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### Author

Shanske, Darien

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**Going Forward by Going Backward  
to Benefit Taxes**

Darien Shanske  
UC Hastings

**Abstract**

There are many paradoxes presented by the relationship of Californians to taxes and spending. Rather than bemoan the seeming disconnects, this short article argues that Californians should be understood as wanting more taxation according to a benefit principle. This approach indicates that benefit charges in California should be increased while general taxes should be decreased through the use of credits against California's income tax. There does not seem to be a legal obstacle to the California Legislature making this change, including Proposition 26. By majority vote, all the legislature needs to do is offer credits against California's income tax for the increased benefit charges that would for the most part be levied by local and/or specialized government entities in return for services provided.

**Keywords:** Prop. 13, taxes, credits, fees, ballot box budgeting



# Going Forward by Going Backward to Benefit Taxes

Darien Shanske  
UC Hastings

## **Introduction: Increasing the Use of the Benefit Principle While Also Increasing the Use of Income Tax Credits**

Since the passage of Proposition 13 in June 1978, Californians have been at the forefront of so-called “ballot box budgeting.” In particular, Californians have time and again sought to limit the taxing power of their government—often at all levels. There is evidence of the success of these measures in limited terms; for instance Proposition 13 did successfully cut Californians’s property taxes,<sup>1</sup> but there is at least as much evidence that, in general, the size of California’s government has not shrunk.<sup>2</sup> Indeed the trajectory of California’s government has been to increase to the same extent—and following the same pattern—as that of other comparable states without California’s battery of tax limitation initiatives.

There are various ways of explaining these phenomena. For one, there is an arguable agency problem. If Californians do not trust politicians and hence limit their ability to raise taxes, then why should Californians trust the same politicians not to work to circumvent tax limitation regimes?<sup>3</sup> This is all the more true since it seems manifest that Californians do reward politicians for providing more services, and one way that politicians pay for these services is through what Laurie Reynolds calls “dues,” a category that subsumes the fees, assessments, and charges that are the subject of this article. According to Reynolds, “dues crucially depend on the relationship between the payer and the purpose for which the revenue raised will be spent. That is, by calculating the charge with a computation of the benefit received by the payer or to offset the cost imposed on the general population by the payer’s activity, dues treat government activities just like any other market transaction in a consumer economy.”<sup>4</sup> As the last part of this short quotation suggests, one can interpret the rise of dues as a sign of a troubling privatization of government services, ei-

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Many people helped talk through these ideas with me, though all opinions and mistakes are my own. I am especially grateful to James Copeland, Ben Fay, David Gamage, David Louk, Susie Morse, Michael Salerno and an anonymous reviewer for the *California Journal of Politics and Policy*. This paper was finalized on March 22, 2011.

ther desired by voters or imposed on them by politicians.<sup>5</sup> Alternatively, one might interpret the curious path of California as determined by the ambivalence of voter preferences—voters hate taxes and want services and so they get some increase in dues, but also deficits.<sup>6</sup>

I would like to propose another explanation for the behavior of California voters, one that does *not* require that California voters are essentially confused about taxes and government or even are fundamentally hostile to the public sphere. Rather, I suggest that Californians have been groping for a different way to fund their government: to the extent possible, they want their government funded according to the benefit principle. At the heart of the benefit principle is the proposition that, as much as possible, the government should be funded like any service provider in the private sector. Charges should be paid on the basis of a voluntary *quid pro quo* between citizen and government.<sup>7</sup> I observe that, at least implicitly, the governor's proposed realignment—i.e., shifting more responsibilities back to local governments—endorses such a benefit principle.<sup>8</sup>

Leaving aside the theoretical arguments for so-called benefit taxation,<sup>9</sup> I think that one can argue persuasively that significant portions of California's tax system once more closely hewed to a benefit tax framework, and this was consistent with large public undertakings. Most obviously, special benefit assessments were once more common in California and elsewhere, financing a significant amount of essential backbone infrastructure,<sup>10</sup> including major portions of California's water system.

One way to capture the shift in California public finance over the last few decades is to note that the legislature is currently hoping that the voters of California approve \$11.4 billion in general obligation bonds to improve water infrastructure<sup>11</sup>—these bonds will be paid back by California's General Fund, which is funded primarily by the state income and sales taxes. It is not hard to imagine an argument for why all the people of California (and even the United States) have a stake in California's water infrastructure, but it is also reasonable to believe that the lion's share of the cost for these improvements should be borne by the immediate beneficiaries of these improvements.<sup>12</sup> After all, it is precisely landowners with land near the strengthened levies who will realize the value of these improvements in increased land values.<sup>13</sup> Furthermore, these landowners are best situated to assess and monitor these government expenditures.

The shift in connection with water infrastructure is just one example, and I realize there is ample room for debate as to what extent California's waves of tax revolts can be explained as a revolt *for* benefit taxation. Nevertheless, this preference for benefit taxation is both plausible and analytically tractable, and it seems appropriate to attribute such a viable preference to voters.<sup>14</sup> A shift to benefit taxation also indicates a way forward for California financially given the current mismatch

between revenues and expenses. And not just forward to a more stable future, but also towards a more efficient future, a small step backwards toward a 21st century tax system.<sup>15</sup> Even beyond efficiency, if the changes advocated herein spur (appropriate) investment (and reinvestment) in California's capital stock, then they are a means for California to achieve both greater short-term and long-term growth.

Let us go back to the funding of water infrastructure to outline this approach. One big theoretical problem with imposing assessments large enough to fund the needed improvements is that many landowners do not currently have sufficient cash. This can be ameliorated somewhat by amortizing the cost for the improvement—say over the lifetime of a project financed by bonds. Still, many individual landowners might not have even the amortized cash payments.<sup>16</sup> Furthermore, and relatedly, a flat assessment according to benefit received would likely be somewhat regressive, affecting poor landowners rich only in land in the same proportion as wealthy agro-businesses.

These are real concerns. Nevertheless, I think that the state has made a mistake in opting to use the expenditure of *general* income and sales taxes to fund *specific* improvements that in many cases can fund themselves. This is because the state can both take advantage of beneficiary financing and mitigate the issues with this kind of financing through use of the income tax.<sup>17</sup> How can the state help the assessment mechanism along? For one, it could allow these kinds of assessments to be deducted from state income taxes—current law does not allow this.<sup>18</sup> It could be objected that the value of a deduction is tied to the marginal state income tax rate of the taxpayer and so in fact this is not much of a help if the idea is to soften assessments for those who are cash poor. Yet this deduction can be a credit, even a refundable credit; there are already such credits in the federal and state income tax codes.<sup>19</sup> If this change is to make the assessments more progressive, then, like many other credits, it would phase out at higher income levels.

There are other sound reasons to use credits rather than direct expenditures; in this case it is the landowners who have the local knowledge as to the desired improvements and so it makes sense on efficiency and administrability grounds to defer to this local knowledge.<sup>20</sup> Of course, using tax credits to spur local investment while mitigating liquidity problems is not free, but this system can be designed to be less burdensome on the General Fund than just paying for these improvements with everyone's taxes. And so this proposal can also be a part of the solution to California's chronic budget problems.

The state should endeavor to enact this shift back towards benefit taxation broadly. There can be tax credits for fees paid in connection with carbon mitigation, for tuition paid to California institutions of higher learning, and for taxes paid to local government entities. A new local tax credit could be a spur for realignment

and is consistent with the benefit principle to the extent that many local taxes, especially for schools, can be rightfully viewed as benefit taxes (at least in large part).

All in all, as will be sketched in the final section of this paper, these expedients can cumulatively amount to a significant revenue solution. But the scope is not the only issue, as this shift would also lead to more efficient and stable allocation of resources over the long term, which is an independent virtue of this proposal. Fiscal volatility imposes its own costs on all Californians, particularly the most vulnerable.<sup>21</sup>

### **Preliminary Legal Analysis**

To what extent do current legal and political arrangements allow for such a shift? The answer to this question is indeterminate, but generally hopeful. It takes a majority of the state legislature to pass tax cuts, though I observe that tax breaks that more efficiently target government revenue should garner bipartisan support.

Both at the state and local level, there is no inherent obstacle to raising the assessment and fees that a shift to more benefit-style taxation would require. To be sure, recent changes to the California Constitution require that the government bear the burden of demonstrating a tight connection between the cost assessed and the benefit received. Yet many of the fees we are discussing are of the most traditional type imaginable—assessment-type financing built many of California’s levees and I do not believe that changes to California’s Constitution prevents assessments from rebuilding these same levees. To the contrary, California voters have signaled that they do not want assessment financing used beyond these parameters, and so I believe that enabling assessment financing is a key way to give the voters what they (reasonably) want, not to flaunt their wishes. From this perspective, what the state needs to do is to use its resources to jumpstart more beneficiary financing.

### **Introducing Proposition 26**

Proposition 26, passed by the voters this past November (2010), targeted the imposition of fees at the state and local level without a two-thirds majority either of the state legislature or of local voters. Proposition 26 comes to mind immediately as standing in the way of the proposal herein. Accordingly, I will analyze Proposition 26 in some depth below—and identify areas of indeterminacy, but I will begin by listing various types of fees that are not threatened by Proposition 26.

Proposition 26 operates by changing the definition of a “tax” to *include* “any levy, charge, or exaction of any kind imposed by the State,”<sup>22</sup> and taxes require a two-thirds vote. However, Proposition 26 clearly *excludes* several kinds of fees from the definition of a “tax.”

These exclusions are numerous and important. The following state-level charge is not a tax and is not subject to the two-thirds requirement: “[a] charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the State of conferring the benefit or granting the privilege to the payor.”<sup>23</sup> This exclusion sounds like it should exclude benefit assessments, which makes sense because their use is already governed—and limited—by Proposition 218. Accordingly, the parallel provision governing local governments declares as much, excluding from the definition of a “tax,” “[a]ssessments and property-related fees imposed in accordance with the provisions of Article XIII D [added by Prop 218].”<sup>24</sup>

Local governments can also continue to levy development impact fees.<sup>25</sup> These fees already had to be reasonable and proportionate and may well have fit under one of the more general exclusions, but Proposition 26 makes their exclusion explicit: “A charge imposed as a condition of property development” is excluded from the definition of a tax.<sup>26</sup>

Other regular direct payments for services, such as tuition, tolls or bus fare, are also excluded from the definition of a tax: “A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the state of providing the service or product to the payor.”<sup>27</sup> Given the value that California’s public colleges and universities continue to provide, this requirement should not pose a big hurdle for any education institution seeking to raise fees.

These exceptions mean that, within the already existing parameters for raising these fees—parameters that do not include a two-thirds majority—all of these kinds of fees can be raised by the state or other government entities.

### **The Bite of Proposition 26**

So what *does* Proposition 26 impact? A kind of charge that is *not* excluded from the definition of a “tax,” but what is that? The key finding from Proposition 26 is somewhat mysterious. It reads:

Fees couched as “regulatory” but which exceed the reasonable costs of actual regulation or are simply imposed to raise revenue for a new program and are not part of any licensing or permitting program are actually taxes and should be subject to the limitations applicable to the imposition of taxes.<sup>28</sup>

Why is regulatory in scare quotes? By what standard is “actual” regulation to be measured? What is an example of a purportedly regulatory fee? There is little need to guess, actually. The proponents of Proposition 26 were targeting the decision of the California Supreme Court in *Sinclair Paint Company v. State Board of Equalization*. This was a decision that upheld the imposition of “regulatory fees” even

though the challengers claimed that the fee was simply a means of raising revenue for a new program that did not benefit them.<sup>29</sup>

The ballot analysis prepared by the nonpartisan Legislative Analyst explicitly discusses *Sinclair* at length. This reference to *Sinclair* is particularly significant since California courts typically look to ballot statements—and especially the summary of the Legislative Analyst—in construing a proposition.<sup>30</sup> Furthermore, in doing so courts attribute fairly sophisticated understanding of the legal issues at stake to the voters.<sup>31</sup>

### What Was Sinclair about?

The plaintiff, the Sinclair Paint Company, challenged the fees levied upon it as part of the “Childhood Lead Poisoning Prevention Act of 1991.” As the California Supreme Court explained, “[t]he Act provided evaluation, screening, and medically necessary follow-up services for children who were deemed potential victims of lead poisoning. The Act’s program was entirely supported by ‘fees’ assessed on manufacturers or other persons contributing to environmental lead contamination.”<sup>32</sup> The Supreme Court agreed with the plaintiff (Sinclair) that these fees were not special assessments and were not development impact fees and, indeed, the court used language that we see clear echoes of in Proposition 26:

According to [the plaintiff], “because the present fees have been imposed solely to defray the cost of the state’s program of evaluation, screening, and follow-up services for children determined to be at risk for lead poisoning, they are not analogous to either special assessments or development fees, for they neither reimburse the state for special benefits conferred on manufacturers of lead-based products nor compensate the state for governmental privileges granted to those manufacturers. As the Court of Appeal observed, the fees challenged here ‘do not constitute payment for a government benefit or services.’”<sup>33</sup>

Though the California Supreme Court agreed that the fees in question were not special assessments or development fees, it found the fees to be nontaxes (and thus requiring only a majority vote) because they were “regulatory fees.” Regulatory fees are the imposition of fees under the police power—as to the act in question, the court found that “[i]t requires manufacturers and other persons whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating the adverse health effects their products created in the community. Viewed as a ‘mitigating effects’ measure, it is comparable in character to similar police power measures imposing fees to defray the actual or anticipated adverse effects of various business operations.”<sup>34</sup>

If one accepts that Proposition 26 takes aim at *Sinclair*, then this broad guidance as to the kind of fee that was at issue in *Sinclair* is not very helpful. After all, many fees—including all development impact fees—are passed to mitigate impacts



of a certain activity and the ultimate power to levy such fees arises from the police power.

The Legislative Analyst identified two special features of the fees at issue in *Sinclair*: (1) broadness of benefit and (2) lack of other duty. These features were present in *Sinclair*, but are not all that much more precise. After all the *Sinclair* court made it clear that:

We observe that [the plaintiff], in moving for summary judgment, did not contend that the fees exceed in amount the reasonable cost of providing the protective services for which the fees are charged, or that the fees were levied for any *unrelated* revenue purposes.<sup>35</sup>

Put in other words, *Sinclair* never stood for the proposition that fees did not need to be proportional and related to the impact they were to mitigate.<sup>36</sup> But there is something special about the fees approved in *Sinclair*; I think that the troubling feature was that they were *retroactive*<sup>37</sup>—retroactivity explains the two features highlighted by the Legislative Analyst. That is, it is reasonable to believe that firms that have been operating for decades did not benefit from the imposition of this fee. Relatedly, since the fee was retroactive, it is not clear how it could have been related to any duty that these particular manufacturers had. And so one target of Proposition 26 is a fee on activities that have been completed and so the voluntary nature of the action triggering the fee is attenuated. Such fees do more strongly resemble taxes, which are defined in part by being coercive. Leaving aside the merits of the California Supreme Court’s analysis in *Sinclair*,<sup>38</sup> the voters have now decided that such fees are similar enough to taxes to be treated as taxes for voting purposes.

Perhaps Proposition 26 goes further. The Legislative Analyst’s analysis suggests that Prop 26 is targeted towards any fee that provides a relatively diffuse benefit. And so the Legislative Analyst states:

Generally, the types of fees and charges that would become taxes under the measure are ones that government imposes to address health, environmental, or other societal or economic concerns. Figure 3 provides examples of some regulatory fees that could be considered taxes, in part or in whole, under the measure.

For instance, per the Legislative Analyst, the “oil recycling fee” would seem to be in danger from Proposition 26.

The Legislative Analyst says such fees “*could* be considered” taxes (emphasis added), and this is a reasonable interpretation of the proposition. Interestingly, however, the proponents of Proposition 26 did not think it went this far. Here, maintaining the formatting of the ballot argument, are the proponents of Prop 26:

Prop. 26 protects legitimate fees and WON’T ELIMINATE OR PHASE OUT ANY OF CALIFORNIA’S ENVIRONMENTAL OR CONSUMER PROTECTION LAWS, including:

- Oil Spill Prevention and Response Act
- Hazardous Substance Control Laws
- California Clean Air Act
- California Water Quality Control Act
- Laws regulating licensing and oversight of Contractors, Attorneys and Doctors

“Proposition 26 doesn’t change or undermine a single law protecting our air, ocean, waterways or forests—it simply stops the runaway fees politicians pass to fund ineffective programs.”—Ryan Broddrick, former Director, Department of Fish and Game.<sup>39</sup>

To be sure, the opponents of Proposition 26 claimed that such environmental fees *would* be impacted by Proposition 26 in the ballot pamphlet and, as we saw, the Legislative Analyst agreed with this potentiality.<sup>40</sup> Nevertheless, aside from the reasonable, but so far unavailing, argument that the view of the proponents should be given special deference,<sup>41</sup> there is another reason why the views of the proponents should be heeded and that is that theirs is quite a reasonable interpretation of the actual language of Proposition 26 and its specific legal history. As to legal history, we saw that *Sinclair*, clearly the target of Prop 26, was primarily novel in its acceptance of a *retroactive* fee. As for more traditional fees, those levied on the voluntary actions of taxpayers and in receipt of a direct benefit, we saw that the language of Proposition 26 assiduously avoided impacting those fees. And, many of these exclusions are written in broad terms, particularly the notion that a fee is not a tax if it is for a “specific privilege granted.”<sup>42</sup>

Still, Proposition 26 was clearly meant to limit fees, including fees that violate at least the spirit of previous revenue limitation measures, such as Propositions 13 and 218.<sup>43</sup> Courts have rightly been sensitive to the larger spirit of what the voters enacted.<sup>44</sup> There is, however, another provision of Proposition 26 that provides courts with a tractable way to vindicate this spirit. Proposition 26 adds Section 3(d) to Article 13A (and (1)(e)(7) to 13D for local governments); it reads:

The State bears the burden of proving by a preponderance of the evidence that a levy, charge, or other exaction is not a tax, that the amount is no more than necessary to cover the reasonable costs of the governmental activity, and that the manner in which those costs are allocated to a payor bear a fair or reasonable relationship to the payor’s burdens on, or benefits received from, the governmental activity.

This change to the law should be understood with several key pieces of context. First, the general rule in California and elsewhere had been for courts to defer to legislative findings on matters such as the amount of fees and assessments.<sup>45</sup> Second, there is little doubt that perpetual fiscal crises have contributed to more aggressive use of fees and assessments. Third, in 1996, the voters passed Proposition

218, which similarly changed the presumption to be one *against* the government in connection with assessments:

In any legal action contesting the validity of any assessment, the burden shall be on the agency to demonstrate that the property or properties in question receive a special benefit over and above the benefits conferred on the public at large and that the amount of any contested assessment is proportional to, and no greater than, the benefits conferred on the property or properties in question.<sup>46</sup>

Just a few years ago, in *Silicon Valley Taxpayers Association, Inc. v. Santa Clara County Open Space Authority*, the California Supreme Court decided the details of this burden shift, and essentially held that the courts would review legislative findings de novo.<sup>47</sup> As an aside, it should be noted that the assessment that was invalidated by the court in this case was aggressive even by the looser standards that prevailed *before* Proposition 218—and this assessment was imposed *after* Proposition 218.

What does all this mean in the context of Proposition 26? It means that courts may well, quite reasonably, accord little deference to legislative findings made by any level of California government. In so doing, they will not only vindicate the letter of Proposition 13 and its progeny, but their spirit. That is, legislators cannot close a budget gap or fund a program by opting to levy a fee as part of a late-night negotiation. Many fees excluded from the ambit Proposition 26, such as special assessments, generally include their own requirements for building a careful record, but as for those fees that are not covered by Proposition 26 but do not have their own statutory requirement to build a careful record—these fees, I believe, must also be supported by a scrupulously developed record because of the burden shift.

### **Global Warming Solutions Act of 2006?**

What about the fees related to the imposition of AB 32—the “Global Warming Solutions Act of 2006”? First, there is a sound argument that the fees authorized by AB 32 fall under the first exception to Proposition 26 discussed above, namely that these fees are a “charge imposed for a specific benefit or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the State of conferring the benefit or granting the privilege to the payor.”<sup>48</sup>

There are two parts of AB 32 that can satisfy this exclusion. First, and most clearly, there is Health and Safety Code 38597, which provides that “the [California Air Resources Board—“CARB”] may adopt by regulation, after a public workshop, a schedule of fees to be paid by the sources of greenhouse gas emissions regulated pursuant to this division, consistent with Section 57001. The revenues collected pursuant to this section, shall be deposited into the Air Pollution Control Fund and

are available upon appropriation, by the legislature, for purposes of carrying out this division.” The board has already issued a regulation governing such fees<sup>49</sup> and they are to be imposed upon approximate 350 emitters<sup>50</sup> of especially problematic gasses.<sup>51</sup> These gasses are precisely those for which a ready alternative is not easily found and so it is a privilege for a business to be able to use such destructive gasses for a small mitigation fee.<sup>52</sup> Certainly, unlike the retroactive fee in *Sinclair*, a business could prospectively choose to use less of these gasses, thereby paying a smaller fee (or no fee).<sup>53</sup>

The CARB can also impose fees of a type under its authority granted by Section 38570, which states “The state board may include in the regulations adopted pursuant to Section 38562 the use of market-based compliance mechanisms to comply with the regulations.” Under 38505(k)(2), a “market-based compliance mechanism” may include: “Greenhouse gas emissions exchanges, banking, credits, and other transactions, governed by rules and protocols established by the state board . . . .” Charging some entities for allowances to emit greenhouse gasses seems consistent with this mandate, as distributing tradable credits would be<sup>54</sup>—not being given a credit or being forced to buy one is the economic equivalent of a fee. Not only does the board seem to have the authority under AB 32 to impose fees of this type, but these fees are consistent with Proposition 26 because emitters are allowed to voluntarily change their behavior in order to reduce the amount of the fee—indeed, that is the whole point.

Under AB 32, the board has an additional power unaffected by Proposition 26, which is the power to penalize emitters who do not comply with its regulations; even more importantly, perhaps, the board can enjoin noncompliance.<sup>55</sup> Depending on the size of the penalties and the rigor of its enforcement, the board can significantly alter the effectiveness of its regulations and any associated revenue. Proposition 26 explicitly excludes fines or penalties from its ambit.<sup>56</sup>

In the end, there is ambiguity as to whether or not any proposed AB 32 fees fit Proposition 26’s exception as to a *specific* benefit granted. However, it is not ambiguous that Proposition 26 does not apply to any fees adopted before January 1, 2010; AB 32 was adopted in 2006. The presumption is that propositions do not apply retroactively, a presumption that can only be overcome with clear intent; here the clear intent only goes back to January 2010.<sup>57</sup> Proposition 26 is clear that it is to apply back to January 2010,<sup>58</sup> but there is no hint that it is to apply any further back in time, which is a reasonable result given that the sponsors of Proposition 26 stated “Proposition 26 doesn’t change or undermine a single law protecting our air, ocean, waterways or forests”<sup>59</sup> and Proposition 23—a proposition aimed at repealing AB 32—failed by a margin even greater than that by which Proposition 26 passed (52.5% for Prop 26, 61.6% against Prop 23).<sup>60</sup>

Assuming that AB 32 fees can proceed, then allowing credits through a progressive income tax would be a natural way to implement a “cap and dividend” system in order to mitigate the possibly regressive impact of any AB 32 fees. This is not the place to endorse such a system, only to note that this approach to fighting global warming has a lot to be said for it,<sup>61</sup> and, though the state may end up backing in to this approach, it could reasonably be thought of as a first-best solution to the problem.

### **Some Back-of-the-Envelope Numbers**

So instituting income tax credits for fees is desirable theoretically and possible politically and legally, but is it worth the trouble? I think it might be. Here are some preliminary numerical musings.

There are approximately 150,000 California resident undergraduates in the UC system.<sup>62</sup> Let us propose a California education credit along the lines of the current federal Lifetime Learning Credit.<sup>63</sup> This (nonrefundable) credit is worth up to \$2,000 and phases out for (joint) incomes between \$120,000 to \$130,000.<sup>64</sup> At the maximum, such a credit would cost the California General Fund \$300 million (150,000 x \$2,000). There are two big reasons why this would not cost the General Fund this much. First, the \$300 million credit will be paired with a \$300 million spending cut, so at worst the credit will be a wash for the General Fund. Second, the phaseout of the credit will mean some percentage of the \$300 million in credits will not be spent by the state.<sup>65</sup> One recent report from UC suggested that the income distribution of UC parents with income over \$72,000 year is about 40%, and so let us suppose that the phaseout on this hypothetical credit is 100% at \$72,000.<sup>66</sup> This means, roughly, that the state can save \$120 million dollars (40% of \$300 million) while, in effect, not cutting UC undergraduate funding at all because UC will benefit from the full \$300 million tuition increase.<sup>67</sup>

There are also tens of thousands of resident graduate students in the UC system, many of them in professional programs. The California State University system has over 400,000 students<sup>68</sup> and the California Community College system serves well over two million students.<sup>69</sup> Though this is not the place to recommend a multi-tiered credit system, one seems appropriate; for instance, a higher credit amount for professional schools (that can perhaps rollover) versus a higher refundable percentage for community college students.<sup>70</sup> Given these other plausible avenues and the basic scale of the \$120 million in savings from a simple federal-style credit just for UC undergraduates, it would seem reasonable to suggest that such credits could in aggregate save the General Fund several hundred million dollars per year, while significantly expanding the benefit principle.<sup>71</sup>

As for the resources the state dedicates to water infrastructure, a significant, if not dominant, portion seems to come from all the state's taxpayers—with the proposed new \$11 billion bond more of the same. I will propose a modest program here too—one specifically targeted at flood control. Some background: potentially hundreds of millions of dollars from the proposed bond measure is available for flood control.<sup>72</sup> The state recently hit a maximum of spending almost \$1 billion dollars per year on flood control (2007-08). However, current spending on flood control is now much less (about \$300 million) and, as explained by a leading commentator, “[l]ocal contributions can be difficult to increase, given that local assessments require voter approval.”<sup>73</sup> Indeed, so far as I can tell the total local contribution made by property assessments to “Flood Control and Water Conservation” was about \$100 million in 2007-08—that is, before the current financial crisis.<sup>74</sup> The anemic level of assessments is a problem that transcends the additional hurdles imposed on assessments by Proposition 218. Maintaining a levee would seem to be about the most traditional use of assessment financing possible, and so such an assessment should be permissible under the changes to the substantive law of assessments made by Proposition 218, though procedurally Proposition 218 does make it harder to proceed. Still, landowners *can* approve such an assessment, but presumably are held back in part for economic reasons, especially liquidity concerns. One solution is to allow for deferred payment of assessments (say when the property is sold), but the state can also utilize tax credits. Or I propose that the state can do both at once. For instance, there can be a \$1,000 credit for assessments used towards (state-approved) flood-control projects.<sup>75</sup> For those landowners who would not benefit from the credit because of the phaseout, then some percentage of the assessment (say 40%) can be deferred until the property is sold. This would help large landowners who might still have liquidity concerns. It could be objected against the deferral proposal that this would still mean that the state would have to front the money to pay off the bondholders for these projects, but that is still a big improvement from the state never being reimbursed at all for its outlays for projects that provide significant private benefits.

It is hard to assess how large a budget solution the water infrastructure shift might amount to, but I am going to suggest that it is reasonable to surmise that it too could amount to several hundred million dollars per year. On one pessimistic hand, even if the state gives a big boost to local flood control spending through credits and deferrals, (say making \$1 billion available) it is not clear how many landowners will take the state up on the offer and how much the credits will actually cost (I do not even have a rough calculation on phaseouts as to this hypothetical water credit). On the other hand, flood control is only one aspect of water policy, and these other aspects, such as improving water efficiency and quality, can also be improved by a benefit approach.<sup>76</sup> And, we must remember that the numbers we are discussing get

very large very fast; the annual debt service on the proposed new water bonds will likely be \$1 billion per year. To the extent that these assessments replace or even delay General Fund borrowing, these are savings with interest.<sup>77</sup> In addition, there are independent reasons for wanting to decrease the amount of annual debt service paid out of the General Fund because the interest expense crowds out other needs and weakens the state's credit rating (which increases the interest expense).<sup>78</sup> Finally, this is not all about budget numbers; a marginal increase in funding and better allocation of resources that helps avoid a catastrophic flood in the Sacramento-San Joaquin Delta is a good on many different levels.

Defining the state's current shortfall is difficult; the number now in use by the governor is \$25 billion.<sup>79</sup> Let us stick to that figure and note as well that the governor has offered a ratio of 1 to 1 of cuts to revenue increases.<sup>80</sup> This means that the General Fund needs \$12 billion in new revenue, and this is going to be quite a challenge.<sup>81</sup> The solutions just now sketched amount to at most \$1 billion, or less than 10% of the required total.<sup>82</sup> I think this percentage might be higher with more study of possible areas in which to apply it, particularly local taxation generally.<sup>83</sup> Furthermore, there is evidence that the structural deficit is lower than \$25 billion (perhaps about half that amount),<sup>84</sup> and so even a modest recovery in California's economy will make these revenue solutions even more significant relative to the real underlying fiscal imbalance. At the very least, these solutions will help stabilize California's revenue system and better allocate its resources. Indeed, to the extent that these changes help stimulate (smart) investment in physical and human capital, then California is likely to net a handsome rate of return over the short and long terms.

### **Conclusion**

There are ample grounds to despair of California's ability to develop an efficient and fair taxing system that provides enough revenue for the services the voters demand. One can focus on the mixed messages that the voters have sent or the external constraints placed on California by federal law or the internal constraints Californians have placed on themselves. Nevertheless a significant portion of the services Californians want can be funded through efficient benefit-type taxation and this system can be made fair by means of California's income tax. So far as I know, there are no major internal or external constraints to such an expedient. Indeed, I think one can make a plausible argument that this is the back to the future tax system that the voters of California have been shuffling toward for decades.

## Notes

<sup>1</sup> Colin H. McCubbins and Mathew D. McCubbins, *Proposition 13 and the California Shell Game*, <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1548024](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1548024)>.

<sup>2</sup> See *id.*; see also Bruce E. Cain and George A. Mackenzie, *Are California's Fiscal Constraints Institutional or Political?* (Public Policy Institute of California, Dec. 2008).

<sup>3</sup> See McCubbins *supra*.

<sup>4</sup> Laurie Reynolds, "Taxes, Fees, Assessments, Dues, and the "Get What You Pay For" Model of Local Government," 56 *Fla. L. Rev.* 373, 380 (2004).

<sup>5</sup> See, e.g., Gary J. Miller, *Cities by Contract* (1981).

<sup>6</sup> See, e.g., Joe Matthews and Mark Paul, *California Crackup* (2010) (tracing the history of Californians' preference for "something for nothing").

<sup>7</sup> Richard A. Musgrave, *The Theory of Public Finance* 62 (1959).

<sup>8</sup> Governor's Proposed Budget 2011-12 at 15-16, <<http://www.ebudget.ca.gov/pdf/BudgetSummary/Realignment.pdf>>, see also LAO, Overview of the Governor's Budget at 17, <[http://www.lao.ca.gov/reports/2011/bud/budget\\_overview/budget\\_overview\\_011211.pdf](http://www.lao.ca.gov/reports/2011/bud/budget_overview/budget_overview_011211.pdf)>. Note that the current overlapping chaos that is the California's local government landscape may not be well-designed to capitalize on the advantages of benefit taxation. Cf. R. P. Inman, *Financing Cities in a Companion to Urban Economics* 311 (Richard J. Arnott and Daniel P. McMillen eds., 2006).

<sup>9</sup> See, e.g., Musgrave *supra*; see also California Commission on the 21st Century Economy, *Final Report* 32-33 (2009), available at <[http://www.cotce.ca.gov/documents/reports/documents/Commission\\_on\\_the\\_21st\\_Century\\_Economy-Final\\_Report.pdf](http://www.cotce.ca.gov/documents/reports/documents/Commission_on_the_21st_Century_Economy-Final_Report.pdf)> (recent reformers arguing that California should impose more taxes according to a benefit principle); Richard A. Epstein, "The Ubiquity of the Benefit Principle," 67 *S. Cal. L. Rev.* 1369 (1994) (support of benefit principle from generally libertarian perspective); William Fischel, *The Homevoter Hypothesis* (2001) (modern classic advocating for benefit taxation, particularly for primary education).

<sup>10</sup> See generally Stephen Diamond, "The Death and Transfiguration of Benefit Taxation: Special Assessments in Nineteenth-Century America" 22 *J. Legal Stud.* 201 (1983).

<sup>11</sup> Safe, Clean, and Reliable Drinking Water Supply Act of 2012, <<http://www.sos.ca.gov/elections/ballot-measures/pdf/sbx7-2-ch-3-stats-09.pdf>> (see 79810(a)).

<sup>12</sup> And the beneficiaries of these improvements did generally bear their initial cost, often in the form of special benefit assessments. See, e.g., Dean Misczynski, *Fixing the Delta: How Will We Pay for It?* 10 (PPIC 2009), <[http://www.ppic.org/content/pubs/report/R\\_809DMR.pdf](http://www.ppic.org/content/pubs/report/R_809DMR.pdf)>. To be sure, the benefit principle is still in use throughout the California water system, LAO, Cal Facts (Jan. 2011) <[http://www.lao.ca.gov/reports/2011/calfacts/calfacts\\_010511.pdf](http://www.lao.ca.gov/reports/2011/calfacts/calfacts_010511.pdf)> at 48-49, but this is not to say that it is used enough, especially as to local flood control. Ellen Hanak, California Water, <[http://www.ppic.org/content/pubs/report/R\\_111EHR.pdf](http://www.ppic.org/content/pubs/report/R_111EHR.pdf)>.

<sup>13</sup> Note that both the state and federal governments will (probably) subsidize assessment bonds through exemptions from state and federal income taxes for the interest paid on these bonds. This means that even a traditional assessment bond already receives a significant subsidy from higher levels of government.

<sup>14</sup> I propose various compromises I can imagine Californians making with one another in Darien Shanske, "What Would the Delegates Talk About? A Rough Agenda for a Constitutional Convention" 37 *Hastings Constitutional Law Quarterly* 641 (2010). The current piece is a continuation where I imagine whether there is a workable system of public finance that a majority of Californians have actually voted for. And my contention as to the voters' will is not chimerical. A leading explanation of Proposition 13 connects the tax revolt to voters' dissatisfaction with the end of benefit taxes mandated by the school finance decisions of *Serrano*. See Fischel, *supra*. Furthermore, as discussed below, neither Propositions 218 nor 26 repudiated the benefit principle; rather, both insisted



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that it be followed more closely.

<sup>15</sup> The COTCE Report was supposed to lead us to such a system, but its many limitations—some self-imposed—have prevented its novel proposal from being adopted. See Kirk Stark, *Houdini Tax Reform*, California Policy Options (Nov. 2010). The current piece can be read as proposing a different—and achievable—way to move towards a more efficient revenue system. I propose a slightly different application of the benefit tax principle in Darien Shanske, “Putting the California Constitution (Back) to Work: A Blueprint for Clearing Legal Roadblocks to Proper Infrastructure Finance” 54 *State Tax Notes* 567 (2009). There I observe that there are ways that Proposition 218 in particular obstructs the use of the benefit principle, and I argue that it would be advisable to amend the constitution to ameliorate these problems. I still think these changes would be meritorious, especially if made in sync with the credit system I propose here. Granted, to the extent that Californians have undermined the benefit principle through Proposition 218 (and Proposition 13), then they have in a sense not embraced the benefit principle. But I think these changes should not be read as undermining a general preference for benefit taxation—what they do indicate is that the signal from the voters has been noisy.

<sup>16</sup> Donald C. Shoup, “Financing Public Investment By Deferred Special Assessment” 33 *Nat’l Tax J.* 413, 413-14 (1980) (proposing the idea of deferred assessments to deal with cash flow problem); see also Darien Shanske, “Above All Else Stop Digging: Local Government Law as a Cause (and Solution) to the Current Financial Crisis” 43 *University of Michigan Journal of Law Reform* 663, 706-07 (2010) (proposing state revolving fund for regional assessments).

<sup>17</sup> This proposal can also be read as a variation of Kaplow’s important claim that different tax policies should be evaluated assuming that the income tax can be adjusted to make the different policies distributionally neutral. Louis Kaplow, *The Theory of Taxation and Public Economics* xvii, 14 (2008).

<sup>18</sup> Cal. Rev. & Tax. Code 17220 (c). Many landowners deduct assessments anyway, but note that adding a credit would still change the status quo significantly, and this is leaving to one side that I am proposing credits for expenditures that taxpayers do *not* deduct anyway (such as tuition).

<sup>19</sup> See, e.g., IRC 25A (federal education credits), Cal. Rev. & Tax. Code 17052.6 (state credit for child and dependent care).

<sup>20</sup> See generally Mark G. Kelman, *Strategy or Principle? The Choice Between Regulation and Taxation* (1999) (arguing that choice between different policy choices should be pragmatic); David A. Weisbach and Jacob Nussim, “The Integration of Tax and Spending Programs” 113 *Yale L. J.* 955, 961-63 (2004) (arguing that in particular the decision of whether to fund a program through a direct expenditure or a tax expenditure is pragmatic and suggesting that using the federal tax code for education credits may make good sense pragmatically).

<sup>21</sup> See generally David Scott Gamage, “Preventing State Budget Crises: Redefining “Tax Cuts” and “Tax Hikes,” 98 *Cal. L. Rev.* 749 (2010).

<sup>22</sup> Cal. Const. 13A(3)(b).

<sup>23</sup> Cal. Const. 13A(3)(b)(1).

<sup>24</sup> Cal. Const. 13C(1)(e)(7).

<sup>25</sup> These fees, which aim to make development pay its own way, are extremely common in California and are also an example of the rise of the benefit principle. State Department of Housing and Community Development, *Pay To Play: Residential Development Fees In California Cities And Counties* (1999). Indeed, much of the infrastructure funded by development fees could have been (and often was) funded through benefit assessments.

<sup>26</sup> Cal. Const. 13C(1)(e)(6).

<sup>27</sup> Cal. Const. 13A(3)(b)(2); also Cal. Const. 13C(1)(e)(2).

<sup>28</sup> Prop 26, Findings, Sec. 1(e).

<sup>29</sup> <<http://voterguide.sos.ca.gov/propositions/26/analysis.htm>>.

<sup>30</sup> Jane S. Schacter, “The Pursuit of ‘Popular Intent’: Interpretive Dilemmas in Direct Democracy” 105 *Yale L. J.* 107, 123 (1995) (California courts show the greatest enthusiasm for ballot pamphlets.).

<sup>31</sup> See, e.g., *In re Harris*, 775 P.2d 1057, 1060 (Cal. 1989) (“[T]he voters who enact [an initiative] may be deemed to be aware of the judicial construction of the law that served as its source.”)

<sup>32</sup> *Sinclair Paint Co. v. State Board of Equalization*, 937 P.2d 1350, 1351 (Cal. 1997).

<sup>33</sup> *Id.* 1354-55.

<sup>34</sup> *Id.* at 1356. This is not an idiosyncratic definition of a “regulatory fee.” As a leading local government scholar puts it:

[F]or a regulatory fee intended to offset the cost of regulating a fee payer whose activity imposes some costs on the community, the fee is nominally voluntary since the duty to pay arises from the payer’s decision to undertake the activity subject to regulation. By not consuming the service or avoiding the activity, the payer could avoid the charge or fee. So, too, by reducing the amount of service consumed or the amount of activity subject to regulation, the payer can reduce her liability. Lacking the coerciveness that is the hallmark of a tax, user charges and regulatory fees have traditionally been treated as not subject to many of the rules applicable to taxes.

Richard Briffault, “Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law” 34 *Rutgers L. J.* 907, 934-35 (2003). Importantly, in the next paragraph Briffault identifies *Sinclair* as an aggressive interpretation of the regulatory fee concept: “[S]ome state courts have validated regulatory fees even when a particular firm’s fee is not a result of the costs attributable to that firm—thereby reducing the ability of the firm to use changes in its behavior to control its fee liability and thus undermining the voluntary nature of the fee.” I think that the retroactivity of the fee in *Sinclair* is at the heart of what makes this fee more coercive and more like a tax.

<sup>35</sup> *Sinclair* at 1356.

<sup>36</sup> See also *id.* at 1358.

<sup>37</sup> See e.g., *id.* at 1356 (“According to [the plaintiff] *Sinclair*, the challenged fees were in effect “taxes” because the compulsory revenue measure that imposed them was not part of a *regulatory* effort.); *id.* at 1357 (“The fact that the challenged fees were charged after, rather than before, the product’s adverse effects were realized is immaterial to the question whether the measure imposes valid regulatory fees rather than taxes.”).

<sup>38</sup> At this point, the merits of *Sinclair* are moot, though it should be noted that, even under the law as it stood before Proposition 26, California courts used the analysis in *Sinclair* to find certain fees to in fact be taxes. See, e.g., *Bay Area Cellular Tel. Co. v. City of Union City*, 75 Cal. Rptr. 3d 839, 841 (Cal. Ct. App. 2008). Furthermore, in the realm of economic theory, the difference between a fee and a tax is murky at best, as a fee imposed on a specific activity could also be interpreted as an excise tax on that activity, a tax scaled to the size of the externality caused by that activity. The situation is even harder with *regulatory* fees, as it has long been understood that taxation and regulation are substitutes. Richard A. Posner, “Taxation as Regulation” 2 *The Bell Journal of Economics and Management Science* 22 (1971). One seeming irony of Proposition 26 is therefore that it incentivizes California governments to act by means of regulation even when, pragmatically, a fee would make more sense. This is not a prospect that has delighted commentators generally interested in a smaller government. See, for example, Geoffrey Brennan & James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* 166 (1980) (“It is relatively easy to envisage a federal budget making up no more than 20 percent of GNP that would reflect more interference with personal liberties than an alternative budget of 40 percent of GNP, but with substantially less direct regulation.”).

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<sup>39</sup> <<http://voterguide.sos.ca.gov/propositions/26/arguments-rebuttals.htm>>.

<sup>40</sup> See also *Paying for Pollution: Proposition 26 and its Potential Impacts on State Environmental and Public Health Protections in California*, <<http://cdn.law.ucla.edu/SiteCollectionDocuments/Environmental%20Law/Paying%20for%20Pollution.pdf>> (expressing alarm at the potential reach of Proposition 26).

<sup>41</sup> Glenn C. Smith, “Solving the ‘Initiatory Construction’ Puzzle (and Improving Direct Democracy) by Appropriate Refocusing on Sponsor Intent” 78 *U. Colo. L. Rev.* 257, 269 (2007) (“[I]t is in states allowing sponsors to make arguments in official voter pamphlets that the lack of parity between initiatory construction and statutory construction becomes especially obvious. Ballot-pamphlet states such as California ignore the long-accepted assumption that statements by legislation supporters (especially sponsors!) are entitled to greater weight than statements by opponents.”).

<sup>42</sup> Cal. Const. 13A(3)(b)(1).

<sup>43</sup> See Findings 1(a) and 1(b).

<sup>44</sup> See, e.g., *Rider v. County of San Diego*, 820 P.2d 1000, 1006 (Cal. 1991) (“[W]e hold that ‘special district’ would include any local taxing agency created to raise funds for city or county purposes to replace revenues lost by reason of the restrictions of Proposition 13.”).

<sup>45</sup> See, e.g., *Silicon Valley Taxpayers Ass’n, Inc. v. Santa Clara County Open Space Authority*, 187 P.3d 37 (Cal. 2008).

<sup>46</sup> Cal. Const. 13D(4)(f).

<sup>47</sup> *Silicon Valley Taxpayers Ass’n, Inc. v. Santa Clara County Open Space Authority*. 187 P.3d 37, 49 (Cal. 2008).

<sup>48</sup> Cal. Const. 13A(3)(b)(1).

<sup>49</sup> 17 Cal. Code of Regs. § 95200 et seq.

<sup>50</sup> <[http://www.arb.ca.gov/cc/adminfee/ab32coi\\_fee\\_fact\\_sheet.pdf](http://www.arb.ca.gov/cc/adminfee/ab32coi_fee_fact_sheet.pdf)>.

<sup>51</sup> See AB 32 Scoping Plan at C189, <<http://www.arb.ca.gov/cc/scopingplan/document/scopingplandocument.htm>>: “These gases have potent global warming potentials and an upstream fee would ensure that the climate impact of these substances is incorporated into their price, encouraging emission reductions and the development of alternatives.”

<sup>52</sup> *Id.*: “The remaining emissions would be difficult to address via traditional regulatory approaches since the gases are used in many small uses in diverse applications and there is potential for new or evolving uses. Additionally, some uses have no current alternative and there is a lack of incentive to either develop alternatives or reduce leakage.”

<sup>53</sup> *Id.*: “As sources comply with the regulatory measures, affected entities would reduce their emissions and therefore the amount of the fee they would need to pay.”

<sup>54</sup> The CARB has moved ahead with such a plan, <<http://www.arb.ca.gov/newsrel/newsrelease.php?id=170>>.

<sup>55</sup> Health and Safety Code 38580(b)(1).

<sup>56</sup> Cal. Const. 13A(3)(B)(5).

<sup>57</sup> See, e.g., *Strauss v. Horton*, 207 P.3d 48, 119 (Cal. 2009) (collecting prior cases, stating and applying presumption).

<sup>58</sup> Cal. Const. 13A(3)(c).

<sup>59</sup> <<http://voterguide.sos.ca.gov/propositions/26/arguments-rebuttals.htm>> (statement of a supporter in the voter guide).

<sup>60</sup> <<http://www.sos.ca.gov/elections/sov/2010-general/complete-sov.pdf>> at 7. See also Jonathan Zasloff, *Does Proposition 26 Undermine California’s Climate Change Law?*, <<http://legalplanet.wordpress.com/2010/11/04/does-proposition-26-undermine-californias-climate-change-law>> (similar analysis).

<sup>61</sup> This is where the CARB seems to be going, at least in part. CARB, *Allocating Emissions Al-*

lowances under a California Cap-and-Trade Program 65, <[http://www.climatechange.ca.gov/eaac/documents/eaac\\_reports/2010-03-22\\_EAAC\\_Allocation\\_Report\\_Final.pdf](http://www.climatechange.ca.gov/eaac/documents/eaac_reports/2010-03-22_EAAC_Allocation_Report_Final.pdf)>.

<sup>62</sup> Governor's Proposed Budget 2011-12, University of California Enrollment-FTE, Figure 6440, <[http://www.ebudget.ca.gov/pdf/GovernorsBudget/6000/6440\\_fig1f.pdf](http://www.ebudget.ca.gov/pdf/GovernorsBudget/6000/6440_fig1f.pdf)>.

<sup>63</sup> IRC 25A.

<sup>64</sup> IRC 25A(c)(1), 25A(d)(2) 25A(h)(2), <<http://www.irs.gov/pub/irs-pdf/p970.pdf>>, at 20.

<sup>65</sup> Also, if not refundable, not all of the credit will be usable by lower income taxpayers. Making at least 50% of the credit refundable seems advisable to this observer.

<sup>66</sup> University of California Office of the President, *Annual Report On Student Financial Support*, Figure 1-20. This hypothetical threshold, partially chosen for ease of calculation, is lower than the federal credit, but note that this very rough hypothetical credit would (1) be in addition to the federal credit and (2) would be partially refundable.

<sup>67</sup> So, in this example UC breaks even and the state nets \$120 million, but there are many other options. For instance, the credits can be, prephaseout, for a smaller amount than the proposed cuts (still \$300 million), say \$200 million in credits, thereby forcing UC to cut at least \$100 million. Alternatively, the credit can be greater than the cut, say \$400 million, thereby encouraging UC to net \$100 million through tuition increases at a cost to the state of only \$60 million. The key here is that the phaseout keeps these shifts to payments by beneficiaries relatively fair and affordable from the state's perspective.

<sup>68</sup> California State University, *Average Term Enrollment and Full-Time Equivalent Students*, Figure 6610, <[http://www.ebudget.ca.gov/pdf/GovernorsBudget/6000/6610\\_fig1f.pdf](http://www.ebudget.ca.gov/pdf/GovernorsBudget/6000/6610_fig1f.pdf)>.

<sup>69</sup> California Community Colleges Chancellor's Office, *Student Financial Aid Programs* (Sept. 2010), at 1, <<http://www.cccco.edu/Portals/4/Reports/FinancialAid2010toPrint4.pdf>>. The low fees at California Community Colleges are already covered by the available federal credits.

<sup>70</sup> If fees at California Community Colleges ever rose sufficiently to go beyond the existing federal credits, which is not currently the case. LAO, *Overview of the Governor's Budget*, <[http://www.lao.ca.gov/reports/2011/bud/budget\\_overview/budget\\_overview\\_011211.pdf](http://www.lao.ca.gov/reports/2011/bud/budget_overview/budget_overview_011211.pdf)>, at 28. This suggests that California is essentially leaving a federal stimulus on the table by not raising its Community College fees. To be sure, many students in the community college system do not necessarily benefit from the federal credit either through lack of knowledge or perhaps lack of eligibility. A concerted effort at education and/or a special California Community College credit to fill gaps could therefore go a long way. The Legislative Analyst has, accordingly, recommended increasing Community College fees to maximize federal support. *The 2011-12 Budget: California Community College Fees*, <[http://www.lao.ca.gov/analysis/2011/highered/ccc\\_fees\\_012711.pdf](http://www.lao.ca.gov/analysis/2011/highered/ccc_fees_012711.pdf)>.

<sup>71</sup> It should also be observed that such tinkering with credits would still leave the taxpayers of California subsidizing higher education to a very significant degree—well more than 50% for most students. See LAO, *CalFacts* at 41, *supra*. This is appropriate in general because higher education is a mixed public and private good; of course what the exact percentages should be is another question.

<sup>72</sup> Safe, Clean, and Reliable Drinking Water Supply Act of 2012, <<http://www.sos.ca.gov/elections/ballot-measures/pdf/sbx7-2-ch-3-stats-09.pdf>> (see sections 79731(a)(1)(D); 79743(a)(3)).

<sup>73</sup> Ellen Hanak, *supra*. Or, as put by another leading commentator, Dean Misczynski, *supra*, “the amount of money available remains modest relative to ‘need,’ and many local levee maintenance agencies have a difficult time (or simply cannot) come up with the local matching funds required by the (state) propositions.”

<sup>74</sup> California State Controller, *Special Districts Annual Report—Fiscal Year 2007-08* at 420 (Table 9 Non-Enterprise Activity Revenues and Expenditures by Non-Enterprise Activity).

<sup>75</sup> I am not sure the credit should be much larger than this or refundable. This is because of “the apparent fact that in many cases the cost of levee improvements substantially exceeds the value

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of the land and assets protected.” Misczynski, *supra*, at 39 (following Lund et al., 2008). Thus, as is generally the case with benefit-type taxation, there are benefits to impelling taxpayers to more efficient actions that should not be fully mitigated by use of credits. If a particular piece of land is not worth protecting even under the kind of scheme outlined above, then it probably should not be protected. And so if a generous credit scheme helps to identify such parcels, then that is a net benefit. Of course, the owners of such parcels might vote against any new assessment, relying on state taxpayers to update the levies. How serious this problem is is an empirical question I do not have a grasp of, but if the number is very large it suggests (to this observer) that state taxpayers should not be paying for these levies either and should proceed by regulation to forbid building in such areas.

<sup>76</sup> The LAO, for example, recommended in 2003 that user fees be used to pay for some administrative costs of the State Water Resources Control Board, and the legislature followed the recommendation. The California Supreme Court upheld the resulting fees—at least from a facial challenge that they are in fact taxes (the litigation will continue it seems about the details of the actual fees). *California Farm Bureau Federation v. State Water Resources Control Bd.*, 2011 WL 285189 (Cal. Jan 31, 2011) (NO. S150518). Manifestly, such shifts should be pursued wherever possible.

<sup>77</sup> As of October 2010, according to the state treasurer, there were over \$3 billion of unissued bonds authorized under the “Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006.” California State Treasurer, *Debt Affordability Report* (Oct. 2010), at App. A, p.10.

<sup>78</sup> The LAO, CalFacts *supra* at 65, reports that the debt service burden on the General Fund has recently increased from 6% to 9% of the General Fund.

<sup>79</sup> Governor’s Proposed Budget 2011-12 at 4, <<http://www.ebudget.ca.gov/pdf/BudgetSummary/Introduction.pdf>>.

<sup>80</sup> Governor’s Proposed Budget 2011-12 at 5.

<sup>81</sup> The legislature has more or less passed Governor Brown’s budget cuts, but not his proposed revenue increases. Kevin Yamamura and Jim Sanders, Brown’s Countdown, day 68: California lawmakers put another dent in deficit, *Sacramento Bee*, Mar. 18, 2011 at 1A.

<sup>82</sup> I should add that other sensible revenue solutions, including some currently in the governor’s budget could help us approach this \$12 billion threshold. For instance, the governor proposes making use of the Single Sales Factor mandatory, not elective, for an annual projected savings of about \$1 billion. Governor’s Proposed Budget at 42. Suppose as well that the state passed laws (not tax increases) that made it easier for the state to collect use tax that is already owed (say on purchases from retailers such as Amazon). That would likely net at least \$150 million. BOE Analysis of AB 178, Skinner & Calderon; see now AB 153, Skinner). This amount could be increased (and made legally stronger, I believe) by passing a different type of “Amazon” law, such as the one in Colorado. See Andrew Haile, “Defending Colorado’s Use Tax Reporting Requirement” 57 *State Tax Notes* 761 (Sept. 20, 2010) (explaining and defending Colorado’s innovative law); *MTC Releases Draft Model Statute for Sales and Use Tax Notice, Reporting* 2011 *State Tax Today* 42-1 (Mar. 3, 2011) (Multistate Tax Commission has proposed a model statute along the lines of the Colorado statute); AB 155, Calderon (the original version of this bill, introduced on January 18, 2011, was similar to the Colorado model); but see Edward A. Zelinsky, “The Siren Song of “Amazon” Laws: The Colorado Example” 59 *State Tax Notes* 695 (Mar. 7, 2011) (arguing that “Amazon” law in Colorado is not constitutional and noting that a Colorado district court has agreed). Finally, tax policy experts have long recommended that California expand its sales tax to cover services, and such a change could produce about \$1 billion. Stark, *supra* at 6; LAO, Overview of the Governor’s 2009-10 Budget at 6 (Jan. 2009), <[http://www.lao.ca.gov/2009/budget\\_overview/09-10\\_budget\\_ov.pdf](http://www.lao.ca.gov/2009/budget_overview/09-10_budget_ov.pdf)>. It is reasonable to imagine that AB 32 fees, net of extensive credits, might eventually have an impact on the same order of magnitude on the General Fund, say another \$1 billion (e.g., that amount of fees could

be used for greenhouse gas mitigation projects that the State is currently funding). See *California Bldg. Industry Ass'n v. San Joaquin Valley Air Pollution Control Dist*, 100 Cal. Rptr.3d 204, 216 (Cal. Ct. App. 2009) (post-*Sinclair* case upholding use of regulatory fees; the structure of the upheld program could be used as a model by the CARB). Taken together with the solutions sketched here, these proposals could amount to over 30% (over \$4 billion out of \$12 billion) of the revenue solutions the governor is looking for and they are all achieved in ways that make California's tax system more efficient and more stable—in contrast to proposals that simply increase current tax rates (especially on income), which serve to further narrow (and hence destabilize) California's tax base. Also notable, three of the five proposals, including the one in this paper, do not require a legislative supermajority. This is significant given that the alternative to well-designed revenue increases seems to be much less well-designed expenditure cuts. Kevin Yamamura, *Brown's Countdown, Day 70: An all-cuts budget may surface*, *Sacramento Bee*, Mar. 20 2011, at 3A.

<sup>83</sup> In 2000, Proposition 39 lowered the threshold to passing certain school bonds to 55% (from two-thirds). Since then, over \$20 billion in local school bonds have been approved and more than half of the money would not have been approved at the old threshold (and an unknown additional number of measures would not have been proposed if not for the possibility of qualifying at the lower amount). Ellen Hanak, *Paying For Infrastructure: California's Choices At Issue* 8-9, available at <<http://www.ppic.org/main/publication.asp?i=863>>. Let us imagine, very conservatively, that lowering the threshold to pass local taxes only generates \$1 billion per year. This would still be a big step. What if the state used some of its "savings" from realignment to incentivize more local projects through the use of credits? Perhaps such a program could lead to an average of \$2 billion more invested locally at a cost of to the General Fund of \$1 billion. There is probably also significant savings to be found in using the assessment mechanism to fund new stations for the State's new high-speed rail.

<sup>84</sup> See Matthew Murray et al., *Structurally Unbalanced: Cyclical and Structural Deficits in California and the Intermountain West* at 6 (Brookings Mountain West, Jan. 2011), [http://www.brookings.edu/papers/2011/0105\\_state\\_budgets.aspx](http://www.brookings.edu/papers/2011/0105_state_budgets.aspx) (finding that California's deficit for 2011 is less than half structural).