

## Living With Proposition 26 of 2010

### *Many Local Fees Will Fit Within Seven Categories of Exemptions*

On Nov. 2, 2010, California voters approved Proposition 26, the “Stop Hidden Taxes Initiative,” by 52.5 percent. In some limited instances, Prop. 26 may require new fees, or existing fees that are extended or increased, to be classified as special taxes requiring approval by two-thirds vote of local voters. Local governments must understand, however, that the Prop. 26 provisions applicable to local government contain seven categories of exceptions to this voter-approval requirement. The vast majority of fees that cities would seek to adopt will most likely fall into one or more of these exemptions. Further, the local provisions of Prop. 26 only apply to fees imposed, extended or increased after Nov. 3, 2010. Fees in place prior to this date will not be subject to voter approval.

Prop. 26 is aimed at a particular class of fees imposed by state and local governments commonly referred to as “regulatory fees.” These fees are placed on a particular class of persons or businesses from which the revenues are used to provide a benefit to the public as well as the fee payor. These regulatory fees are typically intended to mitigate the societal and environmental impacts of a business’ or person’s activities.<sup>1</sup>

### **Background**

State and local governments impose regulatory fees on businesses and individuals to pay for the cost of public programs or projects necessary to regulate activity of the business or person. Well known regulatory fees in local government include fees for the issuance of a license or permit, the conduct of an investigation or inspection, and the administration and maintenance of a system of supervision and enforcement of regulated activity to protect the public health and safety. They also include parking permits, alarm permits, pet licenses, concealed weapons permits; bicycle licenses; alcohol/drug-related emergency response; permits for regulated commercial activities (e.g., dance hall, bingo, card room, check cashing, taxicab, peddlers, catering trucks, massage parlor, firearm dealers, etc.).

However, regulatory fees also have been imposed to mitigate past, present and future adverse impacts of of business’ operations. The California Supreme Court in 1997 ruled in *Sinclair Paint Co. v State Board of Equalization* that those charged a fee need not benefit from the fee’s proceeds as long as the fee bears a reasonable relationship to the negative impact imposed on society from the activities of those charged the fee. The *Sinclair* fee upheld by the Court was a state-imposed fee on companies that use lead in the manufacture of paint and other products. The proceeds of the fee were used to fund programs to screen and treat children for lead poisoning, and to otherwise mitigate the societal and environmental consequences of lead contamination.

Subsequent to this decision, the state and some cities adopted or considered new types of fees. For example, a few cities imposed fees on owners of establishments that sell alcoholic beverages to mitigate the documented consequences and effects of those businesses, beyond just supplemental law enforcement at those businesses. Some local governments and the state have considered fees on sweetened beverages to fund anti-obesity and other public health programs.

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<sup>1</sup> This article addresses the local government implications of Proposition 26. There are additional and somewhat different implications for the state, including a change in the two-thirds legislative approval requirement for taxes and different effective dates.

## Taxes and Regulatory Fees Under Prop. 26

Prop. 26 adds a new definition of “tax” into the California Constitution providing that any government-imposed charge, levy or exaction of any kind is a tax unless it falls into one of a seven express exemptions.

**Local Government Taxes under Prop. 26.** The measure adds the following language (identified by italics) to Article XIII C of the California Constitution (a portion of Prop. 218 governing taxes):

*SECTION 1 (e) As used in this article, “tax” means any levy, charge or exaction of any kind imposed by a local government, 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 local government of conferring the benefit or granting the privilege.*

**Specific Benefit Exemption.** Examples: planning permits, police permits, street closure permits, parking permits in restricted zones, some franchises — to the extent the privilege is not provided to those not charged, and the fee does not exceed the local government’s reasonable costs of service to the fee payer.

- (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 local government of providing the service or product.*

**Specific Government Service or Product Exemption.** Examples: user fees including for utilities (most retail water, sewer, trash and stormwater fees are exempt under exemption #7, discussed below), public records copying fees, DUI emergency response fees, emergency medical and ambulance transport service fees, recreation classes, weed abatement to the extent that the service or product privilege is not provided to those not charged, and the fee does not exceed the reasonable costs of service to the local government.

- (3) *A charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof.*

**Permits and Inspections Exemption.** Examples: permits for regulated commercial activities (e.g., dance hall, bingo, card room, check cashing, taxicab, peddlers, catering trucks, massage parlor, firearm dealers, etc.); fire, health, environmental, safety permits; police background checks; pet licenses; bicycle licenses; (where the costs do not exceed the reasonable regulatory costs to the local government for issuing the license or permit.)

- (4) *A charge imposed for entrance to or use of local government property or the purchase rental or lease of local government property.*

**Local Government Property Exemption.** Examples: facility rental fees, room rental fees, equipment rental fees, on and off-street parking, tolls, franchise, park entrance, museum admission, zoo admission, tipping fees, golf green fees, etc.

- (5) *A fine, penalty, or other monetary charge imposed by the judicial branch of government or a local government as a result of a violation of law, including late payment fees, fees imposed under administrative citation ordinances, parking violations, etc.*

**Penalty for Illegal Activity Exemption.** Examples: parking fines, code enforcement fees and penalties, late payment fees, interest charges and other charges for violation of the law.

- (6) *A charge imposed as a condition of property development.*

**Property Development Exemption.** Examples: planning, CEQA, and building permit fees, construction permits, development impact fees, fees imposed to remedy the effects of the fee payor’s operation that are imposed as a condition of property development (including CEQA mitigation measures requiring the payment of money).

- (7) *Assessments and property related fees imposed in accordance with the provisions of Article XIII D. (Proposition 218).*

**Prop. 218 Exemption.** Examples: assessments on real property for special benefit conferred, fees imposed upon a parcel or a person as an incident of property ownership, and fees for a property related service such as many retail water and sewer fees.

A fee or charge that is not “imposed by a local government” is not covered by Prop. 26. Consequently, payments that are made pursuant to a voluntary contract or other agreement, and that are not otherwise “imposed” by a government’s power to coerce as a government monopoly, are not taxes. This occurs when there is a market in which public and private entities provide the same service or product.

### **Effective Dates**

With regard to the local government provisions of Prop. 26, the measure applies to any levy, charge or exaction imposed, increased, or extended by local government on or after Nov. 3, 2010. Thus, fees adopted prior to that date are not subject to the measure until they are increased or extended, and it is determined that none of the exemptions applies.

### **Frequently Asked Questions**

#### **Q: How does Prop. 26 affect fees or charges adopted prior to Nov. 3, 2010?**

A: Nov. 3, 2010 was the effective date of Prop. 26 for local governments. The law applies to levies, charges or exactions of any kind imposed on or after that date. Therefore, Prop. 26 does not apply unless a fee is proposed to be extended or increased.

#### **Q: My city intends to seek voter approval for a utility users tax (UUT) or hotel tax (TOT) increase next year. How does Prop. 26 affect this?**

A: Prop. 26 does not alter the rules for taxes. A tax increase or extension continues to be subject to voter approval requirements for general and special taxes.

#### **Q: We have a fee — approved by the city council prior to Nov. 3, 2010 — that includes an automatic CPI escalator. Will those adjustments now be subject to the Prop. 26 rules including voter approval?**

A: Probably not. Language in Prop. 218 and the laws implementing it suggest that those cost of living adjustments were imposed prior to the effective date of Prop. 26. An automatic inflationary adjustment is not a new imposition of a levy, charge or exaction because a fee is “imposed” when the governing body approves it, not when the fee takes effect. An inflationary adjustment to a levy, charge or exaction including a fee is merely a fee category set to begin at a certain future effective date. The fee is not “increased” when it is adjusted for inflation (see Government Code Section 53750(h)(2)(A)). As was the case under pre-Prop. 26 law, a fee for providing a service, product, privilege, or regulatory action — including the cost escalator — is limited to the reasonable costs to the city of carrying out the activity.

#### **Q: Most of our fees are for utility services (water, sewer, garbage). Are future increases of these subject to Prop. 26?**

A: Property-related fees imposed in accordance with Prop. 218 (California Constitution Article XIID) must continue to follow those rules. Fees that are subject to Prop. 218 are exempt from Prop. 26. For utility fees not subject to Prop. 218 (gas and electricity, for example,) the exemptions for a charge for a “specific benefit conferred or privilege granted” [Section 1(e)(1)], a charge for a “specific government service or product provided” [Section 1(e)(2)], or a “charge imposed as a condition of property development” [Section 1(e)(1)] may apply. Prop. 218 allows utility fees to be adjusted for inflation and to pass through wholesale water costs without property owner approval or a protest hearing under some circumstances.

#### **Q: My city provides discounted rates for certain fees including: (1) a senior citizen rate for museum admission; (2) a low income rate for sewer service; and (3) free copies of the annual budget to elected and appointed officials (we charge others a fee to cover costs). For fees imposed after Nov. 3, 2010, does Prop. 26 affect these?**

A1: A charge for entrance to or use of government property is exempt from the definition of tax in Prop. 26 and is not subject to cost-of-service rules that may make discounts or fee waivers problematic.

A2: Fees for government-provided sewer services are property related fees under Prop. 218 (California Constitution Article XIII D, section 6). Discounts (low income, senior, etc.) may be valid as long as the costs of the service are not funded by higher rates charged to ratepayers ineligible for the discount, but are instead funded from other sources, such as a general fund transfer or donations from other customers.

A3: Prop. 26 is not completely clear as to the providing of free products or services to some where others are charged for the same product or service. Regardless, the costs of products or services provided to some at no cost may not be recovered from fees imposed on others for the same product or service.

**Q: Each year my city adopts a comprehensive “fee schedule” by resolution. If a fee included in the schedule is not changed from the prior year, does it have to comply with Prop. 26?**

A: No. A resolution adopting a “fee schedule” typically does not “impose” the fee. Rather it is a listing of all fees for the benefit of the public. If, however, a particular fee “sunsets” and then appears on the annual fee schedule, the fee is being “imposed” and the impact of Prop. 26 needs to be evaluated. However, a court recently ruled that restating a fee in a master fee schedule adopted by city council action opened a new statute of limitations to challenge that fee. Accordingly, many city attorneys now recommend that master fee schedules be maintained administratively and that the council approve only fee amounts that change.

**Q: Will the fees that the county imposes on our city, such as Property Tax Administration Fees and Booking Fees have to comply with Prop. 26?**

A: There are differing views among municipal attorneys with regard to the applicability of Prop. 26 to intergovernmental charges. In any case, fees imposed prior to Nov. 3, 2010 are not affected by Prop. 26. Moreover, an automatic inflationary adjustment is not a new imposition of a fee because a levy charge or exaction is “imposed” when the governing body approves it, not when the fee takes effect. The applicability of Prop. 26 to intergovernmental fees is unlikely to arise until state legislation affecting those fees is adopted.

**Q: What about our Franchise Fees (cable/video, telephone and electricity, oil and gas pipeline, solid waste)? Are future increases now taxes under Prop. 26?**

A: The Digital Infrastructure and Video Competition Act (DIVCA) of 2008 provides for franchise payments to local governments. These are state-imposed fees that are characterized as “rent or toll” for the use of local government property, and therefore they are not taxes under the exemption in Section 1(e)(4). Other franchises, including those for telephone, electricity, oil and gas and solid waste may be granted by cities and counties subject to negotiation and, in other cases, subject to limitations imposed by state law. The payments under these negotiated agreements or authorized by state law are not “imposed” by the local government, and nevertheless are “for entrance to or use of local government property.” They are therefore not taxes within the meaning of Prop. 26. However, the word “franchise” is sometimes used for agreements that do not involve use of government property (and payments under such agreements may be voluntary rather than “imposed” by government), so it will be important to consult with your city attorney about such fees.

**Q: Do we now have to cost-justify increases in our parking fines? Facility rental fees? Other fines and penalties? Development impact fees?**

A: No. Parking fines are exempt as a fine or penalty (Section 1(e)(5)) or as “a charge imposed for the entrance to or use of local government property” [Section 1(e)(4)], as are facility rental fees. Charges imposed as a condition of property development [Section 1(e)(6)] are similarly exempt from Prop. 26. However, limitations on development impact fees are found in Government Code Section 66000 (Fee Mitigation Act) and in other law.

**Q: We want to increase our fees for nuisance abatement to clean up properties that are out of compliance with local codes (weed abatement, abandoned vehicles, etc.). Would this increase be a tax under Prop. 26?**

A: Section 1(e)(5) stipulates that a charge imposed as a result of a violation of the law is not a tax. A nuisance abatement fee may also be a “service provided directly to the payor,” if it “is not provided to those not charged,” and “does not exceed the reasonable costs...of providing the service...” [Section 1(e)(2)]

**Q: We are considering a new Business Improvement District Assessment under the 1989 Parking and Business Improvement District Act. The assessment would be on persons, not property (so it’s not a Prop. 218 assessment). How will Prop. 26 affect this?**

A: Given that a 1989 Act assessment is not property-related, it does not fall under the Prop. 218 exemption, and may not readily fall under any other exemption. But it is important to review the exact services funded by the assessment to determine whether the services provide a direct benefit to the business or person paying the assessment. For those assessments that may not qualify for an exemption, the following possible alternatives may be available:

- A two-thirds voter-approved special tax, with the use of the proceeds specified in the ordinance.
- A property-related assessment imposed under the Property and Business Improvement District Law of 1994 in accordance with the provisions of Prop. 218 (Cal Const Article XIID).
- An assessment or fee imposed for specific benefits, privileges, services and/or products provided to the payors, which is (a) not provided to those not charged; and (b) does not exceed the reasonable costs of what is provided.

## Conclusion

There are many uncertainties about Prop. 26. The debate has now begun as to its meaning and its implications. State legislation and litigation will clarify some provisions in time. In the meantime, local agency officials are advised to:

- Familiarize yourself with the text of the measure.
- In consultation with your legal counsel, identify any fees or charges which might, if increased or extended after Nov. 3, 2010, be considered taxes under Prop. 26.
- Adopt no new or increased fees (including adjustments to existing fees), without consulting your legal counsel as to whether that action is subject to Props. 218 or 26.
- Consider segregating revenues of a fee amended after the effect date of Prop. 26 from those collected earlier if Prop. 26 will require a narrower use of those proceeds for the amended fee as compared to the earlier proceeds, which are governed by the earlier, more generous standards of the *Sinclair Paint* case.
- Be alert for further changes and clarifications of this area of the law.

