Municipal taxation is now interesting

Overview

Last week the California Supreme Court decided *City and County of San Francisco v. UC Regents* (S242835 docket and opinion), and in unanimously ruling for the city the court reshaped the local finance landscape and employed a clear new vision for resolving state–local conflicts. The case involved a mundane matter of whether a city can tax private users of parking lots owned by state universities. The universities argued that, as sovereign state entities, their real property operations could not be taxed by local governments.[1] The city argued that the core municipal taxation power was paramount here, and taxing private citizens would not diminish state sovereignty. The court held that a state entity can be asked to collect a local tax imposed on third parties doing business with the entity, where the entity will be reimbursed its costs of doing so.

This decision has three major implications. Added to the recent *City of Upland* decision, this case opens the door even wider to creative new local taxes: *City of Upland* made those taxes easier to enact by initiative, and the *UC Regents* decision expanded the permissible subjects of local taxation to include taxes that pass through the state. This decision clarified a particularly murky area of municipal affairs doctrine by plainly stating that courts will use an interest-balancing approach. And it arguably rejuvenates the state constitution's home-rule provision by placing charter cities on par with the state itself.

Analysis

Local government now has two major new taxation tools

Along with *City of Upland*, this decision gives local government finance vast new opportunities for increasing local revenue. *City of Upland* held that local initiative tax measures can be considered at special elections,[2] and Professor Darien Shanske argues that this means local initiative taxes necessarily are subject to only a majority vote requirement. This new decision makes clear that indirect taxes on the state government are permitted—inasmuch as a charge can be viewed as a direct tax on third parties, where the state's only role is to collect the fee. The decision's emphasis on the fact that the city would reimburse the state for the cost of collection lessens the edge on this. In *UC Regents*, the court's conclusion was founded on its reframing of the broader issue: rather than viewing the ordinance as a tax on the universities, the court saw it as "a tax on private third parties who happen to do business with" the universities.

Taken together, then, *UC Regents* and *City of Upland* mean that both local governments and local electorates have significantly expanded taxing options. Local governments remain bound by the voting restrictions on general and special taxes.[3] But the subject of those taxes is now potentially much broader, and following *City of Upland* such taxes are potentially far easier to enact by initiative.

Indeed, the fact that the dispute here concerned the municipal taxing power may have made the outcome inevitable. While the court has long declined to categorize subjects as state or local matters, its respect for taxation as a core incident of a charter city's home rule powers is equally venerable.[4]

The result here was probably inevitable given the court's historical treatment of local tax disputes. We unscientifically surveyed California Supreme Court decisions that resolved

charter city municipal affairs disputes from 1970 to date (see appended table). Over the past fifty years, we counted 20 decisions. The state won in 12 cases, while the city won in eight. The key takeaway is that of the eight city victories, all but one concerned either taxes, wages, or some other kind of municipal finance ordinance.[5]
The state wins were all on broader issues (vehicle forfeiture, home mortgage lending, highway funding, etc.) as it should be.

This analysis shows that, despite repeated statements by the court that subject matters are not divided into city–state categories, municipal finance generally and local taxes specifically are consistently treated by the court as municipal affairs. And while (as discussed next) we see the *UC Regents* decision as confirming an interest-balancing approach to municipal affairs cases, both logic and the historical trend compel the conclusion that courts likely will favor a charter city's interest when the state challenges a municipal tax.

State–local conflicts are now subject to an interest-balancing analysis

One of the many problems with the municipal affairs doctrine has been the struggle to define the applicable test. The California Supreme Court has tried various approaches over the years, and most recently the test became less confusing — to the extent that one only needed to predict which of two California Supreme Court decisions stated the governing test (*State Bldg. & Construction Trades Council of California v. City of Vista* (2012) 54 Cal.4th 547 or *Cal. Fed. Savings & Loan Assn. v. City of Los Angeles* (1991) 54 Cal.3d 1). This decision resolves the apparent conflict between *City of Vista* and *Cal. Fed*. Note the dates on those cases: *City of Vista* is by far the more recent decision. Yet while the *UC Regents* decision relied heavily on *Cal Fed*, it cited *City of Vista* not even once. The takeaways here are that *City of Vista* was an anomaly; that the apparent dispute is obviated; and that going forward *UC Regents* states the standard. And that standard "calls for a sensitive balancing of constitutional interests, rather than a simple invocation of constitutional rank":

> *In matters concerning the structural division of authority under our Constitution,*

> *we have generally avoided the type of absolutist approach the universities urge in favor of a more flexible one, capable of adaptation to the practical imperatives of governance. . . . [¶] In questions concerning the division of authority between the state and charter cities, in particular, we have recognized the need to maintain a sensitive balance between competing prerogatives.*

Of course, the analysis will be slightly different if the ordinance squarely conflicts with a statute. That was part of the problem with the universities' case: they lacked an on-point statute, and so had to rely on the structural sovereignty argument and implied preemption. Both arguments failed.

The decision's effect is (at least for local taxes) to require express statutory preemption. The court found no statute that expressly preempted the local tax: "a charter city tax—like a charter city regulation—may be preempted by a state statute in appropriate circumstances. But . . . there is no preemptive state statute applicable to the circumstances of this case." And it rejected an implied preemption argument, holding instead that indirect economic consequences alone are insufficient: "If state agencies could invalidate municipal taxes based on these indirect effects on their operations, little would be left of the city's revenue power." Going forward, an implied preemption argument likely will be a weak reed for any state entity. And even if a statutory conflict exists and a court applies a *Cal. Fed.* style preemption analysis, the bottom line will be the interest balancing consideration that governed the *UC Regents* decision.

Finally, note the court's situational reliance on federal precedent. On the question of whether a city can tax private users of university parking, the court applied federal–state cases:

> *The relationship between the federal and state governments is by no means identical to the relationship between state universities and charter cities. But the federal cases nevertheless offer several important lessons that have proved influential in our own case law. The federal cases recognize that "inferior" governments may levy taxes on private parties, even if the economic burden of that tax is passed entirely to the "superior" government.*

But on the sovereignty hierarchy issue, the court declined to analogize federal–state with state–local relations: “it is not clear that even those cases, which concern the unique federalism principles embodied in the United States Constitution, are properly read to adopt a rule of categorical immunity from any and all ministerial requirements one government might impose on another.”

The court’s refusal to analogize federalism with home rule flows from the truism that the federal and state governments are designed differently, and those differences mean that the state–federal and the state–city relationships are fundamentally distinct. The takeaway here is that federal cases are of limited utility in resolving municipal affairs disputes.

Home rule and the municipal affairs clause are revitalized

In its 140-year lifetime, the state constitution’s home rule provision has received at best inconsistent treatment, and at worst has never been judicially interpreted to give charter cities their full due. The *UC Regents* decision recalibrated the balance of power between the state and charter cities, by reading the home rule provision as it was originally intended: to grant charter cities constitutional autonomy equivalent to the state itself.

The universities argued that because state entities outrank locals in the state constitution’s sovereignty hierarchy, a municipality cannot impose burdens on state entities. This argument relied on a long line of appellate decisions that exempted state agencies from local regulatory ordinances.[6] Rejecting that argument, the court limited this line of authority to “substantive regulatory requirements” that interfere with “the state’s substantive judgments about how to perform its assigned functions.”

The decision concludes with the court’s view on the fundamental nature of sovereignty:

> *[W]e conclude that San Francisco's parking tax collection requirement, as applied to the state universities, does not violate principles of state sovereignty embodied in the California Constitution. . . . [I]t is ultimately the People of the State of California who are its "highest sovereign power." [Citation.] The universities exercise those powers granted to them by the People of this state, just as the charter cities exercise those powers granted to them by the People. If San Francisco's tax collection requirement offends state sovereignty, it must be because the requirement in some way offends or disadvantages the People's interests. For reasons already explained, that is not the case here.*

The center's amicus brief in this case argued this sovereignty point: "Because the state's power is superior to politically subordinate cities, sovereignty principles bar a city from regulating the state when it is engaging in governmental activities."

It seemed to us that state–local doctrine had been moving towards a preemption-favoring bias, which placed the court at a crossroads in this case: it could affirm the trend and relegate local government to secondary status, or rebalance the relationship by restoring some local power. The structural hierarchy argument is the ultimate version of the state-favoring trend, so we advanced it to see if the law was really going that direction.

It was not, and that's important news on several fronts. This decision restores some balance to state–local relations, which (as discussed above) have favored the state in recent cases. The broad language about charter city powers revives the municipal affairs clause, which has never received its due respect. And the court's pragmatism, interest-balancing, and refusal to be restrained by bright-line rules that has long characterized its separation of powers doctrine now applies to municipal affairs cases.[7]

Conclusion

This decision is a welcome dose of

clarity in a doctrinal area that's been characterized by opacity and inconsistency since 1879. Two things in particular are now clear. The sovereignty argument is now officially dead, and rather than being governed by federalism-lite principles, expect intergovernmental disputes in California to be reviewed on a pragmatic separation-of-powers-esque standard. The new battle line is the distinction between direct and indirect taxes. Creative charter cities likely will start taking a hard look at all the state employees, properties, and operations within their limits and thinking about how to tax those things indirectly.

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Senior research fellow Stephen M. Duvernay contributed to this article.

STATE **WINS: 12**	**CITY** **WINS: 8**
McWilliams v. City of Long Beach (2013) 56 Cal.4th 613 (state wins: home rule provisions do not limit the legislature's authority to prescribe procedures governing claims against chartered local government entities)	State Building & Construction Trades Council of California v. City of Vista (2012) 54 Cal.4th 547 (city wins on prevailing wage issue)
O'Connell v. City of Stockton (2007) 41 Cal.4th 1061 (state wins: city vehicle forfeiture ordinance preempted)	Johnson v. Bradley (1992) 4 Cal.4th 389 (city wins: state law prohibiting candidates from accepting public funds was not narrowly tailored to state interest in election process integrity, and did not preclude city charter from adopting a partial public financing measure).

American Financial Services Assn. v. City of Oakland (2005) 34 Cal.4th 1239 (state wins: charter city ordinance is preempted because legislature impliedly fully occupied the field of regulation of predatory practices in home mortgage lending)	Fisher v. City of Berkeley (1984) 37 Cal.3d 644 (city wins: rent-withholding provisions of ordinance were not preempted by general state law)
California Fed. Savings & Loan Assn. v. City of Los Angeles (1991) 54 Cal.3d 1 (state wins: taxing financial corporations was a matter of statewide concern that preempted city's attempt to impose annual license tax on financial corporations)	People ex rel. Deukmejian v. County of Mendocino (1984) 36 Cal.3d 476 (city wins: legislature has not preempted local regulation of pesticide use)
Committee of Seven Thousand v. Superior Court (1988) 45 Cal.3d 491 (state wins: legislature may bar local initiatives regarding funding and construction of major highways, a matter of statewide importance)	The Pines v. City of Santa Monica (1981) 29 Cal.3d 656 (city wins: ordinance imposes a revenue tax that does not conflict with the state scheme for regulating subdivisions)
People ex rel. Seal Beach Police Officers Assn. v. City of Seal Beach (1984) 36 Cal.3d 591 (state wins: charter city could not avoid to meet and confer requirement by relying on its charter powers)	Sonoma County Organization of Public Employees v. County of Sonoma (1979) 23 Cal.3d 296 (city wins: the determination of the wages paid to employees of charter cities as well as charter counties is a matter of local rather than state-wide concern)
Baggett v. Gates (1982) 32 Cal.3d 128 (state wins: peace officers bill of rights statute applied to charter cities)	Weekes v. City of Oakland (1978) 21 Cal.3d 386 (city wins: statute prohibiting municipal taxes "upon income" neither conflicts with nor bars city's employee license fee)

Societa Per Azioni De Navigazione Italia v. City of Los Angeles (1982) 31 Cal.3d 446 (state wins: city ordinance directly conflicts with the general law)	A.B.C. Distributing Co. v. City and County of San Francisco (1975) 15 Cal.3d 566 (city wins: payroll expense tax on liquor distributors is not preempted)
County of Los Angeles v. City of Alhambra (1980) 27 Cal.3d 184 (state wins: ordinance preempted by the Vehicle Code because parking meter regulation is a form of traffic control, a matter of statewide concern)	
Metromedia, Inc. v. City of San Diego (1980) 26 Cal.3d 848 (state wins: ordinance preempted to the extent that it permits removing billboards without compensation)	
City of Santa Clara v. Von Raesfeld (1970) 3 Cal.3d 239 (state wins: revenue bonds for sewage treatment facilities that would affect the health of all San Francisco Bay Area inhabitants is not a municipal affair)	
Baron v. City of Los Angeles (1970) 2 Cal.3d 535 (state wins: ordinance to extent it purports to govern practice of law and invades a field of regulation preempted by state law)	

[1] As discussed further in this article, the center filed an amicus brief supporting the UC Regents position.

[2] *Cal. Cannabis Coalition v. City of Upland* (2017) at 948.

[3] Cal. Const., art. XIII C, § 2(b) ("No local government may impose, extend, or

increase any general tax unless and until that tax is submitted to the electorate and approved by a majority vote. . . . The election required by this subdivision shall be consolidated with a regularly scheduled general election for members of the governing body of the local government, except in cases of emergency declared by a unanimous vote of the governing body.”). Art. XIII C, § 2(d) (“No local government may impose, extend, or increase any special tax unless and until that tax is submitted to the electorate and approved by a two-thirds vote. A special tax shall not be deemed to have been increased if it is imposed at a rate not higher than the maximum rate so approved.”).

[4] “In reviewing the applicable law we acknowledge, preliminarily, the long standing principle that the power to raise revenue for local purposes is not only appropriate but, indeed, absolutely vital for a municipality. Moreover, the power to tax for local purposes clearly is one of the privileges accorded chartered cities by the home rule provision of the California Constitution.” *Weekes v. City of Oakland (1978)* at 392 (citations omitted).

[5] *People ex rel. Deukmejian v. County of Mendocino* (1984) is the clear exception; it upheld a local pesticide regulation. *Fisher v. City of Berkeley (1984)* is a possible exception, but its rent-withholding ordinance looks like local finance to us.

[6] *City of Santa Ana v. Board of Ed. of City of Santa Ana (1967)* and *Laidlaw Waste Systems, Inc. v. Bay Cities Services, Inc. (1996)* (exempting school districts from local garbage collection regulations); *City of Orange v. Valenti (1974)* at 242–44 (holding that the state unemployment insurance office did not have to comply with a local parking ordinance prescribing the number of parking spaces that must be available); *Regents*

of University of California v. City of Santa Monica (1978) at 136–137 (holding the city could not enforce a
construction fee against the Regents).

[7]
See David A. Carrillo and Danny Y. Chou, California Constitutional Law: Separation of Powers (2011) 45 USF.L.Rev. 655, 677–78: "California courts have resisted the temptation to create a lodestone definition of the core powers of any of the three branches or a comprehensive list of those powers. Instead, courts have largely avoided the formalist/functionalist debate by classifying on a case-by-case basis the particular power presented based on whether it is identified as an express power in the text of the California Constitution or is a necessarily implied power. . . . But for the most part, courts have largely defined the powers in a piecemeal fashion. Indeed, early California cases recognized that some overlap and interaction between the departments was necessary
and inevitable, and as a result, an attempt at a wholesale categorizing of one branch's powers was unnecessary to resolving the basic separation of powers questions."