



CALIFORNIA BUDGET PROJECT

August 12, 2010

A Preliminary Review of Proposition 22

Proposition 22, which will appear on the November 2, 2010 ballot, would amend the state Constitution to eliminate the state's ability to borrow or shift local revenues and certain state revenues that historically have funded transportation programs to help address a state budget shortfall. The following table provides a preliminary review of Proposition 22. The California Budget Project will release a comprehensive analysis of Proposition 22 in the near future. Proposition 22 was placed on the ballot by initiative and is supported by the League of California Cities and the California Redevelopment Association.

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Key Provisions of Proposition 22 Compared to Current Law

Property Taxes: Cities, Counties, and Special Districts		
	Current Law	Proposition 22
Allocation	<p>Prior to Proposition 13 of 1978, cities, counties, school districts, and other local agencies had the authority to impose property tax rates. Property owners paid a total rate equal to the sum of the rates of each jurisdiction where the property was located.</p> <p>Proposition 13 amended the state Constitution to cap the countywide property tax rate at 1 percent and gave the Legislature responsibility for allocating the proceeds of the property tax among local agencies in the county where a property is located.</p> <p>Proposition 1A of 2004 amended the state Constitution to restrict the state’s ability to reallocate property tax revenues in a county. The measure significantly limited the Legislature’s ability to shift property taxes from local governments – which include cities, counties, and special districts – to educational agencies – which include school districts, community colleges, and county offices of education.</p> <p>Proposition 1A allowed the Legislature to reallocate property taxes <i>among</i> cities, the county government, and special districts within a county with a two-thirds vote.</p> <p>Proposition 1A allowed the state to borrow property taxes by temporarily shifting a portion of those taxes from local governments to schools under limited circumstances. Such a shift allows the state to reduce General Fund support for schools under the Proposition 98 guarantee in order to help close a budget shortfall. The state may borrow property taxes through a temporary reallocation if the Governor proclaims a severe state fiscal hardship and the Legislature approves the temporary reallocation with a two-thirds vote.</p>	<p>Eliminates the state’s ability to temporarily reallocate property taxes from local governments to educational agencies. Consequently, the state could no longer borrow local property tax revenues to help close a budget shortfall.</p> <p>Eliminates the state’s ability to reallocate property tax revenues <i>among</i> local governments within a county in order to reimburse local governments for new or increased program costs.</p>

Key Provisions of Proposition 22 Compared to Current Law

Property Taxes: Cities, Counties, and Special Districts		
	Current Law	Proposition 22
Allocation (continued)	<p>Property tax revenues shifted from local governments must be repaid, with interest, within three years. In addition, the Legislature may not shift property taxes from local governments to educational agencies for more than two fiscal years in a 10-year period.</p> <p>In 2009, the Legislature borrowed 8 percent – the maximum allowed by Proposition 1A – of each local government’s 2008-09 property taxes and transferred those revenues to educational agencies, for a total statewide shift of \$1.9 billion.</p>	
Property Taxes: Redevelopment Agencies		
	Current Law	Proposition 22
Allocation	<p>State law allows cities and counties to establish redevelopment agencies to help eliminate blight in a designated area. Redevelopment agencies receive most of the growth in property tax revenues attributable to property value increases (the “tax increment”) in the project area.</p> <p>A portion of “tax increment” revenues must be shared with other local agencies, including counties and school districts. In addition, at least 20 percent of tax increment revenues must be used to preserve, improve, or expand the supply of affordable housing.</p> <p>The state has periodically shifted property tax revenues from redevelopment agencies to local educational agencies and counties in order to address a state budget shortfall.</p> <p>The July 2009 budget agreement required redevelopment agencies to make two such transfers – \$1.7 billion in 2009-10 and \$350 million in 2010-11. Redevelopment agencies sued to block these transfers. On May 4, 2010, a Sacramento County Superior Court judge ruled that the transfers do not violate the state Constitution. Redevelopment agencies have appealed the ruling.</p>	<p>Prohibits the Legislature from shifting redevelopment agency property tax revenues to schools, counties, or other agencies, except for payments required as of January 1, 2008 or to increase, improve, and preserve the supply of affordable housing.</p> <p>Declares that “the Legislature has been illegally circumventing Section 16 of Article XVI [of the state Constitution] in recent years by requiring redevelopment agencies to transfer a portion of [their share of property] taxes for purposes other than the financing of redevelopment projects.” This language is intended to retroactively declare the \$2.1 billion property tax shift – which is currently subject to litigation initiated by redevelopment agencies – to be invalid.</p> <p>It is unclear how these provisions would affect the recent property tax shift. Proposition 22’s declaration that such shifts are illegal “could affect the outcome of the pending litigation regarding these payments,” according to the Legislative Analyst’s Office.</p>

Key Provisions of Proposition 22 Compared to Current Law

Vehicle License Fee (VLF)		
	Current Law	Proposition 22
Rate	The Legislature sets the VLF rate, which is applied to the depreciated value of cars and trucks. The VLF rate includes a permanent rate of 0.65 percent and a temporary rate of 0.5 percent that expires on June 30, 2011.	No change.
Allocation	<p>The state Constitution requires VLF revenues raised by the 0.65 percent base rate to be distributed to cities and counties, with the allocation determined by the Legislature. The Legislature, for example, may provide counties with a larger share of VLF revenues as reimbursement for new or increased program costs mandated by the state. This occurred as part of the 1991 "realignment," in which the state increased counties' share of certain health and human services program costs and provided counties with a dedicated revenue source that included increased VLF revenues.</p> <p>A portion – 0.15 percent – of the temporary 0.5 percent VLF rate is allocated to local public safety programs. The remainder – 0.35 percent – is deposited in the state's General Fund.</p>	Eliminates the state's ability to reallocate revenues raised by the 0.65 percent VLF rate in order to reimburse local governments for new or increased program costs. This provision would not affect VLF revenues provided to counties as part of the 1991 realignment.

Key Provisions of Proposition 22 Compared to Current Law

State Excise Tax on Gasoline and Diesel Fuel (the "Gas Tax")		
	Current Law	Proposition 22
Rate	<p>The Legislature imposes a per-gallon excise tax rate on gasoline and diesel fuel.</p> <p>The Legislature increased the excise tax on gasoline from \$0.18 per gallon to \$0.353 per gallon effective July 1, 2010 and repealed the state's sales tax on gasoline (see below). This rate will be adjusted annually starting in 2011-12 so that revenues will equal the combined total that would have been raised by the prior \$0.18 per gallon excise tax and the former state sales tax on gasoline.</p> <p>The excise tax on diesel fuel is \$0.18 per gallon. Effective July 1, 2011, the Legislature decreased this rate to \$0.136 per gallon and increased the state's sales tax rate on diesel fuel by 1.75 percent (see below). The diesel fuel excise tax will be adjusted annually starting in 2012-13 so that revenues raised by the reduced excise tax and the increased sales tax will equal those that would have been raised by the prior diesel fuel excise and sales tax rates.</p> <p>These changes were enacted in March 2010 as part of a complex "gas tax swap."</p>	No change.

Key Provisions of Proposition 22 Compared to Current Law

State Excise Tax on Gasoline and Diesel Fuel (the "Gas Tax")		
	Current Law	Proposition 22
Allocation	<p>All revenues are deposited into the Highway Users Tax Account (HUTA).</p> <p>Revenues from the first \$0.18 per gallon of the excise tax on gasoline and <i>all</i> revenues from the excise tax on diesel fuel are allocated as follows: Two-thirds for state highway maintenance and repairs, and one-third to cities and counties for local streets and roads.</p> <p>The portion of the excise tax on gasoline added by the gas tax swap – \$0.173 per gallon in 2010-11 – is also deposited into the HUTA, but is distributed using a different formula. This portion of the gasoline excise tax provides funding for:</p> <ul style="list-style-type: none"> • Debt service on state transportation bonds; • The State Highway Operation and Protection Program (SHOPP) and the State Transportation Improvement Program (STIP); and • Cities and counties for local streets and roads. <p>The state Constitution allows the state to borrow HUTA revenues for cash-flow purposes within a fiscal year. In addition, the state may borrow these revenues if the Governor declares a fiscal emergency or if state revenues are projected to decline after adjusting for inflation and population growth. The state must repay borrowed funds within three years, but does not have to pay interest.</p> <p>The Legislature may amend HUTA allocations.</p> <p>The Legislature may authorize the state, cities, and counties to use up to 25 percent of their share of HUTA revenues to pay debt service on voter-approved transportation bonds.</p>	<p>Prohibits excise tax revenues deposited into the HUTA from being permanently or temporarily loaned to the state's General Fund or any other state fund, including for cash-flow purposes.</p> <p>Prohibits the Legislature from modifying HUTA allocation formulas in effect as of June 30, 2009 unless the California Transportation Commission (CTC) holds public hearings and prepares a report, and the Legislature approves the changes with a two-thirds vote in a stand-alone bill.</p> <p>Imposes new restrictions on the state's use of HUTA revenues. Specifically, the state could use its share of HUTA revenues to pay debt service on voter-approved transportation bonds only if the bonds were issued by the state "on and after" November 2, 2010 and if voters approved using HUTA funds for such a purpose.</p> <p>Continues to allow a city or county to use up to 25 percent of its share of HUTA revenues to pay debt service on voter-approved transportation bonds issued by that jurisdiction without seeking subsequent voter approval and regardless of when the bonds were issued.</p> <p>Declares that if the Legislature reduces or repeals excise taxes on motor vehicle fuels and "adopts an alternative source of revenue to replace the moneys derived from those taxes," the replacement revenue must be deposited into the HUTA and allocated to cities, counties, and the state according to formulas in effect as of June 30, 2009.</p> <p>Proposition 22 is potentially at odds with the provisions of the March 2010 gas tax swap. However, it is unclear whether the measure would override the rate and allocation changes established by the Legislature, particularly since those changes were legal when they were enacted.</p>

Key Provisions of Proposition 22 Compared to Current Law

State Sales Tax on Diesel Fuel		
	Current Law	Proposition 22
Rate	<p>The Legislature imposes and sets a tax on the sale and use of goods, including diesel fuel. (In March 2010, the Legislature repealed the state sales tax on <i>gasoline</i> effective July 1, 2010 as part of the gas tax swap described above.)</p> <p>The Legislature established an additional sales tax rate of 1.75 percent on diesel fuel effective July 1, 2011 as part of the gas tax swap.</p>	No change.
Allocation	<p>Revenues from the first 4.75 percent of the state sales tax rate are deposited into the Public Transportation Account (PTA). Three-quarters (75 percent) of those revenues are provided to local transit agencies and 25 percent are used for state transit purposes, including public transit capital improvement projects and debt service payments on rail- and transit-related bonds.</p> <p>Revenues from the remainder of the state sales tax rate – 1.25 percent in 2010-11 – are deposited into the General Fund.</p> <p>Revenues from the additional 1.75 percent sales tax rate on diesel fuel that takes effect on July 1, 2011 will be deposited into the PTA. Three-quarters (75 percent) of those revenues will be provided to local transit agencies and 25 percent will be used for state transit purposes, such as intercity rail.</p> <p>The Legislature may amend PTA allocations, subject to certain court-imposed limitations.</p> <p>The state Constitution allows the state to borrow PTA revenues for cash-flow purposes within a fiscal year. In addition, the state may borrow these revenues for a longer period if the Governor declares a fiscal emergency or if state revenues are projected to decline. The state must repay borrowed funds within three years, but does not have to pay interest.</p>	<p>Adds a new provision to the state Constitution requiring that certain revenues, including the first 4.75 percent of the state sales tax on diesel fuel, be deposited into the PTA and allocated as follows:</p> <ul style="list-style-type: none"> • 50 percent to local transit agencies and • 50 percent for state transit purposes. <p>These allocations could not be changed without voter approval.</p> <p>Does not directly address the allocation of revenues raised by the additional 1.75 percent sales tax rate on diesel fuel scheduled to take effect on July 1, 2011.</p> <p>Prohibits PTA funds from being permanently or temporarily loaned to the state’s General Fund or any other state fund, including for cash-flow purposes.</p> <p>Proposition 22 is potentially at odds with the provisions of the March 2010 gas tax swap. However, it is unclear whether the measure would override the rate and allocation changes established by the Legislature, particularly since those changes were legal when they were enacted.</p>

Key Provisions of Proposition 22 Compared to Current Law

State Sales Tax on Gasoline		
	Current Law	Proposition 22
Rate	The Legislature eliminated the state sales tax on gasoline effective July 1, 2010 as part of the gas tax swap.	No change.
Allocation	<p>Historically, state sales taxes paid on gasoline were deposited in the state’s General Fund. Most of the revenues funded a broad range of programs, including education, health care, and human services, with only a small share of the revenues used for transportation.</p> <p>Proposition 42 of 2002 and Proposition 1A of 2006 constitutionally dedicated a portion of the recently repealed state sales tax on gasoline to transportation purposes.</p> <p>Proposition 42 amended the state Constitution to require that gasoline sales tax revenues deposited into the General Fund be transferred to the Transportation Improvement Fund (TIF) and allocated as follows:</p> <ul style="list-style-type: none"> ● 40 percent to the STIP; ● 40 percent to cities and counties for local streets and roads; and ● 20 percent for public transportation. <p>Proposition 42 allowed the Legislature to amend TIF allocations with a two-thirds vote in a stand-alone bill.</p> <p>Gasoline sales tax revenues transferred to the TIF were counted as General Fund revenues for calculating the Proposition 98 guarantee for K-14 education. Consequently, these revenues increased the state’s Proposition 98 obligation despite the fact that they were required to be used to fund transportation programs and could not be used to support schools.</p>	<p>Requires revenues from the sales tax on gasoline that would have been deposited into the state’s General Fund to be deposited directly into the TIF instead. It is unclear whether this provision would affect calculations of the Proposition 98 guarantee for K-14 education.</p> <p>Prohibits the state from permanently or temporarily borrowing or redirecting any revenues from the sales tax on gasoline – including for cash-flow purposes – that would otherwise be deposited into the TIF.</p> <p>Prohibits the Legislature from modifying the TIF allocation formulas unless the CTC holds public hearings and prepares a report, and the Legislature approves the changes with a two-thirds vote in a stand-alone bill.</p> <p>Declares that if the Legislature reduces or repeals the state sales tax on gasoline and “adopts an alternative source of revenue to replace the moneys derived from those taxes,” the replacement revenue must be deposited into the TIF and allocated as required by the state Constitution.</p> <p>Proposition 22 is potentially at odds with the provisions of the March 2010 gas tax swap. However, it is unclear whether the measure would override the rate and allocation changes established by the Legislature, particularly since those changes were legal when they were enacted.</p>

Key Provisions of Proposition 22 Compared to Current Law

State Sales Tax on Gasoline		
	Current Law	Proposition 22
Allocation (continued)	<p>Proposition 42 allowed the state to suspend the transfer of gasoline sales tax revenues from the General Fund to the TIF for a fiscal year if the Governor declared that the transfer would have a negative fiscal impact on the state and the Legislature approved the suspension with a two-thirds vote in a stand-alone bill.</p> <p>Proposition 1A of 2006 amended the state Constitution to restrict the state's ability to suspend the transfer to the TIF. Proposition 1A requires the state to repay the full amount suspended, with interest, within three years. In addition, the transfer cannot be suspended for more than two fiscal years within a 10-year period.</p>	
Other Local Revenues		
	Current Law	Proposition 22
Local taxes	<p>The state Constitution allows local governments to impose local taxes for local purposes. Local governments impose a range of taxes, including the local portion of the sales tax, business license taxes, and utility user taxes.</p>	<p>Prohibits the Legislature from reallocating, transferring, borrowing, appropriating, restricting the use of, or otherwise using "the proceeds of any tax imposed or levied by a local government solely for the local government's purposes."</p>