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Julia C. DeVos

University of the Pacific, McGeorge School of Law

Amber Simmons

University of the Pacific, McGeorge School of Law

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CALIFORNIA INITIATIVE REVIEW

Proposition 26: Vote Requirement for State Fees and Levies. Initiative Constitutional Amendment.

By,

Julia C. DeVos

*J.D., University of the Pacific, McGeorge School of Law, to be conferred May 2012
B.A., Exercise Science, Hope College, 2009*

&

Amber Simmons

*J.D., University of the Pacific, McGeorge School of Law, to be conferred May 2012
B.S., Agricultural Business, California Polytechnic State University, 2008*

I. EXECUTIVE SUMMARY

Proposition 26 is a Constitutional amendment proposed by the California Chamber of Commerce.¹ The proposition requires that any revenue increases be approved by a two-thirds vote in each house of the Legislature or local voters.² Proposition 26 has three main provisions.³ First, Proposition 26 expands the definition of taxes to include fees and charges which state and local governments can currently increase with a simple majority vote.⁴ Second, Proposition 26 raises the vote requirement to a two-thirds majority to approve any law that increases taxes on any taxpayer, even if the overall fiscal effect does not increase state revenues.⁵ Third, Proposition 26 is retroactive and repeals state laws passed on or before November 2010 that conflict with this measure, unless they are approved by a two-thirds majority in each house of the Legislature before November 2011.⁶

California voters face a difficult choice in deciding how to vote on Proposition 26: A “yes” vote on Proposition 26 will make it more difficult for state and local governments to raise revenues – something some taxpayers will look forward to.⁷ However, by making it increasingly difficult for governments to raise revenues, this measure could exacerbate California’s budget deficit and financial problems.⁸

A “no” vote on Proposition 26 means that the laws controlling how state and local governments can raise revenue will remain unchanged.⁹ A two-thirds majority vote in both houses of the Legislature would still be required to increase taxes, and only a simple majority vote would be necessary to increase or implement fees.¹⁰

II. BACKGROUND AND EXISTING LAW

a. History of California Tax Laws

In 1978 California voters overwhelming approved Proposition 13, which amended the California Constitution to provide that increases in state taxes could not be approved without a minimal

¹ Stop Hidden Taxes No on 25 Yes on 26, Yes on 26 Fact Sheet, (available at <http://www.no25yes26.com/wp-content/uploads/Yes-on-26-Fact-Sheet-9.16.10.pdf>) (accessed Sept. 14, 2010) [hereinafter Yes on 26 Fact Sheet].

² *Id.*

³ *Legislative Analysis Office, Proposition 26*, http://www.lao.ca.gov/ballot/2010/26_11_2010.pdf (accessed Sept. 14, 2010) [hereinafter *LAO Prop 26 Analysis*].

⁴ *Id.* at 4.

⁵ *Id.* at 6.

⁶ *Id.* at 6-7.

⁷ California Taxpayer’s Association, *Proposition 26: Stops Hidden Taxes by Strengthening Definition of Tax*, <http://www.No25Yes26.com/wp-content/uploads/Proposition26CalTaxAnalysisPW.pdf> (accessed Oct. 5, 2010) [hereinafter Cal-Tax Analysis].

⁸ *LAO Prop 26 Analysis* at 8-9.

⁹ *Id.*

¹⁰ *Id.* at 6, 9.

two-thirds majority vote in each chamber of the Legislature.¹¹ California voters again amended the Constitution in 1996 through Proposition 218 to require that local tax increases be approved by the voters.¹² These measures did not affect the imposition of fees and charges by state and local government, which increase the amount of money Californians pay to the government. Because these revenue increases are labeled as fees rather than as taxes, they can be passed with a simple majority vote. In 2000, Proposition 37, a measure that would have changed the requirement for fee increases to a two-thirds majority rather than a simple majority, was placed on the ballot.¹³ Proposition 37 was narrowly defeated, leaving the voting requirements for fees unchanged.¹⁴

b. Current Definition of Taxes and Fees

The California Constitution defines a tax as a law created “for the purpose of increasing revenues,” and stipulates that such laws must be passed with at least a two-thirds majority in both the State Assembly and State Senate.¹⁵ However, a law that increases the burden on some taxpayers, but is offset by offering an equal tax reduction to other taxpayers, is not considered a tax because it does not increase the State’s overall revenues.¹⁶ These laws are “revenue neutral” because the government is not receiving any more money or increasing revenue despite the change in laws.¹⁷ Consequently, revenue neutral laws may be enacted with a simple majority vote in both Legislative houses.¹⁸

While taxes are considered revenue increases that provide for general public services, fees typically pay for a particular service or program.¹⁹ There are three major types of fees and charges – property charges, user fees, and regulatory fees.²⁰ Property charges are imposed on developers and owners to pay for roads, improvements, or services.²¹ User fees offset the cost of a particular public service or program; examples include state park entrance fees and garbage collection fees. Proposition 26 would not affect most property charges and user fees because they “comply with Proposition 26’s requirements already, or are exempt from its provisions.”²²

Many regulatory fees would be affected by Proposition 26.²³ Regulatory fees place additional burdens on certain types of businesses and activities to offset the public or environmental impact

¹¹ Text of Proposition 26 (available at <http://www.voterguide.sos.ca.gov/pdf/english/text-proposes-laws.pdf>). 114 [hereinafter Prop 26 Text].

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *LAO Prop 26 Analysis* at 6.

¹⁶ *Id.*

¹⁷ Investor Words, Revenue Neutral Definition http://www.investorwords.com/8338/revenue_neutral.html (Oct. 4, 2010).

¹⁸ *LAO Prop 26 Analysis* at 6.

¹⁹ *Id.* at 1.

²⁰ *Id.*

²¹ *Id.*

²² *Id.* at 5.

²³ *Id.* at 4.

of these activities.²⁴ Examples of regulatory fees include oil recycling fees, hazardous material fees and fees on alcohol retailers.²⁵ Regulatory fees often provide revenues in excess of what the public program requires. As such, regulatory fees can pay for broad public services, which is why many businesses consider them to be a tax.²⁶ However, in 1997 the California Supreme Court ruled that regulatory fees that provide for broad public services, rather than a targeted program, are not taxes.²⁷

III. PROPOSED CHANGES

a. New Definition of Taxes and Fees

Proposition 26 would change Section 3 of Article XIII of the California Constitution to define a tax as any statutory change that results in any taxpayer paying a higher tax.²⁸ This new definition broadens what may be considered a tax to include fees and charges that are currently passed by a simple majority vote.²⁹ In addition, revenue neutral legislation – legislation that increases the tax burden on certain individuals, but decreases the burden on other taxpayers – would also require a two-thirds majority vote.³⁰

b. Retroactive Provisions

Proposition 26 not only impacts the voting requirement to approve future fee increases, it would also apply to laws passed prior to its enactment.³¹ The retroactive provision would apply to state laws that conflict with the standards of Proposition 26 adopted between January 1, 2010 and November 2010.³² These measures would be repealed “one year after the proposition is approved” unless they were subsequently passed by a two-thirds majority vote in the Legislature.³³ This “window period” would apply only to measures passed by the Legislature; Proposition 26 would not affect local government decisions until November 3, 2010.³⁴

c. Taxpayer Litigation

Proposition 26 places the burden of proof on the government to show that a charge is not a tax.³⁵ State and local governments would be required to show that the moneys raised by a proposed fee on certain activities equal the reasonable costs of the governmental activity needed to mitigate

²⁴ *Id.* at 1.

²⁵ *Id.* at 5.

²⁶ *Id.* at 2-3.

²⁷ *Id.* at 3.

²⁸ Prop 26 Text at 114.

²⁹ *LAO Prop 26 Analysis* at 4.

³⁰ *Id.* at 4

³¹ See *Id.* at 6-7 (explaining Proposition 26’s impact on state laws in conflict with the proposition).

³² *Id.*

³³ *Id.*

³⁴ Michael G. Colantuono & Michael Coleman, Prop 26: New Supermajority Requirements for Regulatory Fees, available at <http://www.cllaw.us/papers/prop26-testimony.pdf> (last visited Oct. 5, 2010).

³⁵ Prop 26 Text at 115.

the negative impacts of that activity.³⁶ If the government failed to meet that burden of proof, yet continued to pass the proposed fee with only a majority vote in both houses, taxpayers would be able to challenge the law in court.³⁷ The litigation phrase of Proposition 26 is similar to the language in Proposition 218 and reflects existing law.³⁸ Proposition 26's burden of proof provision uses the standard of proof of a preponderance of the evidence, the lowest standard of proof in the court system, which would help define Proposition 218's undefined burden of proof provision.³⁹

IV. DRAFTING ISSUES AND CONSTITUTIONAL IMPLICATIONS

There are no apparent conflicts between Proposition 26 and the Federal Constitution or the California Constitution. There is, however, a potential conflict between Proposition 26 and Proposition 25, a measure which would lower the legislative vote requirement for passing a budget "from two-thirds to a simple majority."⁴⁰ Proponents for Proposition 25 say that it retains the two-thirds vote requirement for tax measures.⁴¹ Opponents of Proposition 25 disagree, however, stating that the measure gives the Legislature the ability to pass taxes with only a majority vote.⁴² See the analysis of Proposition 25 for a more in-depth explanation of the impact of the measure. If both Proposition 26 and Proposition 25 were to pass in the November elections, the measures would be harmonized.

The California budget generally consists of a series of bills, rather than only one legislative measure.⁴³ If the budget legislative packet kept revenue and non-revenue raising bills separate, then it would be possible to meet the provisions of both Propositions 25 and 26.⁴⁴ By allowing the non-tax provisions of the budget to be separate pieces of legislation, it would be possible to have them passed with a simple majority vote.⁴⁵ Placing all of the budget-related legislation which would increase taxes under the new definition set forth in Proposition 26 in separate bills would allow these measures to be subject to the two-thirds vote requirement. Therefore, certain budget provisions could be passed with a simple majority vote and tax increases would still be subject to the supermajority requirement.⁴⁶

³⁶ Cal-Tax Analysis at 2.

³⁷ *Id.* at 2.

³⁸ Colantuono & Coleman Article, *supra* note 34.

³⁹ *Id.*

⁴⁰ Legislative Analysts Office, *Proposition 25*, http://www.lao.ca.gov/ballot/2010/25_11_2010.pdf (accessed Sept. 14, 2010) [hereinafter *LAO Prop 25 Analysis*].

⁴¹ Torey Van Oot, *Judge: Prop 25 Language Can't Say It Retains Two-Thirds Tax Vote*, Sacramento Bee, (Aug. 5, 2010) (available at <http://blogs.sacbee.com/capitolalertlatest/2010/08/judge-strikes-retains-two-thir.html>).

⁴² *Id.*

⁴³ *LAO Prop 25 Analysis* at 1.

⁴⁴ See *Id.* at 3; *LAO Prop 26 Analysis*.

⁴⁵ See generally *LAO Prop 25 Analysis*; *LAO Prop 26 Analysis*.

⁴⁶ *Id.*

Although unlikely, if Proposition 25 and 26 are passed and not subsequently harmonized, California Constitution provides that the proposition receiving the most votes would be enacted and the other proposition would be void.⁴⁷

V. POLICY IMPLICATIONS

a. Arguments in Support

Proponents of Proposition 26 include the California Chamber of Commerce, the California Taxpayers' Association, and the Howard-Jarvis Taxpayers' Association, as well as many other organizations.⁴⁸ In an effort to educate voters about Proposition 26, Stop Hidden Taxes,⁴⁹ a proponent of the measure, launched the No on 25/Yes on 26 campaign ("No25Yes26").⁵⁰ Stop Hidden Taxes believes that state and local government officials have been making an end-run around the Proposition 13 requirements by inaccurately labeling revenue increases as fees instead of taxes.⁵¹

Proponents cite the proposed 2010 increase in taxes on alcohol as one example of an attempt to circumvent the two-thirds vote requirement.⁵² This measure referred to the increase as a "mitigation fee" rather than a tax so that only a majority vote was necessary for the measure to be passed.⁵³ Proponents believe Proposition 26 will prevent efforts such as the one on alcohol taxes but still allow the government to impose truly regulatory or user fees with a simple majority.

Proponents also argue that clearly defining a tax will stop the government from taking more money from Californians and force more responsible behavior when spending California tax dollars.⁵⁴ By placing the burden of proof on the government, the proponents feel that the government will be more accountable for their spending and that taxpayers will have better chances of successfully litigating taxes labeled as fees.⁵⁵ Thus, taxpayers would be protected and government would not be prevented from performing its administrative and regulatory functions.⁵⁶

b. Arguments in Opposition

⁴⁷ Cal. Const. art. II, § 10(b).

⁴⁸ Stop Hidden Taxes No on 25 Yes on 26, About Us <http://www.No25Yes26.com/about-us-2/> (Sept. 14, 2010) (listing members of Stop Hidden Taxes coalition).

⁴⁹ *Id.* (describing Stop Hidden Taxes as a "coalition of taxpayers, employers and small businesses . . . sponsored by the California Chamber of Commerce and California Taxpayers' Association").

⁵⁰ Stop Hidden Taxes No on 25 Yes on 26, <http://www.No25Yes26.com/> (accessed Sept. 14, 2010).

⁵¹ *Id.*

⁵² Cal-Tax Analysis at 1.

⁵³ *Id.*

⁵⁴ Yes on 26 Fact Sheet.

⁵⁵ Cal-Tax Analysis at 2.

⁵⁶ *Id.*

Proposition 26 has a number of opponents, including California Tax Reform Association, California League of Women Voters, and California League of Cities.⁵⁷ The California League of Cities argues that the Proposition 26 will have a negative impact on the ability of local governments to impose fees on certain business activities.⁵⁸ Opponents are concerned that Proposition 26 will have negative effects on the environment by preventing the assessment of fees against for environmental impacts on businesses and corporations – such as oil companies – whose actions can sometimes have a harmful and costly impact on the environment.⁵⁹

Other opponent groups voice concern over the repeal of the changes to fuel taxes passed in the spring of 2010 by a simple majority vote in each house.⁶⁰ These laws increased taxes paid by suppliers of fuel, while decreasing taxes paid by the retailers of fuel, which allowed \$1 billion annually to be shifted to the General Fund of the California budget.⁶¹ Opponents claim that Proposition 26 will cost the state \$1 billion and increase the budget deficit as a result of the repeal of the fuel taxes and the increased difficulty in increasing state revenues. In response to these concerns, No25Yes26 released a statement calling the fuel tax legislation “an accounting gimmick . . . which simply moved money among various accounts and determined winners and losers,” and further stating that “Prop. 26 will not cost taxpayers a dime.”⁶²

c. Fiscal Impact

The fiscal impact of Proposition 26 is indiscernible at this time.⁶³ However, the impacts would likely be significant.⁶⁴ By increasing the voting requirement for fee increases, it will be more difficult for such increases to be approved.⁶⁵ The repeal of some state laws would likely “decrease state revenues (or in some cases increase state General Fund costs).”⁶⁶ State revenue and spending amounts could be reduced by billions of dollars per year if Proposition 26 is enacted.⁶⁷

VI. CONCLUSION

⁵⁷ See No on 26, No on 26 Coalition <http://www.noonproposition26.com/the-no-on-prop-26-coalition/> (accessed Oct. 5, 2010) (listing members of the No on 26 Coalition).

⁵⁸ Colantuono & Coleman Article, *supra* note 34.

⁵⁹ Jim Gordon, *Polluter Bail Outs on November Ballot. Prop 26 – Polluters Want Taxpayers to Clean Up Their Mess*, Newsletter (Consumer Federation of California, San Mateo, Cal). (Summer 2010) at 1.

⁶⁰ *LAO Prop 26 Analysis* at 7.

⁶¹ *Id.* at 7.

⁶² Stop Hidden Taxes No on 25 Yes on 26 Press Release, Prop 26 Will Put an End to Budget Gimmicks, Force Politicians to Abide by State Constitution, <http://www.No25Yes26.com/prop-26-will-put-an-end-to-budget-gimmicks-force-politicians-to-abide-by-state-constitution/> (accessed Oct. 5, 2010).

⁶³ *LAO Prop 26 Analysis* at 8.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.* at 9.

⁶⁷ *Id.*

Proposition 26 would broaden the Constitutional definition of taxes and require a two-thirds vote to increase fees.⁶⁸ The measure would also repeal certain conflicting state laws and would place the burden of proof on the government to show that a proposed fee increase is in fact regulatory and does not provide broad public services.⁶⁹ It is difficult to discern the exact impact, both short and long term, which Proposition 26 would have on California because of the effects of multiple provisions.⁷⁰ It will likely be more difficult for state and local governments to impose fees, due to the two-thirds requirement, which could substantially reduce government revenues and spending.⁷¹ The state revenue may also be decreased by the repeal provision in the measure.⁷² Additionally, by requiring the government to carry the burden of proof when fees are challenged, there may be more successful taxpayer lawsuits.⁷³ If Proposition 26 fails, the definitions of taxes and fees and the California constitutional voting requirements for taxes and fees would not change.⁷⁴

⁶⁸ *Id.* at 3.

⁶⁹ *Id.* at 6-7; Prop 26 Text at 115.

⁷⁰ *LAO Prop 26 Analysis* at 8-9.

⁷¹ *Id.* at 8.

⁷² *Id.* at 8-9.

⁷³ Cal-Tax Analysis at 2.

⁷⁴ *LAO Prop 26 Analysis* at 10.