<ul style="list-style-type: none"> Required approval of new local general purpose taxes by a two-thirds vote of the governing body of a local agency and a majority of the voters. Largely invalidated by the courts.
Proposition 218 (November 1996)	<ul style="list-style-type: none"> Required new, extended, or increased general purpose local taxes, including those taxes in charter cities, to be approved by a majority of voters. Prohibited special districts, including school districts, from imposing general purpose taxes. Clarified that special taxes are taxes designated for specific purposes. Restricted the use of property-related fees by local government and imposed new notice and protest provisions. Allowed voters to repeal any existing local tax, fee, or assessment by a majority vote.

Table 2: Current Tax and Fee Vote Requirements

	Taxes	Fees
State	Two-thirds approval of the Legislature to enact any change in state taxes for the purpose of increasing revenues.	Majority of the Legislature to increase fees.
Local	Majority of the voters for general purpose taxes and two-thirds of the voters for "special" taxes designated for specific purposes.	In general, a majority of the governing body of the jurisdiction. Special provisions apply to property-related fees.

What Is the Sinclair Decision?

In 1997, the California Supreme Court unanimously upheld the constitutionality of a fee imposed on manufacturers of lead-containing gasoline and paint products by the Childhood Lead Poisoning Prevention Act of 1991 in Sinclair Paint Company v. State Board of Equalization. The Sinclair case challenged the imposition of a fee levied to provide a dedicated funding source for a lead poisoning prevention and treatment program administered by the Department of Health Services. Services supported by this fee include 1) evaluating, screening, and providing case management services for children at risk of lead poisoning; 2) identifying sources of contamination responsible for lead poisoning; 3) providing services to children affected by lead poisoning; and 4) providing education on the detection and treatment of lead poisoning to state health care providers. The Department of Health Services initially calculated the amount of fees owed by individual firms on the basis of 1991 market share. Firms that were able to show that they did not contribute to environmental lead contamination were exempt from the fee. The bill imposing the fee and creating the treatment and prevention program was passed by a majority, but not two-thirds, of the Legislature and signed into law by Governor Pete Wilson.

The Sinclair Paint Company filed suit alleging that the fee imposed was actually a tax and thus was unconstitutional since it failed to receive the two-thirds vote of the Legislature needed to pass a bill raising state taxes. The plaintiff argued that the lead prevention fee should be considered a tax since it supported a program that did not provide a special benefit to paint producers or compensate the government for special privileges granted to paint manufacturers. The plaintiffs also disputed the state's authority to impose an industry-wide fee to compensate for adverse consequences generated by an industry's products and, in particular, a fee imposed to provide compensation for an industry's *past* activities.

The plaintiffs did not contend that the amount raised by the fees exceeded the cost of providing lead prevention and treatment services or that there was no connection between lead paint and childhood lead poisoning.

What Did the Court Say?

In a 7-0 decision, the Court ruled that lead paint fees should properly be considered a regulatory fee, rather than a tax, and thus could lawfully be enacted by majority vote of the Legislature. The Court cited a previous decision suggesting that expanded use of regulatory fees was a logical outcome of Proposition 13:

“Proposition 13’s goal of providing effective property tax relief is not subverted by the increase in fees or the emissions-based apportionment formula. A reasonable way to achieve Proposition 13’s goal of tax relief is to shift the costs of controlling stationary sources of pollution from the tax-paying public to the pollution-causing industries themselves.”⁶

The Court further stated that, “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. . . . Sinclair disputes the state’s authority to impose industry-wide ‘remediation fees’ to compensate for the adverse societal effects generated by an industry’s products. To the contrary, the case law previously cited or discussed clearly indicates that the police power is broad enough to include mandatory remedial measures to mitigate the past, present, or future adverse impact of the fee payer’s operations, at least where, as here, the measure requires a causal connection or nexus between the product and its adverse effects.”

What Are the Implications of the Decision?

The Sinclair decision ratified the use of fees approved by a majority of the Legislature to address health or other social problems created by the use or production of a particular product. In order to pass judicial scrutiny, the Court suggests that: 1) a fee must not exceed the cost of providing services related to the remediation of the problem created by a particular product; and 2) a reasonable connection must exist between the social problems remedied by a fee and the payer of the fee.

The Sinclair decision most directly addresses fees imposed to clean up environmental pollution and treat health conditions associated with exposure to or the use of a particular product. Decisions cited by the Court in the Sinclair decision include cases

upholding regulatory fee charges to alcoholic beverage sale licensees to support addressing public nuisances associated with those sales; landfill assessments based on land use to reduce illegal waste disposal; fees for inspecting and inventorying on-premises advertising; and emissions-based fees for recovering direct and indirect costs of pollution emission permit programs. The Sinclair decision does not affect property-related fees, which are subject to the limitations imposed by Proposition 218 of 1996.

Sinclair Paint Company v. State Board of Equalization, the state Supreme Court affirmed the additional regulatory function that fees fulfill. Specifically, the Court recognized that regulatory fees “requir[e] manufacturers and other persons . . . to bear a fair share of the cost of mitigating the adverse . . . effects their products creat[e] in the community.”⁷ In fact, the Court pointed to the direct regulatory effect such fees had in regulating “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.”⁸

Who Should Pay for Adverse Health, Environmental, or Social Effects Resulting From Certain Products or Activities?

Proposition 26 would reverse a key component of the Sinclair decision, which concluded that the state’s power to regulate and police industries also includes the authority to impose fees on industries whose activities result in health, environmental, or social burdens on society. Specifically, Sinclair ratified that such fees were legitimate as long as a “causal connection or nexus between the product and its adverse effects” exists, and therefore could be approved by a majority vote of the Legislature.⁹

Proposition 26 would not change the vote requirement for “reasonable regulatory costs to the State incident to issuing licenses and permits, performing investigations, inspections and audits” and various enforcement functions. Specifically, fees that can be directly linked to and benefit the feepayer could still be enacted or increased by majority vote. However, regulatory fees that “exceed the reasonable costs of actual regulation” and “are not part of any licensing or permitting program” would be considered a tax. In other words, “fees [that] . . . defray the actual or anticipated adverse effects of various business operations” would require a two-thirds vote of the Legislature if Proposition 26 is approved by the voters.¹⁰

By increasing the vote requirement for regulatory fees, Proposition 26 would make it more difficult to impose or increase such fees. Consequently, if approved, Proposition 26 would limit the Legislature’s ability to shift the cost of programs that address the adverse impacts caused by the activities of certain industries, firms, or individuals to those entities. Regulatory fees that already exist in state statute – such as fees used to mitigate the impact of certain industries – would

continue. However increasing those fees or imposing new fees would be subject to the higher approval threshold (Table 3).¹¹

Proposition 26 Requires Two-Thirds Approval for Measures Increasing Taxes for Any Taxpayer

Proposition 26 significantly broadens the circumstances under which a two-thirds vote of the Legislature would be required. As written, Proposition 26 requires a two-thirds vote for “any change in state statute which results in any taxpayer paying a higher tax.”¹² This represents a significant departure from current law, which says “any changes in state taxes enacted for the purpose of increasing revenues” must be approved by a two-thirds vote of each house of the Legislature.¹³

In a recent example, the Legislature approved a complex “fuel tax swap” in March 2010. As part of the fuel tax swap, the Legislature increased two fuel tax rates and reduced two others by majority vote of each house. Taken together, these changes did not increase state tax revenues.¹⁴ Specifically, the Legislature increased the excise tax on gasoline from \$0.180 per gallon to \$0.353 per gallon and exempted gasoline from the state sales tax effective July 1, 2010. At the same time, the Legislature reduced the excise tax on diesel fuel from \$0.180 per gallon to \$0.136 per gallon and increased the state sales tax on diesel fuel by 1.75 percentage points effective July 1, 2011. Consumers, therefore, will pay more of one tax, and less (or none) of another – a change

Table 3: Examples of Fees That Could Be Considered Taxes and Shifted From Certain Fee Payers to All Taxpayers Under Proposition 26
Oil severance fees to mitigate oil spill clean-up and support response and enforcement capabilities.
Fees to mitigate public nuisance associated with sale or consumption of alcoholic beverages.
“Trenching” fees charged to public utilities to mitigate potential damage caused by trenching, including the diminished durability of roads.
Traffic impact and public safety impact fees to mitigate the effects of popular venues such as malls or big box stores.
Road damage fees to mitigate damage to streets and highways caused by heavy truck traffic and spills.
Fees to mitigate effects of compulsive gambling, including screening, education, and treatment.

Source: Stop Hidden Taxes

that would have required a two-thirds vote if Proposition 26 had been in effect.

If approved by voters, Proposition 26 could invalidate the fuel tax swap, which would eliminate \$1 billion in state General Fund savings, unless the swap is re-enacted by a two-thirds vote of the Legislature. Proposition 26 applies retroactively to any laws passed on or after January 1, 2010.

Proposition 26 Could Apply Broadly to Measures Unrelated to Revenues

As written, Proposition 26 could potentially increase the Legislative vote requirement for a broad array of measures that are unrelated to taxes and fees. Proposition 26 states that “*any change* in state statute which results in *any* taxpayer paying a higher tax” would require a two-thirds vote of the Legislature.¹⁵ Proposition 26 does not restrict this definition to measures that directly change tax rates or other features of California’s tax code. As a result, it could be interpreted more broadly to apply to *any* change that resulted in *any* individual paying additional tax. For example, changes in building codes or other laws that required the purchase of goods subject to the sales tax could be interpreted as requiring individuals to pay additional tax. An increase in the state’s minimum wage, which increases an individual’s earnings and thus the taxes they owe, could also be interpreted as requiring the payment of additional tax and could thus require a two-thirds vote of the Legislature.

Burden of Proof Would Shift to the State and Local Governments

If Proposition 26 is approved, taxpayers who challenge a proposed levy would no longer bear the burden of proving whether the charge is invalid.¹⁶ Instead, Proposition 26 would require the state or local entities proposing a fee to prove that the amounts imposed do not exceed “reasonable costs of the governmental activity,” and that the amount bears a “fair or reasonable relationship to the payer’s burdens on, or benefits received from, the governmental activity.” If approved by voters, Proposition

26 may deter the state and local governments from seeking to increase or impose fees by imposing additional costs.

Proponents Argue

Proponents argue that court decisions have created loopholes in the state’s Constitution that enable elected officials to increase certain levies by “disguising” them as fees, which have a lower threshold for approval than taxes. Elected officials “need to control spending, not use loopholes to raise taxes.” Without Proposition 26, elected officials may impose “new and higher” fees, causing “consumers and taxpayers [to] pay increased costs on everyday items...” such as food, cell phones, beverages, and emergency services.¹⁷

Opponents Argue

Opponents argue that fees require “companies that pollute, harm the public health, or create a public nuisance ... to pay to cover the damage they cause The funds raised by these fees are used by state and local governments for essential programs like fighting air pollution, cleaning up environmental disasters, and monitoring hazardous waste.” If Proposition 26 passes, it would “forc[e] taxpayers to pay for cleaning up after polluting corporations.”¹⁸

Conclusion

Proposition 26 raises a number of policy issues. Chief among them is the question of who should be required to pay costs related to monitoring, studying, and mitigating adverse social and economic impacts associated with a product or activity. If enacted, Proposition 26 would likely shift the burden of payment from fees imposed on a limited group of fee-payers, to taxes paid by society as a whole. Proposition 26 also constrains the ability of the state to increase revenues or pass legislation by requiring a two-thirds vote for any measure that increases taxes for any taxpayer, regardless of the measure’s overall impact on revenues. Proposition 26 raises the issue of whether it is desirable public policy to limit policymakers’ flexibility in addressing budget and policy questions.

Hanh Kim Quach prepared this Budget Brief with assistance from Jean Ross. This Budget Brief is designed to help voters reach an informed decision based on the merits of the issues. The CBP was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, subscriptions, and individual contributions. Please visit the CBP’s website at www.cbp.org.

ENDNOTES

- ¹ These assessments fund public improvement projects such as roads, street lights, street paving, and sewers that benefit property owners. Certain property-related assessments on businesses could be subject to voter approval under Proposition 26. Legislative Analyst's Office, "Proposition 26: Requires That Certain State and Local Fees Be Approved by Two-Thirds Vote. Fees Include Those That Address Adverse Impacts on Society or the Environment Caused by the Fee-Payer's Business. Initiative Constitutional Amendment. Analysis by the Legislative Analyst," in Secretary of State's Office, *California General Election Tuesday, November 2, 2010: Official Voter Information Guide*, p. 58, downloaded from <http://voterguide.sos.ca.gov/pdf/english/complete-vig.pdf> on August 24, 2010.
- ² California Constitution, Article XIII A, Section 3.
- ³ Legislative Analyst's Office, "Proposition 26: Requires That Certain State and Local Fees Be Approved by Two-Thirds Vote. Fees Include Those That Address Adverse Impacts on Society or the Environment Caused by the Fee-Payer's Business. Initiative Constitutional Amendment. Analysis by the Legislative Analyst," in Secretary of State's Office, *California General Election Tuesday, November 2, 2010: Official Voter Information Guide*, p. 59, downloaded from <http://voterguide.sos.ca.gov/pdf/english/complete-vig.pdf> on August 24, 2010.
- ⁴ Supreme Court of California, *Sinclair Paint Company v. State Board of Equalization* (June 26, 1997).
- ⁵ Supreme Court of California, *Sinclair Paint Company v. State Board of Equalization* (June 26, 1997).
- ⁶ Supreme Court of California, *Sinclair Paint Company v. State Board of Equalization* (June 26, 1997).
- ⁷ Supreme Court of California, *Sinclair Paint Company v. State Board of Equalization* (June 26, 1997).
- ⁸ Supreme Court of California, *Sinclair Paint Company v. State Board of Equalization* (June 26, 1997).
- ⁹ Emphasis added. Supreme Court of California, *Sinclair Paint Company v. State Board of Equalization* (June 26, 1997).
- ¹⁰ Supreme Court of California, *Sinclair Paint Company v. State Board of Equalization* (June 26, 1997).
- ¹¹ Certain new or increased local assessments, such as those to improve shopping districts, may also be considered taxes under Proposition 26. Personal communication with the Legislative Analyst's Office (August 23, 2010).
- ¹² Emphasis added.
- ¹³ California Constitution, Article XIII A, Section 3.
- ¹⁴ The fuel tax swap was designed to allow the state greater flexibility over the use of certain revenues, not to increase the amount of revenues collected. For further discussion of the fuel tax swap, see California Budget Project, *Proposition 22: Should California Lock In Funding for Local Governments, Redevelopment, and Transportation?* (September 2010).
- ¹⁵ Emphasis added.
- ¹⁶ Legislative acts are typically accorded the "presumption of validity" and challengers bear the initial burden of showing the fee to be invalid. See Supreme Court of California, *Sea and Sage Audubon Society, Inc. v. Planning Commission of the City of Anaheim* (August 29, 1983).
- ¹⁷ "Argument in Favor of Proposition 26," and "Rebuttal to Argument Against Proposition 26," in Secretary of State's Office, *California General Election Tuesday, November 2, 2010: Official Voter Information Guide*, pp. 60-61, downloaded from <http://voterguide.sos.ca.gov/pdf/english/complete-vig.pdf> on August 24, 2010.
- ¹⁸ "Argument Against Proposition 26," in Secretary of State's Office, *California General Election Tuesday, November 2, 2010: Official Voter Information Guide*, p. 61, downloaded from <http://voterguide.sos.ca.gov/pdf/english/complete-vig.pdf> on August 24, 2010.