

June 18, 1992

REPORT TO THE HONORABLE  
MAYOR AND CITY COUNCIL

PROPOSED REALLOCATIONS OF REVENUES DERIVED  
FROM PROPERTY TAXES AND VEHICLE LICENSE FEES  
BY STATE LEGISLATURE; VALIDITY THEREOF

At your budget meeting of June 11, 1992, you were advised by City Manager Jack McGrory that State officials, in an effort to balance the State budget, are considering amendments to certain State statutes which presently provide for the allocation to California cities of some of the revenues derived from property taxes and vehicle license fees. Although, this State budget balancing process is being conducted behind closed doors, it is our understanding that the proposals involve a two-step process wherein the revenues derived from property taxes and vehicle license fees, currently allocated and appropriated to cities, would be reallocated to the counties and then certain revenues currently allocated to counties would be in turn reallocated to either school districts or the State itself. The end result would be a loss of substantial anticipated revenue to the cities, including the City of San Diego. We have been asked to examine the validity of such proposals and give you our views. A summary analysis follows:

VEHICLE LICENSE FEES (VLF)

The Motor Vehicle License Fee is imposed by the State pursuant to sections 10751-10758 of the California Revenue and Taxation Code. The fee is payable annually and is equal to 2% of the market value of the licensed vehicle. The market value is defined as the purchaser's cost (minus sales taxes), adjusted by a fixed depreciation schedule.

Motor Vehicle License Fees are collected annually by the Department of Motor Vehicles at the time of vehicle registration or renewal. Revenue is collected and held in the State Motor Vehicle License Fee Account until disbursement to cities and counties.

After deductions are made from this account for certain costs, the revenue is currently distributed to cities and counties pursuant to legislation passed by the Legislature and signed by the Governor in 1991. According to the City Manager's

Fiscal Year 1993 Budget, the City expects to receive \$45.3 million from Vehicle License Fees which is 9.2% of the General Fund revenues.

At the June 3, 1986 State election, the Constitution of the State of California was amended by Proposition 47 to add section 15(a), Article XI, which states:

SEC. 15. (a) All revenues from taxes imposed pursuant to the Vehicle License Fee Law, or its successor, other than fees on trailer coaches and mobile homes, over and above the costs of collection and any refunds authorized by law, shall be allocated to counties and cities according to statute.

This section requires the State to allocate ALL VLF revenues (other than fees on trailer coaches and mobile homes, and minus collection costs and refunds) to cities and counties according to statute. While the Legislature can change the allocation between cities and counties, it cannot divert VLF revenues to other governmental entities or to the State General Fund.

According to the Argument in Favor of Proposition 47 included in the California Ballot Pamphlet, this amendment was proposed because the Legislature started diverting these fees to State budget purposes although they had traditionally been returned to cities and counties to provide local services.

Both the Official Title and Summary prepared by the Attorney General and the analysis of the Legislative Analyst made it clear that the measure would prevent the Legislature from changing the law to take any portion of vehicle license fees away from counties and cities. Both the Attorney General and the Legislative Analyst also made clear that the State still could reduce other forms of aid to local government or change the existing formula for dividing vehicle license fee revenues between counties and cities. (See a copy of California Ballot Pamphlet, pp. 20 and 21 from the June 3, 1986 Primary Election attached as Enclosure (1).)

An argument can certainly be made that, if the Legislature changes the allocation formula to appropriate most or all of the VLF revenue to the counties and then withholds from the counties' other revenue sources a like amount to appropriate to the schools or the State General Fund, that article XI, section 15 of the State Constitution has been violated. The Legislature would have accomplished indirectly what is clearly prohibited by the State

Constitution. We find no case law preventing the Legislature from doing this, however; and the analysis of the Constitutional amendment by the Attorney General and the Legislative Analyst seem to contemplate a possibility along those lines.

#### PROPERTY TAXES

It is our view that the State Legislatures' proposal to reallocate the cities' property tax revenues to the counties, and then reallocate these revenues to either the school districts or to the State itself, is highly questionable.

Currently, California real property tax revenue allocation is accomplished under a statutory scheme commonly known as Assembly Bill 8 (AB 8) (Statutes of 1979, Chapter 282) (codified at Revenue and Taxation Code Sections 93 and 95 et seq.). AB 8 was enacted in 1979 as the Legislature's response to the passage of Proposition 13. In general, AB 8 shifted part of the property tax revenues from schools to cities, counties, and special districts to fill the funding gap created by the termination of the state block grants. Doerr, *The California Legislature's Response to Proposition 13*, 53 So. Cal. L. R. 77, 85 (1979). The objective of this plan was to establish a local government revenue base at the same level of support as in the previous year with additional revenues for inflationary increases in costs from the growth in property tax. *Id.* It eliminated the State's role in providing cash grants to localities, promoting local responsibility and accountability. *Id.* It further incorporated the property tax provisions relating to the situs distribution of growth by adjusting the base for change in boundaries or transfer of service responsibilities and reducing property tax burdens within each local jurisdiction. *Id.* Under this scheme, the City of San Diego currently receives approximately 20% of the property tax revenue collected, which is estimated to be \$146.8 million for Fiscal Year 1993. Fiscal Year 1993 Proposed Budget at 37. This represents 29% of the General Fund Budget.

Proposition 13, which AB 8 implemented, added new Article XIII A to the California Constitution. Section 1(a) of Article XIII A limits ad valorem taxes on real property to one percent (1%) of its full cash value. Cal. Const. art. XIII A, Section 1(a). Under that section, the one percent (1%) tax is to be "collected by the counties and apportioned according to law to the districts within the counties." *Id.* (emphasis added). Thus, allocation of the property tax under the California Constitution is to be made pursuant to "law."

It is our belief that the term "law" in Section 1(a), Article XIII A, of the California Constitution is used in the generic sense. "Law, in its generic sense, is a body of rules of action or conduct prescribed by controlling authority and having

binding legal force." Black's Law Dictionary 884 (6th ed. 1990) (citing *United States Fidelity and Guarantee Co. v. Guenther*, 281 U.S. 34, 37 (1930)). Thus, the term "law" includes decisions of courts, as well as legislative acts or statutes. *Warren v. United States*, 340 U.S. 523, 526 (1951); *Miller v. Dunn*, 72 Cal. 462, 466, 14 P. 27, 29 (1887). That "law" in Section 1(a) is meant in the generic sense is supported by interpretations of that term with regard to sections of the Federal Constitution, see, e.g., *In re Asbestos Litigation*, 829 F.2d 1233, 1235 (3d Cir. 1987) (common-law precedent announced by state's highest court is "law" within meaning of equal protection clause), cert. denied, 485 U.S. 1029 (1988); and other sections of the California Constitution, see *Miller*, 72 Cal. at 466 (popular meaning of "law," which includes whole body or system of rules of conduct, including decisions of courts and legislative acts, considered in interpreting Cal. Const. art. 4, Section 32, which forbids legislature to pay claims against state under agreement made without authority of law).

Because "law" in Section 1(a) is used generically, the more restrictive meaning of "law" confining that term simply to legislative enactments would, in our view, not comply with the intendment of Proposition 13. Other "law," including court decisions pertinent to the allocation of California property tax revenues must be considered. Such "law" cannot be dismissed under a tax reallocation scheme proposed by the State Legislature which would result in a loss of substantial revenue to the cities, including San Diego. Among this "law" is a recent decision of *County of San Diego v. Cory*, No. 578681 (April 6, 1992) (on appeal).

In *Cory*, the Superior Court of the County of San Diego held AB 8 in violation of the equal protection provisions of the State and Federal Constitutions. Specifically, the court ruled AB 8 invalid because: (1) its discrimination against the residents of formerly (pre-Proposition 13) low taxing counties like the County of San Diego is not rationally related to any legitimate state interest; and, (2) this discrimination infringes on said residents' fundamental right to public safety without furthering a compelling state interest. AB 8 was invalid for the further reason that its scheme discriminated against formerly low taxing counties and their residents in violation of Proposition 13. As a result, the State was ordered to implement, by July 1993, a constitutional system of property tax revenue allocation which: (1) complies with Article XIII A of the California Constitution, and the equal protection provisions of the State and Federal Constitutions; and, (2) is not based on the premise that residents of formerly low taxing counties should be allocated

less property tax revenue for non-school local governmental services than residents of formerly high taxing counties, and does not allocate property tax revenue to counties for non-school local governmental services based on their former level of taxation.

The Cory decision dictates that a property tax allocation scheme may not arbitrarily be applied to disenfranchise a group of residents of a reasonable allocation and infringe on their right to public safety. The State's proposal would be discriminatory to the residents of the City of San Diego because it would remove a large portion of the funds they were intended to receive under Proposition 13, and thereby seriously impair the City's ability to provide basic services to ensure public health, safety and welfare.

#### CONCLUSION

There is one substantial drawback to any legal action at this time. Presently we are, in effect, shooting at a moving target. We think it is very unlikely that any court would interfere with the legislative process at this time. However, if you concur, we will transmit these views to the City's legislative representative for such action as she may deem appropriate.

Respectfully submitted,

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Enclosure (1)

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