



## State & Local Tax Bulletin December 1996

### California Voters Approve Proposition 218's Property Tax Limitations

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On November 5, 1996, California voters approved Proposition 218, an initiative designed to give taxpayers the right to approve or reject local governments' tax increases and special assessments on property. Proposition 218, principally sponsored by the Howard Jarvis Taxpayers Association, is intended to close existing loopholes under Proposition 13 and Proposition 62 which have allowed local governments to burden residents with property-related assessments, fees and charges. Proposition 218 also seeks to expand the 1995 state Supreme Court ruling (*Santa Clara County Local Transportation Authority v. Guardino*<sup>1</sup>) that upheld Proposition 62's voter approval requirements. Proposition 218, which is a constitutional amendment:<sup>2</sup>

- Requires majority voter approval for all local general taxes and two-thirds voter approval for all local special taxes.
- Requires voter approval of existing local taxes enacted after January 1, 1995.
- Applies to all local governments and special districts, including charter cities.
- Defines a special tax as any tax imposed for specific purposes, even if placed into a general fund.
- Requires majority property owner approval of benefit assessments, by weighted voting, of benefit assessments.
- Limits assessments to the special benefits conferred.
- Limits fees and charges to the costs of services provided. Except for fees for sewer, water and refuse collection services, property-related fees would require either majority approval of the fee payers or two-thirds approval of voters.
- Provides that the initiative power shall not be restricted from reducing or repealing local taxes, assessment and fees.

#### Background

##### *Proposition 13 and Proposition 62*

In 1978, voters approved Proposition 13, a constitutional amendment lowering property taxes and placing other restrictions on local government taxation.

Proposition 13 also required two-thirds voter approval of special taxes imposed by cities, counties and special districts.<sup>3</sup> General taxes were not subject to a popular vote requirement. In 1982, the California Supreme Court determined that special taxes were taxes earmarked for a specific purpose, whereas general taxes were taxes that were placed in the general fund to be used for general government purposes.<sup>4</sup>

In 1986, voters approved Proposition 62,<sup>5</sup> a statutory initiative which required majority voter approval of local general taxes and restated the two-thirds voter approval requirement for local special taxes. However, in response to subsequent California court decisions, which labeled the general tax vote requirement unconstitutional, cities, counties and other local governments increased or imposed new general taxes in the 1990s without voter approval. These commonly took the form of utility users taxes, business license fees and hotel taxes.

##### *The Guardino Case*

In 1992, Santa Clara County placed Measure A, a countywide one-half percent sales tax for transportation, on the ballot. After Measure A was approved by 54.1 percent of the voters, the county was prepared to issue bonds payable from the anticipated revenues of this tax. However, opponents of the tax filed lawsuits and the county auditor-controller refused to sign the bonds until the tax's validity was determined.

The California court of appeal, exercising original jurisdiction, held the tax invalid under Proposition 13 because the tax was a special tax requiring a two-thirds vote. In September 1995, the state Supreme Court affirmed the judgment of the court of appeal in *Santa*

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*<http://www.pmstax.com/state/218prop9612.html>*

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*Clara County Local Transportation Authority v. Guardino*, but on the grounds that the tax violated Proposition 62 and its two-thirds vote requirement for special taxes. By deciding the *Guardino* case on the basis of Proposition 62, the Supreme Court held that Proposition 62 is constitutional.

#### *After Guardino*

Although *Guardino* established Proposition 62's validity, certain issues remained unresolved. Uncertain was whether charter cities, which are created under the California Constitution, were subject to Proposition 62, a statutory initiative. Also unresolved was whether *Guardino* would retroactively invalidate post-Proposition 62 special taxes which did not receive two-thirds voter approval, and if a tax were invalidated whether local governments owed refunds on such taxes collected.

Constrained by Proposition 13 and confronted with shrinking budgets, many local governments looked for ways to raise revenues while avoiding Proposition 13's restrictions. They seized upon property-related assessments, which traditionally were used to fund capital improvements that directly benefited property. Because Proposition 13 did not subject assessments to voter approval, local governments quickly broadened their use of assessments. Thus, Proposition 218 was placed on the ballot to expand *Guardino* and close the assessment and other loopholes in Proposition 13.

### **Proposition 218**

#### *Effective Date*

By its provisions, Proposition 218 took effect on November 6, 1996.

#### *Governmental Entities Covered*

Proposition 218 applies to local governments, which include cities, counties, charter cities or counties and special districts in California. Special districts include redevelopment agencies, school districts and, though not expressly listed, community facilities districts.

#### *Taxes, Assessments and Fees Covered*

According to the legislative analyst's estimates, approximately \$100 million of annual taxes, assessments and fees will be affected by Proposition 218.

Proposition 218 applies to both general and special taxes. Special taxes are defined as taxes imposed for specific

purposes, even if placed in the general fund. Under Proposition 218, all future local general taxes, including those imposed by charter cities, must be approved by a majority vote. Existing local general taxes established on or after January 1, 1995 must be ratified by November 1998 or be forgiven. General taxes, such as the hotel room tax, imposed by charter cities are now subject to voter approval.<sup>6</sup> Local governments may not increase or impose new special taxes without two-thirds voter approval.

Proposition 218 also applies to "benefits assessments," "special assessments" and "maintenance assessments," affecting street lighting and landscaping districts, landscape maintenance assessment districts and other assessment districts. In California, property has been assessed for a variety of things such as parks, playgrounds, street lighting, sidewalks, rapid transit, flood control, libraries, police and fire services. Local governments have created assessment districts to levy such assessments. In 1992, the California Supreme Court ruled that Proposition 13 was not intended to limit traditional benefit assessments and thus upheld the validity of a city's special assessment for park maintenance under the Landscaping and Lighting Act of 1972.<sup>7</sup>

However, under Proposition 218, only special benefits and not general benefits are assessable. Special benefits should include traditional improvements that enhance property such as roads, sewers, sidewalks and street lights. On the other hand, general benefits likely include such general government services as emergency services, flood control, habitat for endangered species, open space acquisition, school landscaping and beach cleanup. Proposition 218 leaves unclear whether parks and park maintenance are general or special benefits. The amount of assessments, which must be approved by a majority vote, is limited to the special benefit received by the property owner.

In addition, government-owned property, including schools, will be subject to assessments, unless the government can show that its property receives no special benefit. Finally, only property owners and any renters responsible for paying assessments will have the right to vote on certain assessments. Voting will be weighted based on the amount of the assessment the property owner or renter would pay. Commercial property owners and school districts will have more voting power under this weighted voting provision. Local governments have until July 1, 1997 to obtain a majority vote from property owners for existing assessments that do not meet these new requirements. Existing assessments (1) previously

approved by voters, (2) where all the funds are used to repay bond obligations or (3) where all the funds are used to pay for sidewalks, streets, sewers, water, flood control, drainage systems or mosquito control are exempted from the new requirements.

Proposition 218 also restricts local governments' ability to charge property-related fees. Property-related fees include fees for water, sewer, garbage collection and street sweeping, but specifically does not include gas and electric fees and fees charged to land developers. Proposition 218 limits a property owner's fee to the cost of providing service to that property owner's land. However, no fee may be charged for widely available public services such as fire, police, ambulance and libraries. All local property-related fees must comply by July 1, 1997. New property-related fees, other than sewer, water and refuse collection fees, may not be imposed if a majority of the affected property owners submit a written protest.

#### *Effect on California Municipal Bonds*

Proposition 218 may affect some forms of municipal bond financing, such as general obligation bonds and Mello-Roos Bonds, if the taxes or assessments funding such bonds do not receive the requisite voter approval. Although Proposition 218 assures the repayment of bonds already issued, certain development projects funded by assessment district bonds issued in multiple phases could be affected adversely. For example, certain infrastructure and development projects funded by development bonds that were sold in the first phase of the project but that are dependent on a second phase of bonds being sold could be at risk if the assessments to fund the second-phase bonds do not get a majority voter approval. In addition, bonds such as lease revenue bonds sold by charter cities and secured by taxes from the general fund may be at risk.

#### *Effect on California State Taxes*

Although Proposition 218 specifically addresses local taxes, fees and assessments under section 4 of Article XIII A of the California Constitution, Proposition 218 may impact the interpretation of the term "State taxes" under Article XIII A, section 3. Article XIII A, section 3, which was added to the Constitution as part of Proposition 13, requires that increases in State taxes be passed by a two-thirds vote in both the Assembly and the Senate.

There is no such requirement with respect to fees, which may be passed by a majority vote of the Legislature. Thus, there would appear to be a strong incentive for the Legislature to attempt to avoid the restrictions of Article XIII A, section 3 by enacting "fees" rather than "taxes."

For example, at issue in *Sinclair Paint Company v. Board of Equalization*,<sup>8</sup> a case now pending before the California Supreme Court, is whether the "fee" imposed under the Childhood Lead Poisoning Prevention Act of 1991 (the "Act")<sup>9</sup> is in reality a tax which failed to receive the two-thirds vote of each house of the Legislature as required under Article XIII A, section 3. Under the Act, certain organizations are required to pay annual amounts denominated as "fees." The "fees" imposed by the Act are compulsory rather than voluntary exactions which serve a broad public purpose, and, as argued in *Sinclair Paint*, those paying the "fees" receive no particular government service or direct benefit. Although Proposition 218 does not directly address the issue whether State taxes include fees for purposes of Article XIII A, section 3, Proposition 218 makes clear that property-related "fees" are taxes and not fees if such "fees" are used for general public services. Thus, through Proposition 218 the voters have sent a clear message that the intentions of the voters in passing Proposition 13 cannot be so easily thwarted by calling a tax a "fee," because a tax by another name is still a tax.

#### Notes

- <sup>1</sup> 11 Cal. 4th 220 (1995).
- <sup>2</sup> Proposition 218 adds Articles XIII C and XIII D to the California Constitution.
- <sup>3</sup> Cal. Const. art. XIII A, § 4.
- <sup>4</sup> *City and County of San Francisco v. Farrell*, 32 Cal. 3d 47 (1982).
- <sup>5</sup> Cal. Gov't Code §§ 53720-53730.
- <sup>6</sup> Charter cities include San Francisco, Los Angeles, Long Beach, Sacramento, San Jose and most other large California cities.
- <sup>7</sup> *Knox v. City of Orland*, 4 Cal. 4th 132 (1992).
- <sup>8</sup> 49 Cal. App. 4th 127, review granted, \_\_\_ Cal. 4th \_\_\_ (1996).
- <sup>9</sup> Cal. Health & Safety Code §§ 105275-105310.