

## A Tax by Any Other Name: Constitutional Challenges to Revenue-Raising Schemes

By David A. Battaglia and Kahn A. Scolnick

*“I nvention is continually exercised to furnish new pretences for revenues and taxation.” Thomas Paine, “Rights of Man” (1791).*

Taxes, from a political perspective, are something of an anathema in the United States. After all, aren't we essentially a nation founded by tax objectors? Yet all levels of government (federal, state, and local) must somehow raise revenues if they are to function. Saddled with this dichotomy, or perhaps even inspired by it, a recent and woeful trend has been attempted by clever politicians to circumvent prohibitions on new taxes or limitations on tax increases. New levies have been called “fees” in a form of namesmanship designed to obscure the true nature of the exaction.

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Current budget proposals demonstrate the breadth of this trend: a proposed statewide vehicle registration fee to fund state parks, a proposed new fee on liquor wholesalers to defray the cost of emergency services, and a proposed \$63 million fee to be levied on oil companies and utilities to fund greenhouse gas reduction. The governor highlighted this issue recently in his comments about a proposed surcharge on property insurance: “We consider it a fee.... I let some people debate over that — what's a fee and what's a tax. But I mean, I call it a fee.” Kevin Yamamura, *“When is a Fee Really a Tax,” Sacramento Bee* (Mar. 1, 2010).

Based on our experiences in successfully opposing illegal taxes in a myriad of contexts, there are five separate constitutional arguments that can be utilized effectively as a defense to this inappropriate government action: California's Propositions 13 and 218; the Contracts Clause; substantive Due

Process; Equal Protection; and the Takings Clause.

*Propositions 13 and 218:* The “taxpayer revolt” in California in the late 1970s is well known. After years of skyrocketing property taxes, voters enacted “Proposition 13,” which amended the California Constitution to cap and limit property tax rates in the state. (Article XIII A). In part, Proposition 13 prohibits any new taxes unless approved by a two-thirds majority of the Legislature, and it prohibits any new ad valorem taxes on real property. In 1996, voters enacted Proposition 218, which amended the constitution to close loopholes in Proposition 13 as applied to county and municipal governments. (Articles XIII C-D).

California courts have wrestled with the issue of when a valid regulatory “fee” becomes an unconstitutional “tax.” Fees are valid only if they “do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and...are not levied for unrelated revenue purposes.” *Sinclair Paint Co. v. State Board of Equalization*, 15 Cal.4th 866, 876 (1997). In recent years, however, the governmental inclination towards new taxes disguised as “fees” has become more obvious and rampant as governments seek to plug holes in budget deficits.

As an example, the state and its counties enacted and planned to implement an “annual fire-protection fee,” imposed on each parcel of land outside city boundaries, to fund half of the costs of the state Department of Forestry and Fire Protection. This levy was unconstitutional under Propositions 13 and 218 because it was not passed by a two-thirds majority of legislators, it imposed exactions on real property owners, and there was no nexus between the amount of the fee and the value of the service provided. Instead, it was all a matter of simple arithmetic: divide the amount of revenue needed by the number of acres affected. Upon challenge, the Legislature agreed to repeal the illegal “fee,” saving affected landowners an estimated

\$105 million. See 2004 California Statute 219, Section 1.

Similarly, the state enacted and attempted to enforce a new “water rights fee” imposed on a small group of the state's water rights holders. See California Water Code Section 1525. The state's professed purpose was to fund all the activities of the Division of Water Rights of the State Water Resources Control Board—which previously had always been funded through the state's general fund. This new “fee” crossed the line between a valid regulatory “fee” and a tax. The calculation of the fee was based on the reduction in the general fund, not on the benefits or burdens created by water rights holders. And one class of fee payers, constituting only about one-third of all water right holders in California, was left paying the tab for the rest of the water right holders and the public generally. The governmental action thus was rejected, pending further review. See 146 Cal.App.4th 1126 (2007) review granted.

*Contracts Clause:* The U.S. Constitution forbids state and local governments from



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enacting laws that impair the obligations of contracts, and many state constitutions (including California's) contain similar provisions. U.S. Constitution Article I, Section 10; California Constitution Article I, Section 9. The Contracts Clause, as it is called, applies with even greater force when the government itself is a contracting party. *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 26 (1977). A governmental entity generally is not permitted to change the terms of its own agreements unilaterally by enacting legislation that alters those terms. But again, human nature being what it is, sometimes legislative bodies cannot resist trying to restack the deck in their favor—particularly when governments are faced with budget deficits.

Take, for example, the case of Santa Ana's "trench cut fee." The city agreed in a franchise contract that the Southern California Gas Co. could install and maintain gas pipes below the city's streets. In exchange, Southern California Gas paid a handsome annual royalty. And so it went for many years. But Santa Ana later decided that it wanted more from Southern California Gas and other utilities with which it had franchise contracts. The city enacted a new ordinance requiring all persons, including Southern California Gas, to pay a new "trench cut fee" before excavating in any city street.

This activity, of course, was precisely what Southern California Gas already was paying for. Santa Ana had violated the Contracts Clause: the new "fee" was a thinly disguised means of altering the city's existing contract with the utility company. 336 F.3d 885 (9th Cir. 2003).

*Substantive Due Process and Equal Protection:* The substantive component of the Due Process Clause and the Equal Protection Clause protect against arbitrary and unreasonable state action. U.S. Constitution Amendment XIV, Section 1. While a government possesses a broad police power, it still must establish a reasonable relationship between any new "fee" charged and the benefit enjoyed, or the burden imposed, by the fee payers. Where, for example, fee payers are required to fund not only their own benefits and burdens, but also the benefits and burdens associated with millions of others, this can implicate both substantive Due Process and Equal Protection.

For instance, in the Southern California Gas situation, the "fees" arguably bore no rational relationship to the true costs of repairing the city's streets. And in the "water rights fee" case, only about one-third of water right holders were required to foot the bill for all of the agency's regulatory activity—which benefited all water right holders and

the public generally. This unfair disparity, amongst others, arguably was violative of the individual fee payers' rights to substantive due process and equal treatment under the law.

*Takings Clause:* The U.S. Constitution prohibits federal, state, and local governments from "Taking" private property for public use without just compensation. U.S. Constitution Amendment V. The taking of money can be considered uncompensated when done without an adequate governmental basis or when applied inequitably. *Webb's Fabulous Pharmacies v. Beckwith*, 449 U.S. 155 (1980). It follows that the Takings Clause provides another useful weapon against inventive levies by governmental entities. For instance, where Southern California Gas was made to pay fees as a condition to the exercise of a preexisting contract right, an unconstitutional taking arguably resulted.

Wary of increasing taxes, or imposing new ones, some governmental entities in recent years have resorted to deceptive revenue-raising practices. This circumstance is not unique to California. Fortunately, there is no easy way around federal and state constitutions. Courts should continue to be highly suspicious of legislative attempts to design and impose new exactions that are, namesmanship aside, illegally imposed taxes pure and simple.