MEMORANDUM OF LAW

DATE: June 27, 1991

TO: Jack McGrory, City Manager

FROM: City Attorney

SUBJECT: Transient Transportation Tax

Our memorandum dated June 19, 1991 expressed our concern with the proposed imposition of the Transient Transportation Tax, an increased business tax on the car rental industry ("industry"). The industry has responded to preliminary discussions and drafts of the proposed ordinance with allegations of illegality, based on several grounds: 1) municipal affairs versus matters of statewide concern; 2) preemption by the State of California regarding taxation and regulation of motor vehicles through the California Vehicle Code; and 3) violation of the equal protection requirements of the California and United States Constitutions, the strongest of their arguments.

The first argument, that this particular area or method of taxation is not a municipal affair, is rebuttable. "No exact definition of the term 'municipal' affairs can be formulated, and the courts have made no attempt to do so, but instead have indicated that judicial interpretation is necessary to give it meaning in each controverted case." Bishop v. City of San Jose, 1 Cal.3d 56, 63 (1969). "The power to tax for local purposes clearly is one of the privileges accorded chartered cities by the home rule provision of the California Constitution (Cal. Const., art. XI, section 5, subd. (a)." Weekes v. City of Oakland, 21 Cal.3d 386, 392 (1978).

In a 1987 case, Park 'N Fly of San Francisco, Inc. v. City of South San Francisco, 188 Cal.App.3d 1201, 1213-1214 (1987), the court addressed the amount of tax imposed on certain businesses:

> Undebatably, the challenged ordinance resulted in a dramatic increase in its business license tax rates. But 'such evidence alone of tax increases, even enormous increases, is not evidence of a lack of equal protection.' (Citations omitted.) Nor can we find the ordinance discriminatory simply because appellant has thereby been subjected to a more onerous tax burden than other businesses.

Our response to the industry's argument that, since the State has enacted laws regarding motor vehicles, any law which touches on that subject is preempted is that this proposed tax classification is not regulatory, but revenue-raising. "Whether or not state law has occupied the field of regulation, cities may tax businesses carried on within

their boundaries and enforce such taxes by requiring business licenses for revenue." In Re Groves, 54 Cal.2d 154, 156 (1960).

In a very early case, In Re Galusha, 184 Cal. 697, 699 (1921), concerning the imposition of an occupational tax upon attorneys required to be licensed by the state, the California Supreme Court held:

> The municipality, in imposing an occupational tax upon attorneys, is not interfering with state regulations, for it is not attempting to prescribe qualifications for attorneys different from or additional to those prescribed by the state. It is merely providing for an increase in its revenue by imposing a tax upon those who, by pursuing their profession within its limits, are deriving benefits from the advantages especially afforded by the city. The tax is levied upon the business of practicing law, rather than upon a person because he is an attorney . . . . A license to practice does not carry with it exemptions from taxation. Emphasis in original.

In addition, "the fact, standing alone, that the Legislature has attempted to deal with a particular subject on a statewide basis is not determinative of the issue as between state and municipal affairs." Bishop v. City of San Jose, 1 Cal.3d at 63. In Rivera v. City of Fresno, 6 Cal.3d 132, 139 (1971), regarding a utility users' tax, the court responded to an argument that the tax invaded the field of regulation of public utilities which has been "clearly preempted by the state under applicable provisions of the California Constitution . . . . However, whether or not the state has occupied the field of regulation, cities may levy fees or taxes solely for revenue purposes."

In our June 19 memo, we alerted you to our concern regarding the equal protection argument, but also stated that we had not had an opportunity to research this subject. Since that time, we have looked more closely at the question and reply as follows:

While it is allowable to classify businesses differently for tax purposes, the City must articulate a reasonable basis for differentiating the car rental industry from other industries.

We understand the reason for this particular classification is that the increased operation, maintenance and replacement demands upon the City's infrastructure resulting from utilization of rented cars requires additional revenue to fully accommodate those demands.

The facts that a particular industry may be financially able to pay such a tax, or that a municipality must procure additional income, have not been held reasonable by the courts. A short synopsis of the holdings from California courts follows:

> there is no constitutional requirement of uniform treatment but only that there be a reasonable basis for each classification . . . . Wide discretion is vested in the legislature in making the classification and every presumption is in favor of the validity of the statute; the decision of the legislature as to what is

> a sufficient distinction to warrant the classification will not be overturned by the courts unless it is palpably arbitrary and beyond rational doubt erroneous . . . . A distinction in legislation is not arbitrary if any set of facts reasonable can be conceived that would sustain it. Emphasis added.

City of Los Angeles v. Crawshaw Mortgage, 51 Cal.App.3d 696, 699 (1975).

The court in Clark v. City of San Pablo, 270 Cal.App.2d 121, 127 (1969), held that

> when a legislative classification is questioned, if facts reasonably can be conceived that would sustain it, their existence is presumed, and the burden of showing arbitrary action rests upon the one who assails the classification . . . . Each case appears to depend upon its particular facts and the predilections of the reviewing tribunal as to what is arbitrary and discriminatory.

Although the proposed ordinance has been challenged on equal protection grounds, the level of scrutiny required is not the same as that in other equal protection cases. "Where a suspect classification or fundamental interest is not involved, 'a legislative classification may satisfy the traditional equal protection test without being the most precise possible means of accomplishing its legislative purpose. Only a reasonable relationship to that purpose is required.'" Helton v. City of Long Beach, 55 Cal.App. 3d 840, 844 (1976).

The United States Supreme Court has discussed this issue in several cases and has continually allowed legislatures great discretion in tax classification. "We have long held that 'where taxation is concerned and no specific federal right, apart from equal protection is imperiled, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation.'" Kahn v. Shevin, 416 U.S. 351, 355 (1974).

Further, in Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 359 (1973):

> The states have a very wide discretion in the laying of their taxes . . . . But the Equal Protection Clause imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation. The state may impose different specific taxes upon different trades and professions . . . . We have used the phrase "palpably arbitrary" or "invidious" as defining the limits placed by the Equal Protection Clause on state power . . . . State taxes which have the collateral effect of restricting or even destroying an occupation or a business have been sustained.

The Supreme Court in Regan v. Taxation With Representation, 461 U.S. 540, 547-548 (1983), citing Madden v. Kentucky, 309 U.S. 83, 87-88 (1939), held:

> the broad discretion as to classification possessed by a

> legislature in the field of taxation has long been recognized . . . . The passage of time has only served to underscore the wisdom of that recognition of the large area of discretion which is needed by a legislature in formulating sound tax policies. Traditionally classification has been a device for fitting tax programs to local needs and usages . . . . In taxation, even more than in other fields, legislatures possess the greatest freedom in classification. Since the members of a legislature necessarily enjoy a familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.

CONCLUSION

There is a presumption of validity of local tax legislative decisions and classifications of businesses, unless they are clearly "invidious" or "palpably arbitrary." The increased operation, maintenance and replacement demands upon the City's infrastructure resulting from utilization of rented motor vehicles may satisfy this requirement. However, it must be emphasized that it is not possible to give a definitive answer that would necessarily be upheld by a court, should this matter result in litigation, since, as has been stated, each case must be viewed in light of its own particular facts.

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