

June 9, 2015

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed a statutory initiative regarding bottled water (A.G. File No. 15-0021).

BACKGROUND

Sales and Use Taxes and Excise Taxes. California’s state and local governments levy sales and use taxes on retail sales of most tangible goods. Under the State Constitution and state statute, many foods and beverages—including bottled water—are currently exempt from California’s state and local sales and use taxes. The state also imposes taxes known as “excise taxes” on some specific goods, such as cigarettes and gasoline. There is currently no excise tax on bottled water.

Water Infrastructure. California’s state and local governments have built water projects that serve a variety of purposes, including the delivery, storage, and treatment of water. Most of California’s spending on water programs occurs at the local level. In recent years, local governments, such as cities, counties, and water districts, have spent about \$26 billion per year to supply water and to treat wastewater. About 80 percent of this spending is paid for by ratepayers of water and sewer bills. In addition, local governments pay for projects using other sources, including state funds, federal funds, and local taxes.

Labeling for Bottled Water. Current state law requires that labels on bottled water include certain information, such as the source of the bottled water and the bottler’s name and contact information.

PROPOSAL

Eliminates Statutory Sales and Use Tax Exemption for Bottled Water. As mentioned previously, bottled water is currently exempt from California’s state and local sales and use taxes. This measure would remove bottled water from the statutory list of exempt items. Bottled water would continue to be exempted under the State Constitution.

Creates Excise Tax on Bottled Water. The measure would impose an excise tax on bottled water from various sources within the state, including surface water, groundwater, and municipal water supplies. The tax rate would be five cents per ounce—equivalently, 60 cents on a 12-ounce bottle of water. This likely would make bottles of California water much more expensive than bottles of water from elsewhere.

Directs Revenue Toward Water Infrastructure. The measure would allocate the revenue from the proposed taxes on bottled water to the construction, maintenance, and repair of water infrastructure such as dams, levies, water treatment facilities, and water desalination plants.

Requires Labels on Bottled Water. The measure would require that bottles of water sold in California display (1) contact information for the bottlers' parent companies and (2) a message indicating that the water is "not drought friendly."

FISCAL EFFECTS

Various legal challenges likely would arise concerning implementation of this measure, including challenges concerning the legality of its taxes under both the U.S. and State Constitutions. The fiscal impact of the measure would depend on how the courts act in these cases, as well as how water bottlers and governments respond to the new law. As a result, there is significant uncertainty regarding the fiscal impacts of the measure.

Sales and Use Tax Revenue. This measure does not amend the State Constitution. Accordingly, the measure would not remove the constitutional sales and use tax exemption for bottled water. For this reason, we believe the measure would not raise any sales and use tax revenue.

Excise Tax Revenue. The excise tax revenue raised by the measure would depend on how water bottlers respond to the tax and on how courts regard this tax. Assuming the excise tax can be implemented, it would greatly increase the production cost of water bottled in California, thereby strongly reducing or eliminating the ability of businesses to produce bottled water in the state. Bottled water currently produced in California could be produced or bottled elsewhere. Therefore, the excise tax, if implemented, would likely result in the elimination of all or almost all water bottling in California and raise little excise tax revenue. If, however, a few producers continue to bottle water in California despite the economic disincentives of the excise tax, this tax could raise significant revenue—totaling hundreds of millions of dollars or more per year.

State Spending on Water Infrastructure. To the extent that the measure generates sales or excise tax revenue, it would increase state spending on water infrastructure.

State Administrative Costs Related to Excise Tax. If some businesses continued to bottle water in the state, administering the tax would likely cost millions of dollars per year.

Lower Revenues and Costs for Water Utilities. As described above, this measure would likely reduce water bottling in California substantially. As a result, some of the state's municipal water utilities would collect less fee revenue from current bottled water producers but may also have lower costs. These effects could be significant for a few local water utilities. However, the aggregate statewide effect on local water utilities would likely be minor.

Other Economic Effects. The measure's taxes, if able to be implemented, likely would result in other changes to the state's economy and tax revenues, which cannot be predicted with precision. For example, companies with facilities, equipment, and staff now producing bottled water in the state may attempt to transition to production of beverages not subject to this measure's taxes, and prices of bottled water consumed by Californians could change slightly.

SUMMARY OF FISCAL EFFECTS

This measure would have the following fiscal effects:

- If the measure is able to be implemented, an uncertain, but likely small, net change in state revenues, with any bottled water excise tax revenues funding water infrastructure.
- Potential state costs of up to millions of dollars per year to administer the excise tax.
- Likely reduction in fee revenue and costs for some municipal water utilities.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance