

Proposition 1A (2004) Facts

In November 2004, the voters of California approved Proposition 1A, an amendment to the California state constitution intended to restore predictability and stability to local government budgets. The measure:

- Strengthens prohibitions against unfunded state mandates by requiring the state to suspend state mandates in any year the Legislature does not fully fund those laws.
- Expands definition of state mandate to include transfer of responsibility of a program for which the state previously had full or partial responsibility.
- Prohibits the state from
 - Reducing the local Bradley Burns Uniform Sales & Use Tax rate or altering its method of allocation. Exception to comply with federal law or an interstate compact.
 - Decreasing VLF revenue from the 0.65% rate without providing replacement funding to cities and counties.
 - Shifting property taxes from cities, counties or special districts with certain exceptions.
 - Failing to reimburse to cities and counties for the ¼% local sales tax shifted under the triple flip.

State Mandate Funding

Proposition 1A requires the Legislature:

- to either suspend a mandate or appropriate the necessary funds in the budget to reimburse local governments for all costs of complying with the mandate, including those in prior years;
- to reimburse local governments when the state mandates that local government assume a greater percentage of the financial responsibility for a program or service previously shared with the state; and
- to begin repaying amounts owed to local governments for mandate costs incurred prior to FY 2004-05.

Proposition 1A does not apply to mandates affecting local schools or mandates related to employee relations and collective bargaining

Local Revenue Protection

Proposition 1A protects local property tax, sales tax and VLF revenues by prohibiting the Legislature from taking any action that would:

- Reduce the local Bradley Burns Uniform Sales & Use Tax rate or alter its method of allocation.
- Decrease VLF revenue from the 0.65% rate without providing replacement funding to cities and counties.
- Shift property taxes from cities, counties or special districts to the schools or any other non-

local government function except under certain circumstances.

Sales and Use Tax Rate and Allocation Method. Generally, revenue from the 1% Bradley Burns Local Sales and Use Tax is allocated to the city in which the sale occurs, or, if in an unincorporated area, the county. Proposition 1A prohibits the Legislature from reducing the local sales tax rate, or changing the method of allocation of local sales tax revenues. Proposition 1A permits the Legislature to change the method of allocation in order to comply with federal law or an inter-state compact.

Local Transactions and Use Tax Authority. Proposition 1A prohibits the state from restricting the authority of a local government to impose a transactions and use tax pursuant to Revenue and Taxation code Section 7251 or altering the method of allocation of these tax revenues.

Local Sales Tax Reduction Under the Proposition 57 Triple Flip. In March 2004, the voters of California approved Proposition 57, the California Economic Recovery Bond Act. Legislative provisions implementing Proposition 57 provide for a swapping of $\frac{1}{4}$ cent to be used by the state to repay the bonds effective July 1, 2004. The so called “triple flip” consists of 1) reducing the Bradley Burns Local Sales and Use Tax Rate by $\frac{1}{4}\%$ and $\frac{1}{4}\%$ to the state’s sales tax rate to fund fiscal recovery bond repayment, 2) repayment to cities and counties with additional local property tax previously allocated to local schools, and 3) repayment to local schools with state general fund. Proposition 1A prohibits the Legislature from extending this reduction in local authority to impose the full Bradley Burns Sales and use tax rate beyond the period necessary to repay the Proposition 57 bonds. In addition, it constitutionally protects the reimbursement to cities and counties under the triple flip.

Vehicle License Fee. Proposition 1A requires the Legislature to provide replacement revenue to cities and counties if it reduces the VLF rate below 0.65%. California Constitution Article XI Section 15 requires that VLF revenue be allocated to cities and counties. The state may charge for administrative costs (DMV, Controller) and the Legislature retains the power to change state law allocating the VLF among cities and counties.

Property Tax. Proposition 1A prohibits the Legislature from reducing the share of property tax revenues going to the cities, county and special districts in any county, and shifting those shares to the schools or any other non-local government function. However, the Legislature may alter the allocation of property taxes among cities, counties and special districts within a county with $\frac{2}{3}$ approval in each house.

Under specific conditions, the Legislature may suspend the property tax revenue protection provisions of Proposition 1A. Beginning in FY2008-09, the Legislature may “borrow” not more than 8% of total property tax revenues (currently about \$2 Billion) if:

1. the Governor issues a proclamation of “severe fiscal hardship;”
2. the Legislature enacts an urgency statute suspending Proposition 1A property tax protection with $\frac{2}{3}$ vote of each house; and
3. the Legislature enacts a law providing for full repayment of the “borrowed funds” plus interest within three years.

The Legislature may not enact such a suspension more than twice in any ten year period and may only do so if:

1. the \$1.22 billion FY 2003-04 VLF Backfill Gap Loan (Revenue and Taxation Code Sec. 10754.11) has been repaid;

2. any previous borrowing under this provision has been repaid.

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Frequently Asked Questions

1. What's the basic protection for the property tax in Proposition 1A?

Proposition 1A prevents the Legislature from reducing the combined property tax shares of cities, special districts, and the county, and shifting those shares to the schools or any other non-local government function. If, for example, on November 3, 2004, the property tax shares of cities, special districts, and the county of the hypothetical "California County" equaled 60% of property taxes collected in that county, the Legislature cannot pass a law that reduces the percentage below 60% except to respond to a significant state fiscal problem.

2. Can the Legislature continue to reallocate property taxes on the local level?

Since the passage of Proposition 13, the Legislature has had the power to reallocate property taxes among local governments. The most significant use of this authority has been to allocate city, county and special district shares of the property tax to schools through ERAF and reduce state general fund support for schools. Proposition 1A would prevent future reductions of non-school property tax shares, but the State may transfer property taxes among the cities, county, and special districts in a county with a declaration by the Governor of "severe fiscal hardship" and a 2/3 vote of each house of the State Legislature.

3. Can the state reallocate property taxes in order to fund a state mandate?

No. The amendments to Section 6 of Article XIII B of the state constitution state specifically: "Ad valorem property tax revenues shall not be used to reimburse a local government for the costs of a new program or higher level of services."

4. Does Proposition 1A allow the State to respond to a significant state fiscal problem?

Yes. Beginning in the 2008-2009 fiscal year, the Governor may issue a proclamation that declares that there is a "severe state fiscal hardship" that requires the State to temporarily suspend Proposition 1A's basic protection for the property tax. Next, the Legislature must first adopt a statute with a 2/3 vote that contains a suspension of the basic protection for that fiscal year only. Then it must adopt a separate statute that requires the State to repay cities, counties, and special districts the total amount of property tax loss caused by the suspension. The Legislature may not enact such a suspension more than twice in any ten year period and may only do so if the FY 2003-04 VLF Backfill Gap Loan (\$1.22 billion) and any previous borrowing under this provision has been repaid. The reduction may not exceed 8 percent of the total amount of property tax allocated among local agencies in the previous fiscal year. Currently this percentage is the equivalent of roughly \$1.3 billion.

5. When will local agencies be repaid if property tax is taken during a suspension period?

No later than the end of the third fiscal year following the fiscal year to which the reduction applies. If the reduction applies in the 2010-11 fiscal year, then repayment must occur no later than June 30 of 2014. Repayment will be for the "total amount of revenue losses" including interest.

6. Can the Legislature suspend the Proposition 1A protection each time there is a "severe state fiscal hardship?"

No. Suspension of the protection may only occur twice in a ten year period; and only if the VLF Gap Loan amount has been repaid; and if only any prior suspension of property tax has been repaid with interest.

7. Why was the redevelopment property tax increment not explicitly protected in the final version of Proposition 1A submitted to the voters?

Key legislators and legislative staff argued that the redevelopment property tax increment is already protected by Article 16, Section 16 of the state constitution. Language in the ballot arguments for Proposition 1A states that the redevelopment increment is already protected by the state constitution.

8. What's the basic protection for the sales and use tax in Proposition 1A?

Proposition 1A prohibits the State from reducing the sales and use tax rate or changing the method in which sales and use tax revenues are distributed. The measure prevents the state from restricting city or county authority to impose optional transactions and use taxes as provided in state law as of November 3, 2004.

9. What about the current suspension of one-quarter cent of the sales tax occurring as a result of the passage of Proposition 57? Does Proposition 1A require the suspension to end when the fiscal recovery bonds are repaid?

Yes. Proposition 1A prevents the State from extending the period during which the one-quarter cent is suspended; from failing to pay the property tax backfill during the period of suspension; and from failing to restore the full sales tax rate when the bonds are repaid.

10. Can the State take any action that affects the sales and use tax?

Yes. The Legislature can change how sales tax is distributed if the change is required by federal law or to participate in an interstate agreement, for example, one that addresses payment of sales tax for Internet purchases. In addition, the Legislature has the authority to authorize two or more local agencies within a county to exchange property tax and sales tax.

11. What is the basic protection for the VLF in Proposition 1A?

Proposition 1A guarantees VLF revenue to cities and counties based upon a rate of 0.65%. The Legislature decides how much of the revenue funds realignment programs and how much funds general purpose local government programs. If the Legislature lowers the rate below 0.65%, it must enact a law that provides for an allocation of replacement funds to cities and counties equal to the difference between the revenues received from 0.65% rate and the lower rate.

12. Does Proposition 1A strengthen the requirement to reimburse cities, counties and special districts for the costs of state-mandated programs and services?

Yes. Prior to the passage of Proposition 1A, the Constitution required the State to reimburse local governments for state-mandated programs, but the Legislature sometimes “suspended” mandates, rather than reimbursing local governments. Moreover, the Legislature has transferred additional responsibility for a state program or service to local governments but has not reimbursed local governments for the additional program costs. Under Proposition 1A, beginning in 2005-06, in each fiscal year’s budget, the Legislature must either appropriate sufficient funds to reimburse local governments for their costs of complying with a mandate, including those in prior years, or suspend the operation of the mandate for that fiscal year.

13. Does the “fund or suspend” requirement apply to all mandates?

No. There are two exceptions. The first is for employee and employee organization related mandates. The second is for costs incurred prior to the 2004-05 fiscal year that have not been paid prior to the 2005-06 fiscal year. These costs may be paid over a period beginning in 2005-06.

14. What happens when the State transfers additional responsibility for a program or a service that the local government already had some responsibility for?

Proposition 1A defines “mandate” to include a transfer of additional responsibility for a state program or service.