

## Keep Prop. 26 Requirement for 2/3 Vote on Taxes; Focus on Encouraging Private Sector Growth

According to the Legislative Analyst's Office, California is currently facing a \$13 billion budget deficit that will force the Legislature to:

- find new revenue sources;
- make significant budget cuts; or
- combine both.

In years past, the Legislature often attempted to reduce any budget deficit by improperly labeling taxes as “fees” or enacting taxes that were “revenue-neutral” to avoid a two-thirds vote requirement. In 2010, voters approved Proposition 26 to close these two loopholes and eliminate the Legislature's ability to impose improper taxes.

In 2011, the Legislature and local government responded to Proposition 26 with several creative bills and ordinances that bordered, if not crossed the line, on their legality with regard to Proposition 26. With the current budget deficit, it is likely that there will be similar legislation in 2012 that will test the boundaries of Proposition 26 as the Legislature struggles to resolve California's financial crisis.

### Proposition 26 Background

In November 2010, California voters approved Proposition 26, titled the “Supermajority Vote to Pass New Taxes and Fees Act,” which was sponsored by the California Chamber of Commerce. The main focus of this initiative was to close two loopholes that allowed the Legislature or local government to impose hidden taxes without a two-thirds vote of the Legislature or a vote of the people. Those loopholes were:

- labeling a tax as a “fee;” and
- offsetting a tax increase with a companion tax cut, thereby making the tax “revenue neutral.”

Proposition 26 removed the first loophole by defining the term “tax” to eliminate any ambiguity between a tax and fee. A tax is now defined in Article XIII A, Section 3 of the California Constitution to mean “any levy, charge, or exaction of any kind imposed by the State,” except a charge imposed for a specific benefit, service, or product, the cost of which does not exceed the reasonable cost to the State and is only imposed against the taxpayer who directly receives the benefit, service, or product.

Also excluded from the definition of a “tax” is any charge for the entrance, use, purchase, rental or lease of state property, or any fine, penalty, or monetary charge imposed by the judicial branch or state as a result of any violation of law.

Proposition 26 removed the second loophole referenced above to specify that any change in state statute that results in a higher tax for any taxpayer, regardless of whether there is any net increase in revenue from the tax, must be approved by a two-thirds vote. Any mislabeled “fees” or revenue-neutral enacted taxes that were adopted after January 1, 2010 by only a majority vote of the Legislature were technically void unless re-enacted by the Legislature through a two-thirds vote and signed by the Governor.

### 2011 Legislative Session

Shortly after taking office, on January 20, 2011, Governor Edmund G. Brown Jr. issued a proclamation that reaffirmed the December 2010 proclamation issued by Governor Arnold Schwarzenegger, declaring a fiscal emergency in California due to the projected \$25.4 billion state budget deficit. Pursuant to Article IV, Section 10 of the Constitution, this proclamation required the Legislature to enter into a special session to address the budget shortfall. With the elimination of the two loopholes addressed above that the Legislature previously misused to raise revenue, this task was even more complex.

Two significant bills introduced in 2011 by Senate President Pro Tempore Darrell Steinberg (D-Sacramento) tested the parameters of Proposition 26. Specifically, SB 653/SBX1 23,\* which received a significant amount of attention from businesses statewide, proposed to authorize any governing board of any county, city, school district, community college district, or county office of education to impose a local personal income tax, sales tax, vehicle license fee, or excise tax, including, but not limited to, an alcoholic beverages tax, a cigarette and tobacco products tax, a sweetened beverage tax, and an oil severance tax.

Although a proposed tax by any one of these numerous entities still would have to be voted on and approved by the local taxpayers, the shifting of taxing authority to the local level that SB 653/SBX1 23 proposed was unprecedented. The author of SB 653/SBX1 23 took the position that simply authorizing a local entity to propose a tax, the enactment of which depends upon the approval of the voters, was not subject to the two-thirds requirement of Proposition 26 because it does not necessarily result in a tax increase.

Several opponents to the bill argued that it was subject to the two-thirds vote requirement, as the overall intent and outcome of the taxing authority granted in the bill would be a tax increase. SB 653 was moved to the inactive file in the Senate. SBX1 23 was voted out of the Senate and is now in the Assembly Revenue and Taxation Committee. Both bills could potentially continue to move through the legislative process in 2012.

Senator Steinberg also introduced SB 791, challenging the distinction of a fee versus a tax addressed by Proposition 26. SB 791 would have authorized a metropolitan planning agency to impose a motor vehicle fuel “fee” to pay for the costs incurred in reducing vehicle congestion. Opponents argued that this “fee” was actually a tax according to Proposition 26, as individuals who did not use motor vehicle fuel or pay the “fee” would still benefit directly from the improvements made to alternative sources of transportation, such as public transit or bike pathways, funded by the “fee” imposed.

The CalChamber opposed this bill primarily on the basis that it violated Proposition 26. The bill was ultimately gutted and amended to address an entirely separate issue.

### Proposition 26 Litigation

On October 3, 2011, Hilex-Poly Co., LLC filed a potentially precedent-setting lawsuit against Los Angeles County on the grounds that Local Ordinance 12.85, Title 12, adopted on November 23, 2010, imposes a “tax” on the local voters of Los Angeles and therefore should

have been approved by a two-thirds vote pursuant to Proposition 26. Local Ordinance 12.85 requires retailers to impose a mandatory \$0.10 charge on all carryout paper bags, the revenue from which can be used only for the following purposes:

- costs associated with carrying out the requirements of Ordinance 12.85;
- actual costs of providing paper bags; and
- costs associated with educational materials and campaigns that encourage the use of non-paper carryout bags.

According to Hilex-Poly Co. LLC, this “charge” is really a disguised tax as defined by Proposition 26, and therefore must receive the necessary two-thirds voter approval before it can be implemented. Los Angeles County has raised the issue as to whether Proposition 26 even applies since the “charge” is not collected by the county, city or state, but rather private companies. It is anticipated that this litigation will be resolved in 2012, which will likely provide further guidance on the scope and application of Proposition 26.

### Ballot Measures Regarding Proposition 26

Although Proposition 26 was passed only in November 2010, there already are proposed ballot measures that seek to carve out exceptions to the two-thirds vote requirement for state and local taxes.

The “Polluter Accountability Act Version 1” and the “Polluter Accountability Act Version 2” seek an exemption from the two-thirds vote requirement of Proposition 26 for any fee, penalty, or charge enacted by the Legislature and applied to any activity that pollutes the air or water of the state in order to mitigate the actual or anticipated adverse impacts of such activities.

If ultimately approved by voters, this initiative would undo one of the core provisions of Proposition 26. Specifically, it would restore, for purposes of polluter activities, the Supreme Court holding in *Sinclair Paint Company v. State Board of Equalization*, which stated that under the state’s police powers, the Legislature could impose “fees” to mitigate the actual or anticipated adverse effects of various business operations, even when those “fees” do not fund a direct government benefit or service to the actual fee payer, but rather, society in general.

At the time of publication, these two initiatives were still pending at the Attorney General’s office.

### CalChamber Position

The intent and purpose of Proposition 26 to prevent either the state or local governments from enacting new

\*The text of these two bills is virtually identical. SB 653 was introduced in the regular session and SBX1 23 was introduced as a part of the special legislative session prompted by Governor Brown’s January 2011 fiscal emergency proclamation.

taxes without a two-thirds vote of either the Legislature or local electorate is unambiguous. Although the CalChamber understands the challenge the Legislature faces with regard to resolving California's budget deficit, undermining the will of the voters through legislative tactics or local ordinances that violate Proposition 26 is not the pathway to economic prosperity for the state. Rather, the CalChamber believes that the only way in which to reduce the state deficit is long-term tax reform that encourages private sector growth. The Legislature should focus its efforts on this type of tax reform, rather than creative ways in which to bypass the restrictions of the Constitution.



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January 2012