

## When Is a 'Fee' Really a Tax in Disguise?

### Use CalChamber Three 'Cs' to Make the Call

As state lawmakers search for solutions to address California's significant projected budget deficit, many in the business community are concerned that tax increase proposals will be on the rise.

Ironically, a proposed legislative tax increase forthrightly identified as a tax increase is not the most threatening type of proposal to taxpayers.

More pernicious is the tax increase proposal that is called a "fee."

### Proposition 13 Protection

For *tax increases*, Proposition 13 established an important taxpayer protection in the California Constitution – a requirement that tax increases be approved by a two-thirds vote of the Legislature.

By contrast, *fee* proposals require only a majority vote for approval, a far easier threshold to meet than two-thirds.

Thus, ensuring that a so-called "fee" is in fact a fee rather than a tax is a crucial analysis that taxpayers ought to conduct for every proposed "fee."

Every year, many legislative proposals labeled as "fees" are actually tax increases. These usually span a wide range of subjects, including transportation, the environment, health care, real estate and telecommunications.

Sometimes, designating a tax as a fee is a strategic attempt to bypass the two-thirds vote requirement. Other times, a wrong or questionable designation of a tax as a fee is due to controversy or confusion over the distinction between taxes and fees.



## How to Tell the Difference

	Fee	Tax
No Connection	<input type="checkbox"/>	<input checked="" type="checkbox"/>
No Cost Match	<input type="checkbox"/>	<input checked="" type="checkbox"/>
No Controls	<input type="checkbox"/>	<input checked="" type="checkbox"/>

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### Landmark Court Decision

Unfortunately, court decisions following passage of Proposition 13 muddled rather than clarified the tax v. fee distinction. One of the landmark decisions that did so was *Sinclair Paint v. State Board of Equalization*, 15 Cal.4th 866 (1997).

At issue in *Sinclair* was a monetary assessment imposed under the Childhood Lead Poisoning Prevention Act on manufacturers that were considered to be contributors to environmental lead contamination. Passed by a majority vote of the Legislature, the act created a "fee" to fund health care, research and education programs related to children at risk of lead poisoning.

The California Supreme Court held that the assessment was a fee and not a tax because there was a sufficient connection between it and the adverse effects it was meant to "mitigate." The court broadly held that regulatory agencies can impose fees under their "police power"

(rather than the taxing power), including fees to remedy or mitigate societal effects generated by an industry's products.

The California Chamber of Commerce, many taxpayers and others in the business community reacted with concern, stating that the expansiveness and vagueness of the *Sinclair* decision undermined Proposition 13. In the decade since *Sinclair*, controversy over the distinction between taxes v. fees has been ongoing, resurfacing numerous times in the legislative and court arenas.

### Three 'Cs' Test

Notwithstanding this ongoing controversy, certain principles from *Sinclair* and other tax v. fee cases can provide guidance for determining whether a monetary assessment or charge is really a tax rather than a fee.

The CalChamber has boiled down these principles into three easy-to-remember "Cs":

- **Connection:** *Is there a reasonable connection or nexus between the proposed assessment and the program or service it is supposed to fund?*

In other words, did those who must pay the assessment cause or create the need that the assessment claims to address? Are those individuals who did not cause or create the need specifically exempted?

An illustration of missing causal connection would be a proposed 25-cent surcharge on every beer or wine drink in a restaurant, the proceeds of which would fund law enforcement efforts against alcohol-related crimes. Since not every beer and wine drinker is going to engage in a crime, then even those who didn't create the need for the law enforcement service are funding the service. Thus, the blanket surcharge is likely a tax.

- **Cost:** *Does the amount of the assessment reflect the reasonable cost of providing the government services?*

A proposed assessment should not exceed the amount reasonably necessary to cover the costs of the proposed government program. For example, if it costs the government \$20 to perform the service in question, then the fee assessment should not be \$40.

- **Controls:** *Are there adequate controls in place to ensure that program funding is limited to the assessment monies and vice versa – are assessment monies limited to funding the program?*

For example, in establishing a program, legislation should specify that the program's sole funding source is the assessment revenue and no other, such as the General Fund. Otherwise, there is no safeguard for connection and cost principles over the life of the program.

Similarly, if there is no explicit prohibition on funneling assessment funds to other programs, the answer to the adequate controls question generally will be "no."

The more "no" answers the analysis shows for the above three "Cs," the more likely the assessment is a tax, even if labeled a fee.

It is important to apply the tax v. fee analysis not only at the state level, but also the local level. Local "fee" proposals can sometimes be more onerous and pervasive, and an improper "fee" designation can mean avoiding the Constitution's requirement that most special taxes be subject to approval by two-thirds of voters.

The threat of a projected \$14.5 billion budget deficit means that "fee" proposals are likely to be more prevalent than ever as state and local policymakers search for new revenue sources.

The CalChamber strongly encourages business and other taxpayers to be vigilant about whether any proposed monetary "fee" is in fact a tax and should be subject to Proposition 13's two-thirds vote requirement.