



**CALIFORNIA
TRANSIT
ASSOCIATION**

1415 L Street, Suite 200 • Sacramento, CA 95814

Phone (916) 446-4656 • FAX (916) 446-4318

E-Mail: info@caltransit.org

www.caltransit.org

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To: Members, California Transit Association

Fm: Joshua W. Shaw, Executive Director

Re: Interaction Between Propositions 22 & 26 and the Gas Tax Swap

With the passage last week of both Propositions 22 and 26, we've received many questions about how they interact with this year's "gas tax swap" legislation. The most common question seems to be, "*Does Prop 26 automatically repeal the gas tax swap?*" And if so, "*What remaining transit or transportation funding is protected by Proposition 22?*"

The quick answer is: **We don't yet know**. This memo attempts to provide some guidance on these and related questions. Please note, however, that while we are working with all parties to analyze the situation, **no definitive answers have yet been formulated**.

In fact, the ultimate impact of these measures on transportation funding will not be known until the legislature, new governor and possibly even the courts have acted ; the final resolution may take more than a year to take shape. In the meantime, your California Transit Association's Executive Committee has already begun planning the strategies and tactics necessary to maximize public transit funding in the face of the various scenarios that may play out over this period.

Proposition 26

Sponsored by the California Chamber of Commerce and various individual businesses and taxpayers groups, Proposition 26 was supported primarily by the following groups: California Chamber of Commerce; Small Business Action Committee; Chevron; American Beverage Association; Philip Morris; Anheuser-Busch; MillerCoors; Occidental Petroleum. Opponents of Prop 26 included: American Cancer Society; American Lung Association; California Nurses Association; California Teachers Association; League of Women Voters; Natural Resources Defense Council; Planning and Conservation League; Sierra Club California; and, Union of Concerned Scientists.

Prop 26 amends the California constitution to require any change in state statute resulting in any taxpayer paying a higher tax to be passed by a 2/3 vote of legislature. (The measure also contains a parallel provision relative to local government tax measures.)

The amount now collected from the increased gas tax is designed to first pay for the bond debt service on existing and future highway bonds, as well as replace the old Prop 42 funding for highway expansion projects and streets & roads, plus provide new highway safety and preservation funding.

The amount now collected from the increased sales tax on diesel fuel is designed to enhance the State Transit Assistance program, plus pay for other expenses of the PTA, such as the intercity passenger rail program.

Proposition 26 and the Gas Tax Swap

Because the new tax increases enacted in the gas tax swap were calibrated to produce new revenue equal to the replaced / lost sales tax on gas revenue that the swap legislation eliminated, the legislature used an interpretation of the California constitution to enact the bills with a simple majority vote.

Thus, we now wonder if the passage of Prop 26 repeals the gas tax swap.

While there is no definitive answer yet, here are some points to keep in mind:

- First, when people ask if “the gas tax swap will be repealed,” it’s important to figure out if they mean “the taxes increased in the swap” or “everything in each bill, including the elimination of the sales tax on gas, as well as the increases in the excise gas tax and the rate of sales tax on diesel fuel.” Some argue that the passage of Prop 26 can be used to overturn not only the new tax increases in the gas tax swap, but also to throw out the bill that exempted gasoline from sales tax in the first place, thus restoring the sales tax on gas.
- On the one hand, Prop 26 *seems* only to speak to the definition of a tax or a tax *increase* – it does not seem to speak to the exemption of a product from taxation. That line of reasoning would support the notion that Prop 26 can be used to overturn the excise tax on gas increase and the increase in the rate of sales tax on diesel fuel contained in the gas tax swap bills, while retaining all other aspects those bills, including the exemption of gasoline from the sales tax. Under this scenario, there would be no new revenue from the excise tax on gas or the sales tax on diesel, and there would be no restoration of the old sales tax on gas revenue.
- On the other hand, there is case law that *might* suggest that when an initiative repeals one section of law – in this case, the new taxes increased with the simple majority vote used to pass the gas tax swap – that the entire bill in which that now-illegal tax increase was contained is now itself repealed. Under this scenario, there would be no new revenue from the excise tax on gas or the sales tax on diesel, but there *would* be a restoration of the old sales tax on gas revenue.

The measure also defines “tax” as any levy, charge or exaction of any kind imposed by the State, but includes several exceptions. For our purposes, the most important exception to note is, “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.”

In other words, Prop 26 allows the legislature to continue to enact *some* state fees with a simple majority vote of the legislature : those which charge specific taxpayers and whose proceeds are then used to benefit those taxpayers charged, and *only* those taxpayers.

Finally, Prop 26 repeals any tax adopted this year if not adopted in compliance with the measure’s new definition of taxes. Specifically, the measure states:

“Any tax adopted after January 1, 2010, but prior to the effective date of this act, that was not adopted in compliance with the requirements of this section is void 12 months after the effective date of this act unless the tax is reenacted by the Legislature and signed into law by the Governor in compliance with the requirements of this section.”

Thus, the question is begged: *Did the gas tax swap of March, 2010, enact a tax that is not a tax under Prop 26, and that therefore must be repealed?*

To begin to understand, we first look back at the gas tax swap.

Gas Tax Swap

A package of two bills (ABx8 6 and ABx8 9) passed by the legislature and signed by the governor on March 22, 2010, the so-called “gas tax swap” *exempted* gasoline from the state sales tax. That *eliminated* about \$2.5 billion a year in public transit, streets & roads, and highways funding (i.e. by eliminating Proposition 42 funding – 40% of which was available for highways, 40% of which was available for streets & roads, and 20% of which was available for the Public Transportation Account; and, by eliminating two other sources of PTA funding – the spillover and the sales tax on nine cents of the historic excise tax on gas).

At the same time, the bills *increased* two different taxes – the excise tax on gasoline, and the rates of the sales tax on diesel fuel.

The amount projected to be collected annually under the new excise gas tax / diesel fuel sales tax scheme is calibrated to equal the amount of annual lost funding under the old sales tax on gas.

- There is some guidance already promulgated on this question, by the Legislative Analyst's Office. The LAO wrote the analysis of Prop 26 contained in the Official Voter Information Guide sent to every voter and posted on the Secretary of State's web site, which included the following excerpt:

"State Laws in Conflict With Proposition 26

Repeal Requirement. Any state law adopted between January 1, 2010 and November 2, 2010 that conflicts with Proposition 26 would be repealed one year after the proposition is approved. This repeal would not take place, however, if two-thirds of each house of the Legislature passed the law again.

Recent Fuel Tax Law Changes. In the spring of 2010, the state increased fuel taxes paid by gasoline suppliers, but decreased other fuel taxes paid by gasoline retailers. Overall, these changes do not raise more state tax revenues, but they give the state greater spending flexibility over their use.

Using this flexibility, the state shifted about \$1 billion of annual transportation bond costs from the state's General Fund to its fuel tax funds. (The General Fund is the state's main funding source for schools, universities, prisons, health, and social services programs.) This action decreases the amount of money available for transportation programs, but helps the state balance its General Fund budget. Because the Legislature approved this tax change with a majority vote in each house, this law would be repealed in November 2011—unless the Legislature approved the tax again with a two-thirds vote in each house.

Other Laws. At the time this analysis was prepared (early in the summer of 2010), the Legislature and Governor were considering many new laws and funding changes to address the state's major budget difficulties. In addition, parts of this measure would be subject to future interpretation by the courts. As a result, we cannot determine the full range of state laws that could be affected or repealed by the measure."

- A key point made by the LAO is that the original sales tax on gasoline was paid (to the state) by fuel retailers. And, the new taxes created in the gas tax swap are paid (to the state) by fuel suppliers. Thus, even though the same amount of revenue is generated overall that was lost, the fact that different taxpayers pay the new taxes versus the old taxes suggests that the new taxes contained in the gas tax swap do not meet Prop 26's definition of exempted charges (i.e. because they have a differential impact on taxpayers).
- To understand when some resolution of this whole question of Prop 26's impact on the gas tax swap may occur, we must first understand that the "repeal" clause in Prop 26 states that a noncomplying tax enacted earlier this year "is void 12 months after the effective date of this act unless the tax is reenacted by the Legislature and signed into law by the Governor in compliance with the requirements of" Prop 26 [emphasis added]. In other words, if the tax increases contained in the gas tax swap are, in fact, now illegal pursuant to Prop 26, the legislature *still* has 12 months to reenact the same tax increases through a new statute; but, this time, to qualify as a tax as defined by Prop 26, the statute increasing the excise gas tax and new sales tax on diesel fuel would have to be

passed with a 2/3 vote of the legislature, not with a simple majority vote. The point is: We may not know for at least one year whether the legislature *must* or *is able* to reenact the tax increases legally.

- As a matter of law, we may not even know the outcome unless some party chooses to first sue under Prop 26 and the courts decide, thus compelling the legislature to act. In other words, just because Prop 26 may seem to suggest the tax increases in the gas tax swap (if not the entire bills themselves) are now illegal, there is no reason to believe the legislature will come back into session and immediately try to reenact tax increases that no court has found to be illegal. We are currently not aware of any party planning to sue to repeal the gas tax swap increases, including Prop 26's sponsors. And, even if such a suit were pending, it seems like the party or parties would not have standing to sue until 12 months have passed from now, the effective date of Prop 26 – i.e. until after the time the legislature is granted to bring all noncomplying tax increases into compliance with passage of a 2/3 vote bill.
- In the meantime, why would the legislature either act to make the new tax increases go away, or, act to pass a new statute increasing taxes with a politically difficult 2/3 vote, if it doesn't have to take either action?

Proposition 22 and Prop 26 / Gas Tax Swap

Notwithstanding all the caveats pointed out above, *what if* the new taxes in the gas tax swap are someday deemed to be illegal – what would Proposition 22 protect?

Assuming just the tax increases are deemed illegal (i.e. and not every other aspect of the bills originally authorizing the gas tax swap), for this example we will assume that Prop 26 does *not* restore the old sales tax on gas. We would then need to know whether the legislature is able to reenact the gas tax swap's tax increases.

- If the legislature *does* legally reenact with a 2/3 vote bill the excise tax on gasoline and the sales tax on diesel originally authorized in the gas tax swap legislation, then Prop 22 is interpreted to protect and determine the method of expenditure of those two new sources, under Prop 26's amendments of Article XIX of the constitution.
- On the other hand, if the gas tax swap's tax increases are deemed illegal, and the legislature is unable (or chooses not) to muster the 2/3 vote threshold necessary to reenact the taxes legally, then about \$2.5 billion in gas tax swap revenue would not exist to be protected by Prop 22, including about \$120 million a year in new sales taxes on diesel fuel intended by the gas tax swap legislation to flow through the Public Transportation Account. (On the other hand, Prop 22 would still protect the historic sales tax on diesel fuel which existed before the gas tax swap, and dedicate those revenues – about \$315 million a year – to the PTA.)

And, if Prop 26 were somehow used to overturn not only the gas tax swap's tax increases, but *also* to repeal the elimination of the sales tax on gas in the first place, and if the legislature were unable (or chose not) to muster the 2/3 vote threshold necessary to reenact the taxes legally and to re-exempt gasoline from the sales tax, then about \$2.5 billion in sales tax on gas revenue would be restored, while the excise gas tax and sales tax on diesel fuel increases in the gas tax swap would be lost. The new / old sales tax on gas would be protected by Prop 22, with the spillover, the sales tax on nine cents of the gas tax, and 20% of the Prop 42 revenue all flowing to the Public Transportation Account and available only for expenditure on public transit as defined by Prop 22; and, the other 80% of the Prop 42 revenue would be protected by Prop 22 and would have to flow to highways and streets & roads. (In this scenario Prop 22 would also still protect the original sales tax on diesel, another \$315 million for the PTA.)

Analysis Continues

We are working with a coalition of public agencies and transportation interest groups to monitor, analyze and respond to the various Prop 26 / gas tax swap / Prop 22 scenarios. As more information comes to light, we will provide that to you.

For a short PowerPoint presentation staff recently made to the Association's Legislative and Executive Committee's on these topics, [please click here](#). We urge you to be circumspect in making any definitive statements to your governing board, the press or the public at this time relative to the impact of Proposition 26, and we appreciate your judicial use of this presentation.

In the meantime, please let us know if you have additional questions.



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**Funding Transit and
Transportation in the Future:**

**Proposition 22, Proposition 26 and
the “Gas Tax Swap”**

Next Steps

Election Results

Yes

No

• Proposition 19 Marijuana	46%	54%
• Proposition 20 Congress Redist	61%	39%
• Proposition 21 State Parks	42%	58%
• Proposition 22 Transit Funding	61%	39%
• Proposition 23 AB 32	39%	61%
• Proposition 24 Tax Loopholes	42%	59%
• Proposition 25 Budget Vote	55%	45%
• Proposition 26 Fee Vote	53%	47%
• Proposition 27 State Redist	41%	59%

Proposition 22:

Impact on Transit Funding

- Prop 22 protects \$1.8 billion in *state and state-supported* transit funding!
 - \$1.4 billion in local TDA revenues
 - \$431 million in PTA revenues
- Prop 22 protects hundreds of millions *more* in *local* county-option sales, parcel and other taxes for transit!
- Prop 22 provides the strategic leverage to ensure long-term a higher State Transit Assistance program than ever before!

**Proposition 22 was designed to
constitutionally protect...**

- Public Transportation Account revenues
- Transportation Development Act revenues
- Proposition 42 revenues
- Gas tax revenues
 - State
 - City & county
- City & county property tax revenues
- Redevelopment agency revenues
- Locally levied taxes and fees

But, for transit, gas tax swap...

- Eliminated sales tax on gasoline –
 - eliminates 3 of 4 core PTA revenues:
 - Spillover
 - Sales tax on 9¢ Prop 111 gas tax increase
 - Prop 42 / TIF sales tax on gas
- Converts value of eliminated PTA revenues into General Fund savings (payment of debt service on transp bonds) & new transportation spending

Specifically, gas tax swap...

- Increases gas tax to fund Prop 42's streets, roads and STIP obligations, plus new SHOPP
- Appropriates \$400 million from PTA to STA program
- Increases rate of sales tax on diesel fuel July 1, 2011, to enhance remaining core PTA revenue source
 - New 1.75% rate generates about \$118 million / yr to the PTA
- Dedicates all sales tax on diesel fuel in 2011-12+:
 - 75% to the STA program
 - 25% to all other PTA expenditures (i.e. PUC 99315)

But, Prop 26 also passes...

- Amends California constitution
- Requires any change in statute resulting in any taxpayer paying a higher tax to be passed by a 2/3 vote of legislature
- Defines “tax” as any levy, charge or exaction imposed by the state, but NOT one which conveys a specific benefit to the payor not also provided to those not charged
- Repeals any tax adopted after 01/01/10 not conforming within 12 months

Prop 22 + Prop 26 =

What?!?!

- Legal uncertainties, political uncertainties
- Prop 26 may overturn some or all of the gas tax swap (i.e. without corrective legislation within a year), or, none of it :
 - *Might* restore sales tax on gasoline (i.e. spillover, Prop 111 PTA, and Prop 42)...
 - *Might just* destroy new sales tax on diesel and new excise tax on gas...
 - Or, *might* do nothing to the gas tax swap...

Proposition 22:

Impact on Transit Funding

- Prop 22 protects \$1.8 billion in *state and state-supported* transit funding!
 - \$1.4 billion in local TDA revenues
 - \$431 million in PTA revenues (some @ Prop 26 risk / or, could be more..)
- Prop 22 protects hundreds of millions *more* in *local* county-option sales, parcel and other taxes for transit!
- Prop 22 provides the strategic leverage to ensure long-term a higher State Transit Assistance program than ever before!

Likely legal scenarios?

Best Case

- Prop 26 repeals new sales tax on diesel and new excise tax on gas
- Prop 26 repeals sales tax gas exemption; restores spillover, Prop 111, Prop 42
- Net ~\$1.1 billion in new PTA revenues protected by Prop 22
- All likely split 50%/50%

Worst Case

- Prop 26 repeals new sales tax on diesel and new excise tax on gas
- Prop 26 does not restore spillover, Prop 111, Prop 42
- Net loss of gas tax swap's new ~\$118 million in PTA revenues
- Prop 22 splits remainder (~\$313 million) 50%/50%

“Middle” Case?!

- Nobody sues, or, Prop 26 doesn't affect gas tax swap
- Or, all parties work to maintain – possibly restore – gas tax swap, legally
- Would presumably include 2/3 vote to increase excise tax on gas and add 1.75% rate to sales tax on diesel (but might not)
- For transit, either way, would allow room to explore additional STA funding split