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December 15, 1999

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Connie Lemus
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Section 9005 of the Elections Code, we have reviewed the proposed initiative entitled the "Two-Thirds Vote Preservation Act of 2000" (File No. SA 1999 RF 0060).

Background

Current law generally allows the state and local governments broad discretion in establishing fees and charges. These revenues are collected for the privilege of engaging in certain activities, and for the purpose of regulating a particular activity. In some cases—such as many user charges, admission fees, and some regulatory fees—the payment is closely linked to the cost of providing a particular service to an *individual* beneficiary or regulated party. In other cases—for example, certain environmental or regulatory fees—the payment may not be directly related to the costs associated with particular participants, but more loosely related to a discrete *group* of participants or an industry. In some situations, the payment may not relate to direct regulation per se, but rather to broad social costs associated with particular activities—for example, environmental mitigation fees.

Although the state and local governments enjoy wide latitude in establishing fees and charges, under current law some link must exist between these payments and the related cost to governments in order to avoid the voter approval requirements of a "tax." Fees or charges must be based on some established relationship between the amount of the payment on the one hand, and the costs associated with the regulation of an activity or the provision of a good or service, on the other. If a sufficient relationship, or "nexus," is not established between the fee and costs of provision or regulation, the charge is considered a tax.

Proposal

This constitutional measure seeks to expand the definition of the word "tax." It does so by specifying that certain compulsory fees that do not impose a significant "regulatory obligation" on the fee payors' activities shall be deemed taxes. While the scope of this definition of tax is not clear (as discussed below), the proposed definition may recast as a "tax" some future state and local governmental revenue-raising measures that otherwise would be considered fees or payments to government. To the extent that a future governmental revenue source is recast as a "tax" by this measure, the revenue source becomes subject to existing constitutional provisions relating to:

- ***Governing Body and Voter Approval Requirements.*** Specifically, state tax increases require approval by two-thirds of the Legislature; local tax increases must be approved by a majority or two-thirds of the local electorate.
- ***Expenditures Limits.*** Under the California Constitution, each level of government has a limit on the amount of tax revenues it may spend.

The measure specifies that its provisions do not apply to any fee authorized by law prior to July 1, 1999, or to any increase in such fee which is attributable to inflation or increased workload.

Fiscal Effect

The fiscal effect of the new definition of tax is subject to considerable uncertainty, as it would be dependent upon a number of factors. For instance, there are many legal questions as to the definition given various terms used in the measure, such as: "regulating the activity," "regulatory obligation," and "societal and economic effects of an activity." For example, if the courts adopt (1) a narrow interpretation of the types of programs which may be included as part of "regulating the activity" and (2) an expansive definition of the other two terms, the scope of this measure may be broad. Con-

versely, if the courts allow a wide variety of programs and activities to be a component of "regulating the activity" and narrow definitions of the other terms, the scope of this measure would be very limited.

The fiscal effect of this measure also would depend on future actions by state and local governments. For example, government entities may be able to avoid having some fees reclassified as taxes if they enact broad regulatory programs in conjunction with new fees.

Given these factors, estimating the level of future government revenues that would be affected by the measure is subject to considerable uncertainty. The measure, however, may result in the reclassification of some future state and local fee revenue into taxes. These revenues, in turn, would then require approval by the Legislature or local governing bodies and the local electorate in order to be continued. To the extent governments were unable to obtain such approvals, they would experience reductions in revenues. The magnitude of this potential reduction in future fee revenues is unknown, but could range from minimal to significant.

Summary

The measure would result in the following major fiscal impact:

- Unknown, but potentially significant, reduction in future state and local fee revenues as a result of classifying more governmental revenues as taxes.

Sincerely,

Elizabeth G. Hill
Legislative Analyst