California Special Districts Association

Districts Stronger Together

Proposition 26 Guide for Special Districts

A GUIDE TO UNDERSTANDING THE IMPACTS OF PROPOSITION 26 ON SPECIAL DISTRICTS.

Proposition 26

The proponents of Proposition 26 intended to target state and local government fees that they asserted exceed the reasonable costs of regulation or the reasonable costs of providing a specific benefit, privilege, government service, or product.

On November 2, 2010 California voters approved Proposition 26, a ballot initiative that established new limitations on the State's and local governments' power to impose fees and charges.[1] Proposition 26 amended provisions of Article XIII A of the California Constitution, which governs the imposition of taxes by the State, and Article XIII C of the California Constitution, which governs the imposition of taxes by local governments, by providing a new definition of the term "tax." For local governments, this narrow definition defines "tax" to mean any levy, charge, or exaction of any kind imposed by a local government,[2] except for seven specifically identified exceptions. As a consequence, fees and charges that do not fall within one of the seven exceptions are redefined as taxes and are subject to voter approval.[3]

The proponents of Proposition 26 intended to target state and local government fees that they asserted exceed the reasonable costs of regulation or the reasonable costs of providing a specific benefit, privilege, government service, or product. While many issues remain to be addressed by the courts or through clarifying legislation, this Proposition 26 Guide for Special Districts addresses the impacts Proposition 26 may have on special districts and issues that special districts should consider when adopting fees and charges in light of these new limitations.[4]

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Background

Articles XIII A and XIII B work in tandem, together restricting California governments' power both to levy and to spend [taxes] for public purposes.

State and local agencies impose a variety of special taxes, assessments, fees, and charges on individuals and entities in order to pay for the costs of or provide funding for government services, facilities, and programs. Several ballot initiatives have been approved by the voters between 1978 and 1996 that have restricted the ability of state and local agencies to raise revenue through these funding sources.

In 1978, California voters approved Proposition 13, the first of this series of initiatives. Proposition 13 added Article XIII A to the California Constitution. Billed as a property-taxpayer relief measure, it included "an interlocking 'package'" comprised of a real property tax rate limitation (Article XIII A, § 1), a real property assessment limitation (Article XIII A, § 2), a restriction on state taxes (Article XIII A, § 3), and a restriction on local taxes (Article XIII A, § 4).[5] Additionally, Article XIII A, section 4 placed limitations on local governments by establishing a two-thirds voter approval requirement for any special tax to be imposed by cities, counties, and special districts.[6]

Initial restrictions on the ability of local governments to raise revenue were implemented in 1996, when voters approved Proposition 218.

The State Legislature enacted Government Code sections 50075 and 50076 to implement Proposition 13. Section 50075 provides that it is the intent of the Legislature to provide all cities, counties, and special districts with the authority to impose special taxes pursuant to the provisions of Article XIII A. Section 50076 then excludes from the definition of special tax "any fee which does not exceed the reasonable cost of providing t*he service or regulatory activity* for which the fee is charged and which is not levied for general revenue purposes."

In 1979, California voters approved Proposition 4, which added Article XIII B to the California Constitution. While Proposition 13 limited the State's and local governments' power to increase taxes, Proposition 4 imposed a complementary limit on the rate of growth in government spending.[7] "Articles XIII A and XIII B work in tandem, together restricting California governments' power both to levy and to spend [taxes] for public purposes."[8]

Article XIII B also included provisions intended to prevent state government attempts "to force programs on local governments without the state paying for them."[9]

Section 6 was included in article XIII B in recognition that article XIII A of the Constitution severely restricted the taxing powers of local governments. The provision was intended to preclude the state from shifting financial responsibility for carrying out governmental functions onto local entities that were ill equipped to handle the task. Specifically, it was designed to protect the tax revenues of local governments from state mandates that would require expenditure of such revenues.[10]

The concern that prompted the voters to include Article XIII B, section 6 in the California Constitution "was the perceived attempt by the State to enact legislation or adopt administrative orders creating programs to be administered by local agencies, thereby transferring to those agencies the fiscal responsibility for providing services which the state believed should be extended to the public."[11]

Additional restrictions on the ability of local governments to raise revenue were implemented in 1996, when voters approved Proposition 218. The initiative amended the California Constitution by adding Article XIII C and Article XIII D. Article XIII C established voter approval requirements for general and special taxes and provided the initiative power to voters to reduce

Background continued

or repeal any local tax, assessment, fee, or charge, and further made that power of initiative applicable to all local governments. Article XIII D established procedural requirements for levying assessments and imposing or increasing property-related fees and charges.[12] Additionally, Article XIII D placed substantive limitations on the use of the revenue collected from assessments and property-related fees and charges and on the amount of the assessment and fee or charge that may be imposed on each parcel. *(For in-depth information on Proposition 218, see CSDA's Proposition 218 Guide for Special Districts.)*

Shortly after the adoption of Proposition 218, the California Supreme Court determined in *Sinclair Paint Co. v. State Board of Equalization* that a fee assessed on manufacturers of materials that contributed to environmental lead contamination could reasonably be characterized as a regulatory fee and not a special tax.[13] The purpose of the fee was to fund a program to reduce lead poisoning of children. The statute imposing the fee required paint manufacturers and others whose products exposed children to lead contamination to bear a fair share of the cost of mitigating the adverse health impacts of the manufacturers' products.

The Sinclair Paint Company claimed that the fee should have been imposed as a tax with the approval of a two-thirds vote of both houses of the State Legislature because proceeds of the fees did not benefit the fee payers. The court found that as long as the fee bears a reasonable relationship to the burden caused by those charged, the use of proceeds from regulatory fees does not have to confer benefits or privileges on the fee payer because the proceeds are imposed under a public agency's police power rather than its taxing power, and supermajority approval is not required.[14]

The Sinclair Paint Company also disputed the State's authority to impose industry-wide "remediation fees" to compensate for the adverse effects of an industry's products. The court, however, acknowledged that "the police power[15] 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."[16]

Table 1.

Voter Initiatives Restricting Local Revenue
Proposition 13 (1978) • Real property tax rate limited to 1 percent of property value and 2 percent annual growth • Reassessment only occurs after a change of ownership of the real property • Any local special tax must be passed by the voters by a two-thirds majority
Proposition 4 (1979) • State and local governments must reimburse taxpayers if tax revenue is greater than spending • State must reimburse local governments for the cost of complying with state mandates
Proposition 218 (1996) • Local governments must obtain majority voter approval for any new or increased general tax • Voters may repeal or reduce any local tax, assessment, fee or charge • Local governments must put all assessments, charges and fees to a vote of the people before imposition or increase • Benefit assessment must be calculated by the benefit received by each parcel of real property • Local governments prohibited from imposing fees on property owners for services that are available to the public at large *(For in-depth information on Proposition 218, see CSDA's Proposition 218 Guide for Special Districts.)*
Proposition 26 (2010) • "Tax" redefined to mean any levy, charge or exaction of any kind imposed by a local government, except for seven specifically defined exceptions that are considered fees • Fees and charges that do not fit one of the seven exceptions must receive voter approval

Post-Proposition 13 and 218

Other post-Proposition 13 and 218 cases have defined a regulatory fee as an imposition that funds a regulatory program or that distributes the collective cost of a regulation and is "enacted for purposes broader than the privilege to use a service or to obtain a permit. . . . [T]he regulatory program is for the protection of the health and safety of the public."[17] In general, prior to Proposition 26, courts have upheld regulatory fees when the fees (1) constitute an amount necessary to carry out the purposes and provisions of the regulation; (2) do not exceed the reasonable cost of providing the services necessary to regulate the activity on which the fees are based; and (3) are not levied for an unrelated revenue purpose. [18]

Proposition 26 Findings & Declarations

...the proposition targets fees that are "couched as 'regulatory' but which exceed the reasonable costs of actual regulation" or that are "imposed to raise revenue for a new program and are not part of any licensing or permitting program."

The regulatory fees imposed by local governments to mitigate the past, present, or future adverse impact of the fee payer's operations after the adoption of Proposition 218 are one of the primary targets of Proposition 26. The "Findings and Declarations of Purpose" of the ballot initiative note that taxes within California escalated as a result of the State and local agencies "disguising" new taxes as fees without having to comply with the voter approval requirements of Articles XIII A and XIII C. In particular, the proposition targets fees that are "couched as 'regulatory' but which exceed the reasonable costs of actual regulation" or that are "imposed to raise revenue for a new program and are not part of any licensing or permitting program."[19] These fees, the proposition declares, are actually taxes that should be subject to the limitations applicable to the imposition of taxes.[20] The proposition further declares that in order to ensure the effectiveness of the constitutional limitations placed on taxes, fees, and charges established in Propositions 13 and 218, it is necessary to define what a tax means. Consequently, Proposition 26 "defines a 'tax' for state and local purposes so that neither the Legislature nor local governments can circumvent these restrictions on increasing taxes by simply defining new or expanded taxes as 'fees.'"[21]

Proposition 26 Definition of Tax

For local governments, Proposition 26 establishes a new definition of the term "tax"

Although the primary target of Proposition 26 may have been the "mitigating-effects regulatory fees" approved by local governments after the adoption of Propositions 13 and 218, its impact on other fees and charges imposed by special districts is much broader. Article XIII C, section 1(a) defines "general tax" to mean "any tax imposed for general governmental purposes."[22] Article XIII C, section 1(d) defines "special tax" to mean "any tax imposed for specific purposes, including a tax imposed for specific purposes, which is placed into a general fund."[23] Although Article XIII C provides definitions of the terms "general tax" and "special tax," it does not provide a definition of the term "tax."[24]

For local governments, Proposition 26 establishes a new definition of the term "tax" by adding Article XIII C, section 1(e) ("Section 1(e)").[25] The definition is as follows:

(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[26] 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.

(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.

(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.

(4) A charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property.
(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.
(6) A charge imposed as a condition of property development.
(7) Assessments and property-related fees imposed in accordance with the provisions of Article XIII D.[27]

As is evident from the definition above, Section 1(e) defines what a tax is by defining what it is not. As a consequence, Proposition 26 narrows the purposes for which certain fees may be imposed by local governments and in effect reclassifies them as taxes. A discussion of the impacts this definitional change may have on fees and charges imposed by special districts follows.

Table 2.

Fee vs. Tax
FEE: A charge for a BENEFIT or PRIVILEGE directly provided. TAX: A charge imposed for a BENEFIT or PRIVILEGE provided to others at a reduced or no cost. A charge that exceeds the reasonable costs of providing the benefit or privilege.
FEE: A charge for a SERVICE or PRODUCT directly provided. TAX: A charge imposed for a SERVICE or PRODUCT provided to others at reduced or no cost. A charge that exceeds the reasonable costs of providing the service or product.
FEE: A charge for costs associated with issuing licenses and permits; performing investigations, inspections, and audits; and enforcing agricultural marketing orders. TAX: A charge above and beyond reasonable cost recovery for issuing licenses and permits; performing investigations, inspections and audits; and enforcing agricultural marketing orders.
FEE: A charge for use, purchase, rental or lease of local government property.
FEE: A charge imposed by the judicial branch of government or a local government for a violation of the law.
FEE: A charge imposed as a condition of property development.
FEE: Assessment or property-related charge imposed in compliance with the provisions of Proposition 218.

When Are Fees and Charges "Imposed"

Understand what it means to "impose" a fee or charge.

Preliminarily, in order for a fee or charge to be subject to Section 1(e), the fee or charge must be "imposed" by a local government. An understanding of what it means to "impose" a fee or charge is therefore the first step in determining whether a special district fee or charge is subject to the limitations of Section 1(e).[29]

When interpreting a provision of the California Constitution, a court will seek to determine and effectuate the intent of those who enacted the constitutional provision at issue. To determine the voters' intent, the court begins by examining the constitutional text, giving the words their ordinary meanings.[30] Cases interpreting what it means to impose a fee or charge are therefore instructive in this analysis.

In *Ponderosa Homes, Inc. v. City of San Ramon*,[31] the court examined what it means to "impose" a charge in the context of the Mitigation Fee Act. The court found that

> [t]he phrase "to impose" is generally defined to mean to establish or apply by authority or force, as in "to impose a tax."… As applicable here, the phrase refers to the creation of a condition or fee by authority of local government; it is not synonymous with the act of complying with that condition or fee.[32]

In *City of Madera v. Black,*[33] the court considered the meaning of the terms "tax," "impose," and "impost":

> A tax, in the general sense of the word, includes every charge upon persons or property, imposed by or under the authority of the Legislature, for public purposes. The word "impost," in its broader sense, means "any tax or tribute imposed by authority, and applies as well to a tax on persons as to a tax on property." … The money for which the plaintiff sued was a charge upon persons; it was imposed by the legislative authority of the city of Madera for public purposes, and under these definitions it was a tax; also, it was a tribute or contribution required by legislative authority and to be used for public purposes, and so comes within the definition of the word "impost."[34]

In *Richmond v. Shasta Community Services District*,[35] the court considered a water connection fee imposed by the district as a condition of receiving water service. In characterizing the fee, the court described it as a fee that "applicants for new water service connections would be required to pay."[36] In the context of Richmond, "imposed by" referred to a fee unilaterally adopted by the district and applied and charged to applicants for new service connections.

In summary, the courts have interpreted the term "impose" to mean an act of a local government, through ordinance or other legislative act, exercising its authority to levy, establish or apply something such as a tax on the public, a taxpayer, or a ratepayer. "Impose" therefore means a unilateral exercise of governmental authority to levy, establish, or apply a fee, charge, or exaction of some type. Thus, if a fee or charge is paid to a special district on a voluntary or negotiated basis, rather than by virtue of force or authority, the fee or charge arguably is not "imposed" and is therefore not subject to the provisions of Section 1(e). A discussion of each of the seven exceptions and the impact they may have on fees or charges "imposed" by special districts follows. Examples of specific fees and charges are provided to illustrate the application of Section 1(e) to fees and charges that may be imposed by a special district.

Imposing Fees For Benefits, Privileges, Services and Products

The first two exceptions of Proposition 26 clarify two situations as imposing a "tax" rather than a "fee." The first occurs when some fee payers are required to pay more so that other "fee" payers may pay less or nothing at all, an arrangement sometimes called a cross-subsidy. The second occurs when the "fee" imposed is greater than the local government's cost of conferring the benefit or privilege or providing the service or product. The second issue may be implicated by the first. The elements of Section 1(e)(1) and 1(e)(2) may be broken down as follows:

a fee is a tax if:

(1) the fee is imposed for a specific benefit conferred or privilege granted, or service or product provided directly to the payer and the same benefit is conferred, privilege is granted, or service or product is provided to others who are not charged for such benefit, privilege, service or product; and

(2) the fee exceeds the reasonable costs of the benefit conferred, privilege granted, or service or product provided.

As previously discussed, California Government Code section 50076 provides that any fee that does not exceed the reasonable cost of providing the service for which the fee is charged and that is not levied for general revenue purposes is not a special tax. While at first blush the provisions of Section 1 subdivisions (e)(1) and (2) do not appear to add anything new to when a fee may be deemed to be a tax, they do suggest that a more rigorous nexus for the imposition of fees and an accounting of the revenues from fees are now required. (For further discussion of these implications, see the discussion following under the heading "Burden of Proof.") Moreover, subdivisions (e)(1) and (2) extend the reach of what fees are deemed to be a tax to include fees not only for services, but also fees for a specific benefit conferred or privilege granted or specific government product provided.

Proposition 26 does not define what is meant by a "benefit," "privilege," "service," or "product." Applying a plain meaning to the terms "benefits" and "privileges,"[37] the types of fees that may fall within this category include fees for planning, permits, and licenses that grant an advantage or special legal right to perform or conduct certain activities. Similarly, the types of fees that fall within the category of "services" or "products" may include fees and charges imposed by special districts for gas and electric utility services, park and recreation services and programs, emergency response services,[38] wholesale water services,[39] and transit services.

In some instances, special districts provide services or products at discounted rates or at no cost to certain identified classes of individuals, or at differential rates for certain identified classes or

...a fee paid voluntarily by individuals who choose to participate in a program or receive services or products arguably is not "imposed."

individuals. These discounts may trigger other ratepayers' charges to be deemed to be "taxes" under Section 1(e). To demonstrate, the fees levied in the following examples may be implicated by Section 1(e)(1) and 1(e)(2):

- A county water district imposes a fishing permit fee for fishing in its local reservoir (i.e., a fee for a privilege or benefit) but waives the fee for local residents.
- A park district provides discounted fees to seniors and students who participate in a ceramics class (i.e., a fee for a service or product) provided at its community center.
- A community services district imposes different fees for adults, seniors, and children for swim classes (i.e., a fee for a service) provided at its aquatics center.
- An irrigation district provides gas and electrical service (i.e., a fee for a service or product) within its jurisdiction and provides discounted fees to low income customers.

In these examples, the fees may be deemed to be taxes if (1) the cost of providing the discount, fee waiver, or differential rate for the benefit, privilege, government service or product is diverted to other fee payers who are required to pay for the same benefit, privilege, government service or product; and (2) the fee or charge paid by the other fee payers exceeds the cost of providing the benefit, privilege, government service, or product. If, however, the incremental cost of providing the benefit, privilege, service, or product at a discount, or no cost is funded by unrestricted revenues other than the fees or charges imposed on other fee payers (e.g. real property tax revenues, grants, or donations), and the fees or charges imposed on the other fee payers do not exceed the cost of providing the benefit, privilege, service or product, the fees or charges would not be deemed taxes under Section 1(e)(1) or (1)(e)(2).

Notably, an argument can be made that the fees in the first three examples above are not taxes within the meaning of Section 1(e)(2). In these instances, the fees arguably are not "imposed" on the participants because the fee is not established or applied by authority or force, but rather is paid voluntarily by the person choosing to have the benefit conferred, privilege granted, or service or product provided.[40] Based upon the court decisions described previously interpreting what it means to impose a fee or charge, a fee paid voluntarily by individuals who choose to participate in a program or receive services or products arguably is not "imposed."

Imposing Regulatory Fees

Pursuant to Section 1(e)(3), a fee is not a tax if it is imposed for the reasonable regulatory costs of the local government. By definition, reasonable regulatory costs are limited to the costs of "issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof."[41] Any regulatory fees or charges,[42] or any portion of regulatory fees, imposed to recover other costs of a regulatory program, including (1) regulatory fees or charges imposed to mitigate the past, present, or future adverse impact of the fee payer's operations (like those identified in Sinclair Paint Co., discussed previously under the heading "Background"); and (2) regulatory fees and charges imposed to raise revenue for a new program or service,[43] are taxes under Section 1(e)(3).

The following examples are provided to demonstrate the types of regulatory fees and charges that may be implicated by Section 1(e)(3):

- In addition to a tipping fee, a community services district imposes on waste haulers delivering trash to a district-owned landfill a surcharge to mitigate the adverse impacts waste has on the environment. The fee is used to fund a no-cost program to dispose of household toxic materials (e.g., paint, solvents) and electrical appliances (e.g., computer hardware, small appliances).

- A fire protection district imposes an inspection fee for brush management on properties located adjacent to canyons, hillsides, and other open spaces. A portion of the inspection fee is used to fund an emergency preparedness education program.

- A municipal water district adopts a water conservation ordinance and imposes an inspection fee on property owners who violate the ordinance. A portion of the fee is used to fund a rebate program for the installation of low volume water fixtures.

In each of these examples, the fee, or a portion of the fee, could be deemed to be a tax because it is imposed to recover costs other than the reasonable regulatory costs to the local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administration and enforcement of the regulations. Because the fee would be imposed for a specific purpose, it would be deemed to be a special tax requiring a two-thirds voter approval.

Imposing Regulatory Fees and Charges Not Impacted by Proposition 26

Four categories of fees that are excepted from the definition of tax are unaffected by Proposition 26. These include the following specific categories of fees:

(1) charges imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property;[44]

(2) fines, penalties, or other monetary charges imposed by a court or local government as a result of a violation of law;[45]

(3) a charge imposed as a condition of development;[46] and

(4) assessments and property-related fees imposed in accordance with Article XIII D.[47]

Although the fees provided for in Section 1(e), subdivisions (4) through (7) are not taxes within the meaning of Section 1(e), they may or may not be subject to other constitutional or statutory limitations. Examples of fees under these exceptions and how certain constitutional or statutory requirements may affect them follows.

1. Fees and Charges For Use, Purchase, Rental, Or Lease Of Special District Property

- A park district discounts the special events fees paid by non-profit organizations for use of district-owned parks (i.e., a fee for use of real property).
- A California water district imposes a fee of $20.00 per hour for use of its boats at its local reservoir and provides discounted rates to local residents (i.e., a rental fee for use of personal property). [48]

In these examples, the public agencies would not be restricted from providing the discounts because the fees are imposed for entering, using, leasing, or renting local government property. There are no other limitations on the fees and charges public agencies may impose for these purposes. Rather, a local government may charge whatever the market will bear.[49]

Notwithstanding the foregoing, an argument can be made that, in the first example, the special event fee is a fee imposed for a benefit conferred or privilege granted under Section 1(e)(1)—i.e., the benefit or privilege of conducting the special event. In this instance it may be important to look at whether (1) the district's special events ordinance, resolution, or regulations require a permit (suggesting that this fee is imposed for a benefit conferred or privilege granted); (2) a contract is required between the district and the event holder (suggesting an arm's length transaction, and therefore a negotiated fee that is not "imposed"); or (3) the ordinance or resolution adopting the fee refers to the fee being imposed for the use of public property. This is a good example of how some fees may have more than one characteristic under Section 1(e). Consequently, it is important to establish in the administrative record the nature and purpose of the fee or charge to ensure that the fee or charge falls within one of the identified exceptions of Section 1(e), subdivisions (4) through (7).[50]

2. Fines and Penalties

- A cemetery district imposes a penalty of five percent for a late payment for a monument or marker at an interment plot.
- A park district imposes a fine of $1,500 for a first violation of its administrative regulation that prohibits any person from throwing a lighted cigarette onto park property.

The penalty in the first example is excepted from the definition of tax under Section 1(e)(2). The fine in the second example is also an exception under Section 1(e). However, in the second example the dollar amount of the fine is governed by another statutory restriction, namely, California Health and Safety Code section 13002(b), which limits penalties for throwing a lighted cigarette onto park property to no more than $1,000 for a first violation. As a result, the district may be preempted by state law from imposing a higher fine.

3. Fees Imposed as a Condition of Development

- As a condition of approval of a development project, a municipal utility district imposes a fee of $2.5 million for construction of a water pump station necessary to serve the proposed project. The estimated cost of the pump station is $1.5 million.

In this example, the fee is imposed as a condition of development and is an exception pursuant to Section 1(e)(6). The fee, however, is subject to the Mitigation Fee Act, which regulates development impact fees[51] Because the fee in this example exceeds the estimated reasonable cost of the facilities for which the fee is charged, it would be invalid and subject to challenge under the Act.[52]

Other Informative Guides

Find this guide useful? Check out CSDA's other informative guides: CSDA's Grassroots Advocacy Guide, Reserve Guidelines and Proposition 218 Guide for Special Districts.

4. Assessments and Property-Related Fees and Charges

- A resource conservation district levies an assessment for the acquisition of land for open space purposes but exempts city property located within the assessment district from the levy of the assessment.

Although assessments are an exception to the definition of a tax, they are restricted by the provisions of Article XIII D, section 4. Unless it can be shown that the city property in question does not receive any special benefit from the landscape improvements, the assessment would be invalid pursuant to Article XIII D section 4(a).

- An irrigation district discounts the rates of its water service fees imposed on low income water customers.

Water service fees are subject to the substantive limitations of Article XIII D, section 6, which require that the amount of a fee imposed upon any parcel or person as an incident of property ownership must not exceed the proportional cost of the service attributable to the parcel.[53] In this instance, to the extent that other water customers would be paying for the incremental cost of providing water service to low income water users, discounted water service fees would be prohibited. However, if no revenues from water service fees of other customers are used to fund the discount, the discount would not be prohibited.

5. Other Fees and Charges Not Imposed

- A community services district enters into a franchise agreement with a solid waste hauler to provide solid waste services to residential property within the district. Pursuant to the franchise agreement, the district collects a franchise fee from the solid waste hauler.

In this example, the franchise fee is the subject of an arms-length negotiation between the community services district and the waste hauler. Accordingly, it is not a fee "imposed" by the district but instead is an agreed-upon price for the right to provide solid waste services within the district. Because the fee is not "imposed" on the waste hauler, it is not a fee subject to Section 1(e). Moreover, the amount of the franchise fee that may be imposed is not necessarily restricted.[54]

Check out the endnotes!

Want to know more about the resources used to complete this guide? Check out the Endnotes section and find an extensive list of additional information on all things related to Proposition 26 as well as court cases related to this subject.


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Burden of Proof

Once a special district has determined to adopt a new fee or charge or increase an existing fee or charge that may be implicated by Section 1(e), the district should consider how it will demonstrate that the fee or charge in question is not a tax.

Once a special district has determined to adopt a new fee or charge or increase an existing fee or charge that may be implicated by Section 1(e), the district should consider how it will demonstrate that the fee or charge in question is not a tax. Pursuant to Section 1(e), local agencies have the burden of demonstrating by a preponderance of the evidence (i.e., that it is more likely than not)

> "...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 government activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity."[55]

Although this amendment does not change the law with respect to who bears the responsibility for proving that a fee or charge is not a tax, it does specify what standard of proof—a preponderance of the evidence—will be applied in the event of any challenge. Although this standard of proof is not rigorous, it does suggest that the proponents of Proposition 26 intended that a more rigorous documentation of expenses being paid for with local agency fees, and a more rigorous documented nexus between a local agency fee or charge and the allocation of related costs, will be required.

Because the burden is on a special district to demonstrate that its fees and charges are not taxes under Section 1(e), prior to adopting any new or increasing any existing fee or charge, a special district should carefully review the basis upon which the fee or charge is calculated. Additionally, the local government should ensure that the administrative record prepared in

connection with the adoption of the fee or charge provides a sufficient basis for demonstrating that the fee or charge qualifies within one of the seven exceptions.

It is worthwhile noting that the burden of proof language incorporated into Section 1(e) by the drafters of Proposition 26 repeats nearly verbatim the language of prior cases assessing whether a purported regulatory fee was in fact a fee or a special tax. As stated in *San Diego Gas & Electric Co. v. San Diego Air Pollution Control District*,

> [a] "special tax" under section 4 [of California Constitution article XIII A] does not embrace fees charged in connection with regulatory activities which do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and are not levied for unrelated revenue purposes. . . . [T]o show a fee is regulatory and not a special tax, the government should prove (1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which costs are apportioned, so that charges allocated to the payor bear a fair and reasonable relationship to the payor's burdens on or benefits from the regulatory activity.[56]

In *California Farm Bureau Federation v. State Water Resources Control Board*, the Supreme Court was called upon to determine the validity of a fee imposed upon water appropriators by the State Water Resources Control Board.[57] Although this case did not concern Section 1(e), the court analyzed the language that originated in San Diego Gas & Electric Co. and was later adopted by the drafters of Proposition 26. The court's analysis of whether the state had produced enough evidence to demonstrate a fee is not a tax is instructive regarding this burden of proof and should be considered by any special district in determining the amount of any fee or charge that may be subject to provisions of Section 1(e). The court held that

> [t]he scope of regulatory fees is somewhat flexible and is related to the overall purposes of the regulatory governmental action. . . . . The question of proportionality is not measured on an individual basis. Rather it is measured collectively, considering all rate payors. Thus, permissible fees must be related to the overall cost of the governmental regulation. They need not be finely calibrated to the precise benefit each individual fee payor might derive. What fee cannot do is exceed the reasonable cost of regulation with the generated surplus used for general revenue collection. An excessive fee that is used to generate revenue becomes a tax.[58]

Fees Grandfathered In by Proposition 26

Any new fees or charges or any increases to any existing fees or charges of a special district after the effective date of Proposition 26 must qualify under one of the seven exceptions.

Proposition 26 voids any existing fee or charge created or increased by the State between January 1, 2010 and November 2, 2010 that conflicts with Proposition 26 unless the fee or charge is reenacted by a two-thirds vote of both houses of the Legislature and approved by the governor within a year of the effective date of Proposition 26.[59] There are, however, no similar repeal provisions for existing local government fees and charges that may be deemed to be taxes under Section 1(e). Any new fees or charges or any increases to any existing fees or charges of a special district after the effective date of Proposition 26 must qualify under one of the seven exceptions or the fees or charges will be subject to the super-majority voter approval requirements of Article XIII C, section 2(d).

Conclusion

Special districts are restricted from imposing new or increasing certain types of fees and charges without voter approval as a result of Proposition 26. Particularly affected are (1) regulatory fees and charges imposed to mitigate adverse impacts on public health and safety and the environment or for purposes other than direct regulation; and (2) fees or charges imposed for a specific benefit conferred, privilege granted, or government service or product provided where discounts, fees waivers, or differential rates have been established and are subsidized by other fee payers. Fees in these categories may be reclassified as taxes following Proposition 26.

Future court interpretations of Proposition 26 and clarifying legislation will likely provide special districts with further guidance regarding the application of Proposition 26 to fees and charges. To avoid challenges to future fees and charges and increases to existing fees and charges, special districts should closely review:

(1) the purpose of the fee or charge proposed to be adopted and imposed;
(2) the basis upon which the fee or charge is calculated; and
(3) how revenues from the fee or charge are proposed to be expended.

A special district should be prepared to identify, preferably in the administrative record for the adoption of any fee or charge, why the fee or charge in question is not a tax within the meaning of Section 1(e).

Endnotes

1 Complete copies of the ballot initiative and ballot arguments submitted for and against Proposition 26 may be obtained at http://voterguide.sos.ca.gov/past/2010/general/propositions/26/index.htm.

2 "Local government" is defined in California Constitution article XIII C, section 1(a) to mean "any county, city, city and county, including a charter city or county, and special district, or any other local or regional government entity."

3 All taxes imposed by a special district are special taxes and must be submitted to the electorate and approved by two-thirds of the votes cast by the qualified voters voting on the proposition. Cal. Const. art. XIII C, § 2(d); Cal. Gov't Code § 53722; *Rider v. Cnty. of San Diego*, 1 Cal. 4th 1 (1991).

4 This Guide does not address in any length the impacts that Proposition 26 will have on the State. For an understanding of what impacts Proposition 26 may have on the State, reference may be made to the analysis of Proposition 26 by the Legislative Analyst's Office, which is available at http://www.lao.ca.gov/ballot/2010/26_11_2010.pdf.

5 *Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization*, 22 Cal. 3d 208, 231 (1978).

6 Cal. Gov't Code § 50076 (emphasis added).

7 *San Francisco Taxpayers Ass'n v. Bd. of Supervisors*, 2 Cal. 4th 571, 574 (1992).

8 *City of Sacramento v. State*, 50 Cal. 3d 51, 59 n.1 (1990).

9 *Cnty. of Sonoma v. Comm'n on State Mandates*, 84 Cal. App. 4th 1264, 1282 (2000).

10 *Cnty. of Fresno v. State*, 53 Cal. 3d 482, 487 (1991) (citations omitted).

11 *Long Beach Unified Sch. Dist. v. State*, 225 Cal. App. 3d 155, 174 (1990) (emphasis removed).

12 Property-related fees and charges include water, sewer, solid waste, and storm water service fees and charges. *See Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205, 214-15 (2006); *Howard Jarvis Taxpayers Ass'n v. City of Salinas*, 98 Cal. App. 4th 1351 (2002).

13 *Sinclair Paint Co. v. State Bd. of Equalization*, 15 Cal. 4th 866 (1997). Significantly, if a fee or charge is classified as a regulatory fee or charge, a simple majority vote of both houses of the State Legislature, or the legislative body of the local government proposing to adopt the fee or charge, is required for approval of the fee or charge. If a fee or charge is deemed to be a tax, a two-thirds approval of both houses of the State Legislature is required.

14 *Id.* at 875-76. The court held that

> [f]rom the viewpoint of the general police power authority, [there was] no reason why statutes or ordinances calling on polluters or producers of contaminating products to help mitigate or cleanup efforts should be deemed less "regulatory" in nature than the initial permit or licensing programs that allowed them to operate. Moreover, imposition of "mitigating" effects fees in a substantial amount . . . also "regulates" 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.

Id. at 877.

15 The police power derives from the authority of a local government to promote the public health, safety, morals, and general welfare of the community. *See* Cal. Const. art. XI, § 7; *Cnty. of Plumas v. Wheeler*, 149 Cal. 758, 762 (1906); *Comty. Mem'l Hosp. v. Cnty. of Ventura*, 50 Cal. App. 4th 199, 206 (1996); *Kern Cnty. Farm Bureau v. Cnty. of Kern*, 19 Cal. App. 4th 1416, 1424 (1993); *Carlton Santee Corp. v. Padre Dam Mun. Water Dist.*, (1981) 120 Cal. App. 3d 14, 24 (1981).

16 *Sinclair Paint Co.*, 15 Cal. 4th at 877-78.

17 *Cal. Ass'n of Prof'l Scientists v. Dept. of Fish & Game*, 79 Cal. App. 4th 935, 946-50 (2000) (the cost of comprehensive environmental review far surpassed the amount of the fees generated and therefore was a legal use of regulatory fees); *see, e.g., Cal. Bldg. Indus. Ass'n v. San Joaquin Valley Air Pollution Control Dist.*, 178 Cal. App. 4th 120 (2009) (upholding indirect source rule fee to fund off-site projects that will reduce emissions); *City of Oakland v. Superior Court*, 45 Cal. App. 4th 740 (1996) (upholding regulatory fees charged to alcoholic beverage sale licensees to support project to address public nuisances associated with those sales); *Kern Cnty. Farm Bureau*, 19 Cal. App. 4th 1416 (upholding landfill assessment based on land use to reduce illegal waste haulers); *San Diego Gas & Elec. Co. v. San Diego Cnty. Air Pollution Control Dist.*, 203 Cal. App. 3d 1132 (1988) (upholding air pollution permit fees based on volume of pollutants emitted by permittee rather than cost of staff time devoted to issuance of permit as regulatory fees).

18 *Cal. Ass'n of Prof'l Scientists*, 79 Cal. App. 4th at 945. A local government need only "apply sound judgment and consider probabilities according to the best honest viewpoint of informed officials in determining the amount of the regulatory fee." *United Bus. Comm'n. v. City of San Diego*, 91 Cal. App. 3d 156, 166 (1979) (internal quotation marks omitted).

19 Proposition 26, § 1(e) (uncodified).

20 *Id.*

21 *Id.* § 1(f) (uncodified).

22 A tax is a general tax only if its revenues are placed into the general fund of a local government and made available for any and all governmental purposes. *See* Cal. Gov't Code § 53721. A general tax may not be imposed by a local government unless it is submitted to and approved by a majority of the qualified electors voting in the election on the general tax. Cal. Const. art. XIII C, § 2(b); Cal. Gov't Code § 53723.

23 "The revenues from any special tax shall be used only for the purpose or service for which it was imposed, and for no other purpose whatsoever." Cal. Gov't Code § 53724(e). A special tax may not be imposed by a local government unless it is submitted to and approved by a two-thirds vote of the qualified electors voting in the election on the issue. Cal. Const. art. XIII C, §2(d); Cal. Gov't Code § 53722. Article XIII C, section 2(a) provides that, to the extent that they possess the power to tax, "[s]pecial purpose districts or agencies, including school districts, shall have no power to levy general taxes." Any tax imposed by a special purpose district or agency, including school districts, is therefore a special tax.

24 The courts have previously acknowledged that the term

> "tax" has no fixed meaning, and that the distinction between taxes and fees is frequently 'blurred,' taking on different meanings in different contexts. In general, taxes are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted. Most taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges.

Sinclair Paint Co. v. State Bd. of Equalization, 15 Cal. 4th 866, 874 (1997) (citations omitted).

25 Although there are minor language differences between them, Proposition 26 adds a similar definition of "tax" to Article XIII A, section 3 that will be applicable to taxes imposed by the State. For the State, however, the definition provides only five exceptions. Excluded from the definition of "tax" in Article XIII A, section 3(b) are fees imposed as a condition of property development and assessments and property-related fees imposed pursuant to Article XIII D.

26 It is worth noting that the drafters of Proposition 26 have used language almost identical to that used by the court in *Sinclair Paint Co.*: "In general, taxes are imposed for revenue purposes, rather than in return for a *specific benefit conferred or privilege granted*." *Sinclair Paint Co.*, 15 Cal. 4th at 874.

27 Cal. Const. art. XIII C, § 1(e) (emphasis added).

28 A "charge" is generally synonymous with a "fee." The term "fee" is defined as a "fixed charge." *The Merriam-Webster Dictionary* 264 (11th ed. 2004). "Exaction" generally means a monetary exaction such as taxes, fees, rates, charges, assessments, and development fees. *See Apartment Ass'n of Los Angeles Cnty.,* 24 Cal. 4th at 839; *Ehrlich v. City of Culver City*, 12 Cal. 4th 854, 892 (1996) (Mosk, J., concurring); 70 Ops. Cal. Atty. Gen. 153 (1987).

29 The terms "levy" and "impose" may be used interchangeably. *Howard Jarvis Taxpayers' Ass'n v. Fresno Metro. Projects Auth.*, 40 Cal. App. 4th 1359, 1373 (1995).

30 *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205, 212 (2006).

31 *Ponderosa Homes, Inc. v. City of San Ramon*, 23 Cal. App. 4th 1761 (1994).

32 *Id.* at 1770 (citation omitted) (quoting *Webster's Third New International Dictionary* 1136 (1970)). Similarly, the Merriam-Webster online dictionary defines to "impose" as "to establish or apply by authority," such as to impose a tax, impose new restrictions, or impose penalties. *Definition of "Impose,"* Merriam-Webster, http://www.merriam-webster.com/dictionary/impose (last visited July 16, 2012). As an example, the dictionary provides: "The judge *imposed* a life sentence." Synonyms include "assess," "charge," "exact," "fine," and "levy."

33 *City of Madera v. Black*, 181 Cal. 306 (1919).

34 *Id.* at 310-11 (citations omitted); *see also Howard Jarvis Taxpayers' Ass'n*, 40 Cal. App. 4th at 1373 (stating that "impose" is synonymous with "levy," which means to impose, levy, or collect a tax, tribute, fine, or other payment); *Dare v. Lakeport City Council*, 12 Cal. App.3d 864, 868 (1970) (using the word "impose" to refer to a tax, fee, or burden imposed by ordinance or other legislative action).

35 *Richmond v. Shasta Cmty. Servs. Dist.*, 32 Cal. 4th 409 (2004).

36 *Id.* at 416.

37 *Black's Law Dictionary* defines "benefit" to mean an "advantage or privilege," and defines "privilege" to mean a special legal right granted to a person or class of persons. *Black's Law Dictionary* 178 (9th ed. 2009). "A privilege grants someone the legal freedom to do or not do a given act." *Id.* at 1316; *see also The Merriam Webster Dictionary* 573 (11th ed. 2004) (defining "privilege" to mean "a right or immunity granted as an advantage or favor especially to some and not others).

38 Although fees for gas and electrical services are specifically exempted from the substantive and procedural requirements of Article XIII D, these same fees are not exempted from the provisions of Article XIII C or the provisions of Section 1(e). *See* Cal. Const. art. XIII D, § 3(b). Because Section 1(e)(2) is applicable to services and products provided directly to a fee payer, public agencies that provide gas and electrical service will likely be required to ensure that fees provided for those services do not exceed the reasonable cost of providing the service and comport with the provisions of Section 1(e)(2) and California Government Code section 50076.

Fees imposed by a city for gas and electric utility services were the subject of a recent post-Proposition 26 challenge in the City of Redding. *See Citizens for Fair REU Rates v. City of Redding*, No. CV-11-171377 (Cal. Super. Ct. 2011), *available at* http://media.redding.com/media/static/REU_Decision.pdf. The City of Redding operates an electric utility and imposes a payment in lieu of taxes ("PILOT") on the utility. The City's electric utility revenues are accounted for separately from the City's general fund revenues. The PILOT was established at the rate of one percent of the electric utility's total fixed assets, as if the utility were paying property taxes on them. The revenues from the PILOT are transferred to the City's general fund and used for general purposes of the City. In December 2010, after the adoption of Proposition 26, the City approved a rate increase to its electric service fees. No change, however, was made to the rate of the PILOT. A group of citizens challenged the City's electric service fees as a tax. They asserted that the passage of the resolution adopting the rate increases incorporated the PILOT. Because the PILOT is not attributable to any costs incurred by the utility or the City for providing electric service, the citizens' group claimed that the fees exceeded the cost of providing the service and were therefore taxes within the meaning of Section 1(e)(2). The City argued that the transfer was approved legislatively and occurred as a part of its budget process, and was therefore not an increase to its electric service fees. At the time of publication of this Guide, the City of Redding was successful in defeating the challenge, but an appeal is likely. The ultimate outcome of this case may provide guidance on which types of fees fall within the penumbra of Section 1(e)(2).

39 Wholesale water service fees are not property-related fees because they are not imposed as an incident of property ownership. Consequently, water service fees are not subject to the provisions of California Constitution article XIII D, section 6. However, water service fees may qualify as fees for a service or product and may therefore be subject to the provisions of Section 1(e)(2).

40 *Ponderosa Homes, Inc. v. City of San Ramon*, 23 Cal. App. 4th 1761, 1770-72 (1994) (discussing what it means "to impose" a charge in the context of the Mitigation Fee Act). For further discussion of what it means to impose a fee or charge, see the discussion under the heading "When Are Fees and Charges Imposed?"
41 Cal. Const. art. XIII C, § 1(e)(3). Proposition 26 provides a similar limitation in Article XIII A, section 3(b)(3). The State currently funds most of its environmental programs through such regulatory fees and will be significantly impacted by the amendment.
42 Examples of regulatory fees that may be impacted include fees for permits and licenses for fire, building, and other health and safety related permits.
43 Regulatory fees imposed to raise general fund revenues are already deemed to be special taxes pursuant to California Government Code section 50076.
44 Cal. Const. art. XIII C, § 1(e)(4). Examples include fees for use of park district playing fields, park entrance fees, community services district golf green fees, entrance fees for a community services district aquatic center, rental of tennis racquets at a park district tennis and racquet facility, and rental payments to a cemetery district for locating a cell tower on its property.
45 Cal. Const. art. XIII C, § 1(e)(5). Examples include local government administrative fines and penalties for violations of water district rules and regulations or fire district policies and procedures.
46 Cal. Const. art. XIII C, § 1(e)(6). Examples include development impact fees and construction permit fees.
47 Cal. Const. art. XIII C, § 1(e)(7). Examples include assessments imposed pursuant to the Landscape and Lighting Act of 1972 and water, sewer, and solid waste service fees.
48 Section 1(e)(4) does not distinguish between a local government's real and personal property. Consequently, the term "property" in Section 1(e)(4) includes both real and personal property. Because fees imposed for use of local government property are not otherwise restricted, the district may provide the discount.
49 *City of Oakland v. Burns*, 46 Cal. 2d 401, 407 (1956).
50 See the discussion under the heading "Burden of Proof."
51 *See* Cal. Gov't Code §§ 66000-66025.
52 *See Id.* § 66001.
53 Cal. Const. art. XIII D, § 6(b)(3); *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205 (2006).
54 *See* Cal. Pub. Res. Code § 40059(a)(2) ("The authority to provide solid waste handling services may be granted under terms and conditions prescribed by the governing body of the local governmental agency by resolution or ordinance.")
55 Cal. Const. art. XIII C, § 1(e).
56 *San Diego Gas & Elec. Co. v. San Diego County Air Pollution Control Dist.*, 203 Cal. App. 3d 1132, 1145-46 (citations omitted); *see also Sinclair Paint Co.*, 15 Cal. 4th at 878.
57 *Calif. Farm Bureau Fed'n v. State Water Res. Control Bd.*, 51 Cal. 4th 421
58 *Calif. Farm Bureau Fed'n*, 51 Cal. 4th at 438.
59 Cal. Const. art. XIII A, § 3(c).

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