

Passage of Proposition 26 Alters Future of Regulatory Fees in California

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On November 2, 2010, California voters approved Proposition 26, an initiative that broadens the definition of “taxes” to include many regulatory fees currently imposed by the State of California and its municipalities. This change will make enactment of regulatory fees more difficult by requiring a supermajority vote of the State Legislature or, in the case of local fees, direct voter approval. The regulatory fees affected by Proposition 26 fund many of California’s environmental and other regulatory programs, and they include fees imposed in 2010.

Background

Proposition 26 aimed to strengthen provisions of Articles XIII A and XIII C of the California Constitution, which voters previously adopted through the initiative process to limit the State government’s taxing power. The 1978 initiative that enacted Article XIII A, Proposition 13, is best known for imposing limits on property taxes. However, it also imposed a two-thirds majority approval requirement for “changes in state taxes enacted for the purposes of increasing [state] revenues”¹ In 1996, voters approved Proposition 218 and added Article XIII C to the California Constitution, thereby requiring that increases in local taxes be approved by the voters.²

Because neither Proposition 13 nor Proposition 218 defined “tax”, the restrictions on government levies were not as stringent as their proponents had hoped. At the state level, lawmakers soon began utilizing “regulatory fees” that were not subject to the supermajority vote requirement to fund a variety of state regulatory programs.

In 1997, within certain parameters, the California Supreme Court accepted the practice of imposing regulatory fees based on a majority vote of the governing body as being consistent with the limitations embodied in Article XIII A of the California Constitution. In *Sinclair Paint Co. v. State Board of Equalization*, the Court held that compulsory “fees to mitigate the actual or anticipated adverse effects of the fee payers’ operations” were not necessarily subject to the approval thresholds established by Propositions 13.³ Specifically, levies for the primary purpose of “legitimate regulation” (not mere revenue raising) that did not exceed the “reasonably necessary expense of the regulatory effort,” could be adopted by a simple majority vote.⁴

Tax limitation advocates concluded that the broad definition of “fee” adopted in *Sinclair Paint* would further encourage lawmakers to use fees to circumvent the tax limitations imposed by Propositions 13

and 218.⁵ To avert this outcome, they qualified an initiative for the November 2000 ballot that would have overturned the *Sinclair Paint* decision. Proposition 37 was unsuccessful. Ten years later, however, Proposition 26 similarly attempted to end the “phenomenon whereby the Legislature and local governments have disguised new taxes as ‘fees’ in order to extract . . . revenue from California taxpayers without having to abide by . . . constitutional voting requirements.”⁶ This time, the proposition “to end hidden taxes” succeeded.

Proposition 26 – What it Says for State Government⁷

Proposition 26 amends Section 3 of Article XIII A of the California Constitution to require a two-thirds vote by “all members elected to each of the two houses of the Legislature” prior to the imposition of “[a]ny change in state statute which results in any taxpayer paying a higher tax”⁸ After approval of Proposition 26, the two-thirds vote requirement applies not just to statutes that increase levies, but also to “revenue neutral” bills that result in at least one taxpayer paying more.

Proposition 26 also establishes a constitutional definition of “tax.” With respect to taxes imposed by the Legislature, the term includes “any levy, charge, or exaction of any kind imposed by the State”, while excluding the following:

1. A charge imposed for a specific benefit . . . which does not exceed the reasonable costs to the State of conferring the benefit . . . to the payor.
2. A charge imposed for a specific government service or product . . . 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 [and performing other administrative investigatory/enforcement duties].
4. A charge imposed for entrance to or use of state property
5. A fine, penalty, or other monetary charge imposed by . . . the State[] as a result of a violation of law.

As a result of this definition, legislators seeking to impose a new charge will need to either garner the support of a supermajority or enact a charge that fits within the exclusions identified above.

In addition to the above, Proposition 26 shifts the burden of proof in lawsuits alleging that a charge is a tax. The initiative puts the burden on the State (rather than the challenger) to prove “by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the . . . benefits received.”⁹ This burden is not insignificant.

Proposition 26 – What it Means

After passage of Proposition 26, legislators will need to develop bipartisan support for new taxes. When these efforts fail, they will be left with the option of bringing a proposed charge within one of the stated exclusions from the definition of “tax.”

The impact of Proposition 26 probably will not be fully understood for some time. Although its supporters had a clear goal in mind when they placed Proposition 26 on the ballot—namely, to “stop hidden taxes”—numerous commentators have raised questions about whether and how the initiative will impact past, present, and future laws. In particular, the following two types of fees have received attention:

- Fee/tax increases that occur (1) automatically as a result of preexisting language that pegs assessments to fluid indicators like inflation or (2) deliberately as a result of an agency’s exercise of its authority, delegated by the Legislature, to set fees consistent with statutory guidance. In scenarios involving such authority, taxpayers may pay a higher fee/tax, but not as a result of any change in state statute enacted after the effective date of Proposition 26. Whether increases accomplished through mechanisms other than amended statutes are inconsistent with the initiative will likely be brought before the courts. At the same time, those responsible for administering programs generally authorized by statute but requiring significant definition by regulatory agencies—in particular those responsible for the implementation of California’s AB 32 greenhouse gas reduction program—reportedly are confident at this point that Proposition 26 will not impact their plans.¹⁰
- Fees imposed after January 1, 2010, but before passage of Proposition 26. Proposition 26 repeals any statute passed by a mere majority in 2010 that imposes a tax (as now defined) unless the Legislature reenacts the measure by a two-thirds vote prior to November 3, 2011. Legislation that others have identified as potentially being impacted by this clause includes AB 2398 and AB 1343 (requiring companies in certain industries to create a funded product stewardship plan and imposing a stewardship assessment on each unit sold in California¹¹), and AB x8-6 and AB 70 (a set of bills, designed to be tax-neutral, that reduced sales taxes and increased excise taxes on motor vehicle fuel and did the opposite with respect to diesel fuel¹²).

The initiative also may affect bills enacted to assist renewable energy companies, such as SB 401 (a bill to, *inter alia*, bring state tax laws in conformity with federal law; includes measures to ensure that alternative energy developers can exclude federal grant dollars from their income tax liability for 2009-10 in lieu of receiving tax credits¹³) and SB 855, which repealed a provision that exempted renewable energy plants from the obligation to pay the processing fee for an application for certification and for compliance monitoring.¹⁴

Proposition 26 may exacerbate the State’s budget deficit if recently enacted revenue neutral bills are severed and tax increases are annulled while tax cuts remain valid. In addition, the State may need to scale back or suspend certain environmental and other regulatory programs while the Legislature works out the best way to fund them going forward.

What to Look Out For

Proposition 26 is anticipated to reduce the amount of legislation imposing new taxes previously enacted as regulatory fees, and will make it much more difficult to pass legislation renewing or increasing such charges. Parties subject to new fees imposed by state statute, or based on statutory authorization, that were approved by a simple majority of the Legislature should closely scrutinize the exclusions set forth in what will become section 3(b) of Article XIII A of the California Constitution. Interpretations of the first exclusion, which permits charges commensurate with “the reasonable costs

to the State of conferring [a specific] benefit or granting [a] privilege” directly to a payor,¹⁵ will be of particular interest.

Given legislators’ response to Propositions 13 and 218, those subject to new, renewed, or increased charges imposed by state statute should also scrutinize the findings of the enacting legislation and the opinions of the Legislative Counsel’s office when they conclude that such charges do not involve a tax. In the future payors may have the opportunity and the need to challenge such charges when they are imposed by a simple majority of the Legislature.



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- 1 Cal. Const. Art. XIII A, § 3.
- 2 Cal. Const. Art. XIII C, § 2.
- 3 15 Cal. 4th 866, 869, 874 (1997). The fee at issue in Sinclair Paint was imposed on manufacturers whose operations contributed to environmental lead contamination. Proceeds from this fee funded a testing and treatment program for children who were affected by lead poisoning. Although the fee raised revenue, the Court held it was not subject to the two-thirds vote requirement because it was not imposed for the “primary purpose” of raising revenue. *Id.* at 876.
- 4 *Id.* at 879-80. The Court also identified potential limitations on the impositions of such “regulatory fees,” considering, for example, the amount of the fee imposed and the relationship of the fee payor to the asserted problem. *Id.* at 881.
- 5 Ballot Pamp., Gen. Elec. (Nov. 7, 2000) text of Prop. 37, p. 70, available at <http://vote2000.sos.ca.gov/VoterGuide/pdf/textproposedlaws.pdf>.
- 6 Ballot Pamp., Gen. Elec. (Nov. 2, 2010) text of Prop. 26, p. 114, available at <http://cdn.sos.ca.gov/vig2010/general/pdf/english/complete-vig.pdf>.
- 7 As previously noted, Proposition 26 imposes new limits on fees imposed by State and local governments by redefining “taxes” and changing the voting requirements for enacting a new tax or increasing an existing one. The remainder of this Client Alert focuses on how Proposition 26 impacts regulatory fees imposed by the State Legislature.
- 8 *Id.* (emphasis added).
- 9 Ballot Pamp., Gen. Elec. (Nov. 2, 2010) text of Prop. 26, p. 115.
- 10 Kristin Eberhard, Proposition 26 Will Not Stop AB 32 (Nov. 5, 2010) (Resources Defense Council Staff Blog), available at http://switchboard.nrdc.org/blogs/kgrenfell/proposition_26_will_not_stop_a.html.
- 11 Cara Horowitz, et al., Paying for Pollution: Proposition 26 and its Potential Impacts on State Environmental and Public Health Protections in California 6 (Oct. 26, 2010), available at <http://cdn.law.ucla.edu/SiteCollectionDocuments/Environmental%20Law/Paying%20for%20Pollution.pdf>.
- 12 Ballot Pamp., Gen. Elec. (Nov. 2, 2010) analysis by the Legislative Analyst of Prop. 26, p. 59.
- 13 John Howard, Impact of Proposition 26 roiling Capitol (Nov. 12, 2010), available at <http://www.capitolweekly.net/article.php?xid=z9Speyexs7twz7&done>.
- 14 Cal. Pub. Res. Code § 25806(d), (e); Sen. Bill 855, 2009-10 Gen. Sess. (Cal. Budget Trailer Bill); Howard, *supra* note 13.
- 15 Ballot Pamp., Gen. Elec. (Nov. 2, 2010) text of Prop. 26, p. 115.