CalTax
California Taxpayers Association

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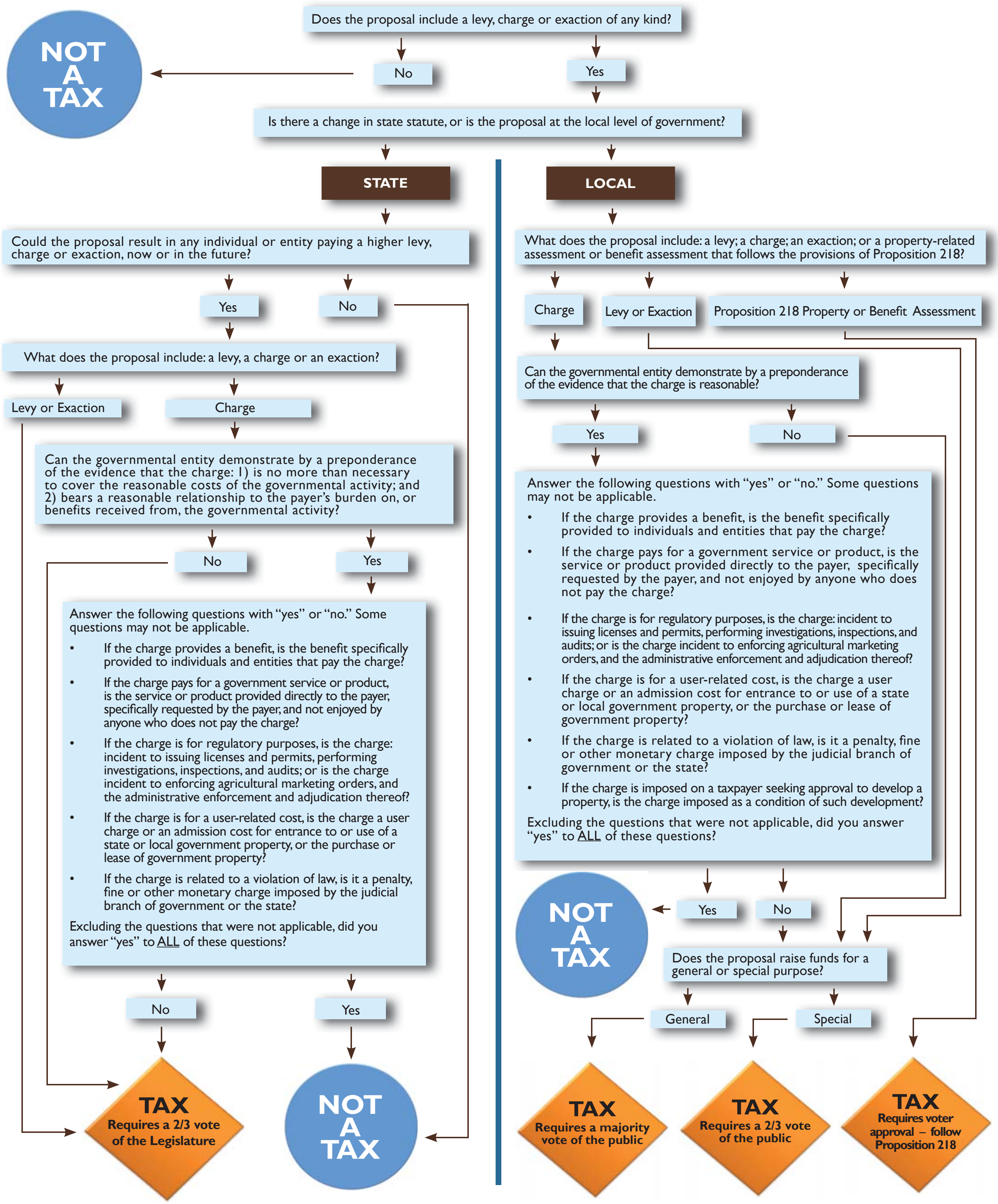
The Tax Test

A Roadmap to Understanding Proposition 26



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A Roadmap to Understanding Proposition 26

The California Taxpayers Association has prepared "*The Tax Test: A Roadmap to Understanding Proposition 26*" to answer questions as state and local policymakers navigate through various policy issues associated with passage of Proposition 26. Below are a few highlights of the "Stop Hidden Taxes" initiative:

- **What Is a Tax?** Proposition 26 defines a "tax" as any levy, any exaction and certain charges imposed in a state statute or by a local government that result in a taxpayer paying a higher tax. Exactions, levies, and charges mean the following:
    - **Exaction** – An exaction is a monetary demand by the government from an individual or entity, with no benefit to the payer. An exaction is more forceful than a tax levy or a charge.
    - **Levy** – A levy includes a new tax or tax increase – including but not limited to the personal income, corporate, sales and use, or excise tax – as defined by the *Sinclair Paint* decision.
    - **Charge** – A charge is a monetary demand by the government from an individual or entity for a service, an intangible benefit, or a good or product provided to the payer of the charge. A charge will not necessarily be compulsory, since not all individuals or entities desire or need a particular service, benefit or good/product. While a charge does not always have a consistent label, most are labeled as either a "fee" or a "charge."
- **What "Results" in a Taxpayer Paying a Higher Tax?** As defined by Merriam-Webster's Dictionary, "result" means something that happens "because of something else that happened or was done before; to be caused by something else." Any change in state statute that directly or indirectly results in any taxpayer paying a higher tax must be approved by a two-thirds vote of the Legislature. Changes include any state statute that authorizes local government or a regulatory agency to impose a charge, levy or exaction, since it is an element that will result in a taxpayer paying a higher tax.

For a complete analysis of Proposition 26 and its impact on California's tax structure, see CalTax's policy paper titled: "Understanding Proposition 26: A Sponsor's Guide to California's New Tax Structure."

Issues to Consider Before Imposing a Tax

Before imposing any charge, state and local governments should consider if such a charge is warranted, if additional revenue is necessary, and if a charge is the most equitable revenue source. If a charge is deemed necessary, then state and local policymakers can prove that a charge is not a tax by answering the following questions:

1. **Does the Charge Meet One of the Exceptions Provided by Proposition 26?**

2. **Does the Charge Specifically Benefit Those Who Pay the Charge?** Government activity funded by a charge should benefit only the individuals and entities that pay the charge. Governmental activity benefiting entire communities or populations, and charges that exclude or exempt certain segments of the population, are not evenly distributed. Therefore, such charges require a two-thirds vote of the Legislature and/or approval of voters at the local level.

3. **Is the Charge Reasonable?** State and local governments must be able to demonstrate through a preponderance of the evidence that a charge is reasonable. A charge is reasonable if it does not exceed the necessary cost of the governmental activity and if the cost allocated to the payer bears a fair or reasonable relationship to the payer's burden and/or benefits.

If policymakers answer "no" to any of the questions above, the charge is a tax. Proposition 26 does not prohibit state or local governments from increasing taxes – it merely ensures that a tax is deliberated with diligence, and that a significant segment of society agrees that a tax is necessary to support quality governmental services.