

COURTS: REDDING'S 'PAYMENT IN LIEU OF TAX' IS A TAX UNDER PROPOSITION 26, COURT OF APPEALS RULES

Redding's Payment in Lieu of Taxes (PILOT) system, in which a municipally owned utility sends money to the city's general fund in an amount designed to be equivalent to the *ad valorem* property tax the utility would have to pay if privately owned, constitutes an illegal tax, the Third District Court of Appeal ruled January 20.

In its published 2-1 decision in *Citizens for Fair REU Rates v. City of Redding*, the court found that the PILOT, funded by consumers via utility rates that are higher than they otherwise would be, is a tax that was not approved by Redding's voters, and therefore cannot be imposed unless the city can prove that the amount is necessary to cover the reasonable costs to the city to provide electric service.

Now, the issue will go back to the trial court for proceedings on whether the PILOT does or does not reflect the reasonable cost to provide electric service.

Proposition 26, the Stop Hidden Taxes Initiative, clarified the distinction between taxes and fees for local and state government, and set specific voter-approval requirements for local taxes, and legislative vote thresholds for taxes approved in the Capitol. A local tax requires approval by the affected jurisdiction's voters (either a majority vote or a two-thirds vote, depending upon whether the tax is for general or special purposes).

If a local government imposes a charge that it claims is not a tax, Proposition 26 puts the burden on the government to prove its claim. The initiative, cosponsored by CalTax and approved by voters in 2010, states: "The local government 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."

The court ruled that Redding, which has been using a PILOT since 1988, did not meet that burden. The court noted that the PILOT has been adjusted over the years to keep it equivalent to the *ad valorem* tax, but "has not been designed to approximate the reasonable costs of providing electric service in Redding."

"We conclude the PILOT constitutes a tax under Proposition 26 for which Redding must secure two-thirds voter approval unless it proves the amount collected is necessary to cover the reasonable costs to the city to provide electric service," the court wrote "We reject Redding's assertion the PILOT is grandfathered-in by preceding Proposition 26's adoption. As a budget line item, the PILOT is subject to annual discretionary reauthorization by Redding's city council. The PILOT does not escape the purview of Proposition 26 because it is a long-standing practice."

The court also rejected Redding's assertion that PILOT comports with Proposition 26 because the city's electricity rates are lower than those paid in many other cities. "Even if Redding's

rates were the lowest in California, Proposition 26 would nonetheless require the PILOT to either reflect the city's reasonable cost of providing electric service or be approved by two-thirds of voters," the court wrote. "An unconstitutional tax is not rendered lawful simply by being bundled with otherwise reasonable utility rates."

In a footnote, the court noted that PILOTS are "not uncommon among California's municipalities," but added, "We do not consider or address the validity of any PILOT other than the one presented in this case."

The majority opinion was written by Justice Andrea Lynn Hoch, with concurrence from Acting Presiding Justice Louis Mauro.

Justice Elena Duarte dissented, arguing that the result of the majority opinion "is disruptive, uncertain, and chaotic, and, in my view, is not compelled by Proposition 26."