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**CITY ATTORNEYS DEPARTMENT
LEAGUE OF CALIFORNIA CITIES
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INTERGOVERNMENTAL FISCAL IMMUNITY

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INTERGOVERNMENTAL FISCAL IMMUNITY¹

The purpose of this paper is to review the concept of intergovernmental fiscal immunity, i.e., the exemption of one governmental entity from liability for the payment of taxes, assessments or fees levied or imposed by another governmental entity:

- Where does such immunity exist?
- How is such immunity created?
- When does it apply?
- What is the extent of such immunity?
- What are the exceptions to the application of such immunity?

This paper shall in turn review the application of intergovernmental fiscal immunity to:

- Taxes;
- Capital facility fees;
- User fees; and
- Assessments.

TAXES

Property Taxes.

Publicly Owned Property as Generally Exempt from Property Taxation.

Unless otherwise provided by the Constitution of the State of California or the laws of the United States, all property is taxable. *California Constitution Article 13, Section 1* (All references to the term “Article” shall mean the California Constitution). However, the Constitution expressly exempts the following types of property from property taxation:

- Property owned by the State of California (the “State”). *Article 13, Section 3(a)*.

¹ I would like to thank Mrunal Mehta of Best Best & Krieger LLP for her invaluable assistance in the preparation of this paper.

- Property owned by a local government, except as otherwise provided in Article 13, Section 11(a). *Article 13, Section 3(b)*.
- Property used exclusively for public schools, community colleges, state colleges, and state universities. *Article 13, Section 3(d)*.

See also *Revenue and Taxation Code Sections 201 and 202*.

Construction of the Constitutional Exemption.

The general rule is that exemptions from taxation are to be strictly construed. Such rule, however, does not apply in the case of publicly owned property:

“That [general] rule applies to exemptions of property held in private ownership. But where the question is whether or not public property shall be taxed, the rule is that it is not to be taxed unless there is express authority therefor.” *State Land Settlement Board v. F.R. Henderson* (1925) 197 Cal. 470.

See also *Housing Authority of the City of Los Angeles v. Dockweiler* (1939) 14 Cal.2d 437, 454.

Use of Publicly Owned Property.

The actual use of publicly owned property for the operations of a local government is not required for such property to be exempt from property taxation. The Constitutional exemption of publicly owned property from property taxation makes ownership the sole test of such exemption and the use to which such public agency makes of such property is immaterial. *Anderson-Cottonwood Irrigation District v. John Klukkert* (1939) 13 Cal.2d 191, 199. In *Sutter-Yuba Investment Company v. Helen Waste* (1942) 52 Cal.App.2d 785, 789, the Appellate Court citing *Anderson-Cottonwood Irrigation District, supra*, held:

“It has been definitely determined by the Supreme Court that all land and **property belonging to the United States, or to the State of California or any subdivision thereof, is absolutely exempt from taxation regardless of whether it is held in a proprietary sense, or is used in a governmental capacity.**”
Emphasis added.

See also *Glenn-Colusa Irrigation District v. J.C. Ohrt* (1939) 31 Cal.App.2d 619, 624 in which the appellate court held that grain paid to the irrigation district as rental for properties owned by the irrigation district was exempt from taxation. The court ruled that the Constitutional exemption from property taxation made no distinction between operative and nonoperative property.

See the discussion below on ASSESSMENTS regarding the application of the pre-Proposition 218 implied exemption of publicly owned property from assessments in which public use of such property is a necessary element of such an exemption.

Property Owned by a Public Agency Outside its Jurisdictional Boundaries.

The State Constitution formerly granted a blanket exemption to all municipal property wherever located and whenever acquired. *Sacramento Municipal Utility District v. County of El Dorado* (1970) 5 Cal.App.3d 26, 33. In 1914 the State Constitution was amended to provide that lands owned by a local government that are located outside its boundaries, including the rights to use or divert water from surface or underground sources and any other interests in lands, are taxable if such lands were taxable when acquired by such local agency.¹ *Article 13, Section 11(a)* (formerly Article 13, Section 1). The purpose for this provision is primarily to safeguard the tax revenues of small counties in which a local government may acquire extensive holdings not located within the boundaries of such local government. *City of Los Angeles v. County of Mono* (1959) 51 Cal.2d 843, 848 citing the acquisition of extensive holdings in the counties of Mono, Inyo and Tuolumne by the City of Los Angeles and the City and County of San Francisco. See also *City of Long Beach v. Board of Supervisors of Los Angeles County* (1958) 50 Cal.2d 674, 677.

Once property owned by a city outside its jurisdictional boundaries is annexed to such city, however, such property becomes exempt from taxation and the existing tax liens on such property and the city's tax liability disappear as of the date of annexation, regardless of the date of acquisition of such property by the city. *City of Long Beach v. Board of Supervisors of Los Angeles County*, *supra* at 50 Cal.2d 674, 680.

Improvements owned by a local government that are outside its boundaries are taxable if they were taxable when acquired by such local government or were constructed by such local government to replace improvements which were taxable when acquired. *Article 13, Section 11(a)*.

Taxation of Possessory Interest.

Notwithstanding the general exemption from taxation of property owned by a local government, private uses of public property are subject to taxation when such uses are deemed to be "possessory interests." In *City of San Jose v. Alfred E. Carlson* (1997) 57 Cal.App.4th 1348, the City of San Jose appealed from a decision of the superior court that short term users of the City's convention center held a possessory interest in the convention center when they obtained use permits upon more than one occasion. In upholding the decision of the superior court, the court of appeal explained the rationale for the taxation of possessory interests:

"Because the facilities at issue are owned by the City, they are not subject to real property taxes. (Cal. Const., art. XIII, § 3.) Private uses of such property may be taxed, however, if those used constitute 'possessory interests.' (Cal. Const., art. XIII, § 1; Rev. & Tax. Code § 104, 107, 201.) As the Supreme Court has explained, 'When the city leases its land . . . it does not merely use it. Its possession creates valuable privately-held possessory interests, and there is no reason why the owners of such interests should not pay taxes on them just as lessees of private property do through increased rents. Their use is not public, but private, and as such should carry its share of the tax burden.' (citation omitted). Thus, taxation of possessory interests is rooted in the belief that 'the holder of a

valuable use of public property that is tax exempt should contribute taxes to the public entity which makes its possession possible and provides a certain amount of exclusivity.’ (citations omitted).” *City of San Jose v. Alfred E. Carlson*, *supra* at 57 Cal.App.4th 1353.

See also *Cox Cable San Diego, Inc. v. County of San Diego* (1986) 185 Cal.App.3d 368 (the beneficial use of land as part of a special franchise given by local governments to private corporations creates a locally assessable possessory interest).

A “possessory interest” is defined to mean (a) possession of, claim to, or right to the possession of land or improvements that is independent, durable, and exclusive of rights held by others in the property, except when coupled with ownership of the land or improvements in the same person and (b) taxable improvements on tax-exempt land. *Revenue & Taxation Code Section 107*.²³ See *City of San Jose v. Alfred E. Carlson* (1997) 57 Cal.App.4th 1348 for a comprehensive discussion of the “independent,” “durable” and “exclusive” elements of a possessory interest.

A lease or contract with a private party that may create a possessory interest subject to taxation must include specific language regarding the possible existence of such possessory interest and the potential liability of the private party for the payment of such tax (a “Notice of Possible Possessory Interest”). *Revenue & Taxation Code Section 107.6(a)*. The state or any local public entity entering into such a lease or contract is required to insure that a Notice of Possible Possessory Interest is included in such an agreement. Failure to include a Notice of Possible Possessory Interest in such a lease or a contract is not construed to invalidate such a lease or agreement. The private party to such an agreement may, however, recover damages from the state or local public entity where such entity failed to provide a Notice of Possible Possessory Interest in such agreement, where the private party can show that without the notice, he or she had no actual knowledge of the existence of a possessory interest tax. *Revenue & Taxation Code Section 107.6(b)*. A private party to such an agreement is rebuttably presumed to have no actual knowledge of the existence of a possessory interest tax. In order to show damages in any such action, the private party is not required to show that he or she would not have entered the contract but for the failure of the state or local public entity to provide a Notice of Possible Possessory Interest. Damages in any such action are measured by the amount of the possessory interest taxes payable throughout the term of the lease or contract. *Revenue & Taxation Code Section 107.6(c)*

Practice Tip: Note *Revenue & Taxation Code Section 107.6* discussed above requires that any lease or contract with a private person or entity that may create a possessory interest include specific language notifying such private party of such possibility and the potential liability of such private party for payment of any tax levied on such possessory interest. Failure to include the notification language could result in the city being liable to the private party for payment of any such tax.

As to property owned by a redevelopment agency and leased to any person, Health & Safety Code Section 33673 provides:

“Whenever property in any redevelopment project has been redeveloped and thereafter is leased by the redevelopment agency to any person or persons or whenever the agency leases real property in any redevelopment project to any person or persons for redevelopment, the property shall be assessed and taxed in the same manner as privately owned property, and the lease or contract shall provide that the lessee shall pay any taxes upon the assessed value of the entire property and not merely the assessed value of his or her leasehold interest.”

Miscellaneous Statutory Provisions or Decisions Related to Property Taxation

The property and bonds of a housing authority are expressly exempt from taxation. *Health & Safety Code Section 34400*. The property of a housing authority is exempt from all taxes and special assessments of the State or any city, county, or political subdivision of the State. In lieu of such taxes or assessments, a housing authority may agree to make payments for services, improvements, or facilities furnished by a city, county, or political subdivision for the benefit to a housing project owned by such authority; provided, however, such payments may not exceed the estimated cost to such city, county or political subdivision of the services, improvements, or facilities. *Health & Safety Code Section 34401*.

An ordinance of the County of Sonoma levying a tax on the generation of electricity of geothermal steam that (a) exempted any person required to pay property taxes on improvements directly utilized by such person to generate electricity and that (b) called for the use of the tax revenues to provide property tax relief and to fund governmental activities historically funded by property tax revenues conflicts with Article 13, Section 3. *Sacramento Municipal Utility District v. County of Sonoma* (1991) 235 Cal.App.3d 726.

Cities are deemed to be “political subdivisions” of the State of California for purposes of Revenue & Taxation Code Section 11922 and are, therefore, exempt from the payment of a documentary transfer tax upon the acquisition of title to real property. *Ops. Atty. Gen. No. 02-509* dated November 21, 2002.

Sales and Use Taxes.

A sales tax is a tax imposed upon the retailer and not a city or other public agency which purchases taxable goods from a retailer. Consequently, the exemption from taxation pursuant to Article 13, Section 3 does not apply to sales taxes. See *Rio Grande Oil Company v City of Los Angeles* (1935) 6 Cal.App.2d 200 (the appellate court rejected the contention of the City of Los Angeles that the City is entitled to purchase gasoline from a distributor without the payment by either the distributor or the City of the tax imposed by the Motor Vehicle Fuel License Tax) and *Graham Brothers, Incorporated v City of Los Angeles* (1935) 6 Cal.App. 2d 203 (the appellate court rejected the contention of the City that the City cannot as a result of Article 13, Section 1 [predecessor to Article 13, Section 3(b)] be compelled to pay a sales tax paid on rock and gravel pursuant to the Retail Sales Tax Act of 1933).

Business License Tax.

In *Sacramento Municipal Utility District v. County of Solano* (1997) 54 Cal.App.4th 1163, the court of appeals in the Third Appellate District ruled that the County of Solano was prohibited from taxing the utility district because the relevant enabling statute did not authorize taxation of government functions performed by public agencies. The County of Solano adopted an ordinance imposing a business license tax on electrical energy produced by commercial wind turbine generators within the County. The ordinance was enacted pursuant to Revenue & Taxation Code Section 7284 which authorizes any county to license every kind of lawful business transacted in the unincorporated area of the county for revenue and regulation.

The Sacramento Municipal Utility District (“SMUD”) was established to provide utility services within SMUD. SMUD owned and operated a wind-driven power generation plant in the County which it used to generate electrical power for distribution to customers within SMUD. The court of appeals determined that the performance of a governmental function by a public agency does not constitute the transaction of business within the meaning of Revenue & Taxation Code Section 7284 so as to authorize the licensing and taxation of that activity. *Sacramento Municipal Utility District v. County of Solano, supra*, at 54 Cal.App.4th 1165. In reaching this conclusion the court of appeal first recognized that the County (a) is a political subdivision of the state, (b) is able to exercise only those powers granted by the State, and (c) has no inherent taxing power and, therefore, has only such taxing power as is granted by the State Constitution or legislature. *Supra* at 54 Cal.App.4th 1166. The court then recognized that:

“It is a well-settled rule of statutory construction that absent express language to the contrary, governmental entities are excluded from the operation of general statutory provisions that implicate the exercise of sovereign powers. (citations omitted) . . .

A particular application of the foregoing rule of construction precludes one arm of state government from taxing another arm absent express authorization.” *Sacramento Municipal Utility District v. County of Solano, supra*, at 54 Cal.App.4th 1167

In applying this rule of statutory construction to Revenue and Taxation Code Section 7284 the court concluded:

“A statute encompassing ‘every kind of lawful business transacted,’ though broadly stated, is nevertheless limited by the term ‘business.’ As previously explained, the Supreme Court in *Marin Municipal Water District v. Chenu, supra*, 188 Cal. 734, narrowly defined the term ‘business’ as used in a statute exempting from a registration requirement vehicles not used ‘for the conveyance of persons for hire, pleasure, or business, nor for the transportation of freight.’ This definition encompasses ‘the ordinary occupations engaged by private persons or private corporations, either for business or pleasure, and so far as it refers to business it would include private business and not public business.’ (188 Cal. at p. 738.)

Although the term ‘business,’ when use in legislation, is not necessarily limited to activities engaged in for profit (citation omitted), it is nevertheless confined to activities engaged in by private entities, unless a contrary intent is apparent from the statutory language. (citation omitted) The language of section 7284 does not manifest a contrary intent.” *Supra*, at 54 Cal.App.4th 1169.

Special Taxes.

Article 13A, Section 4 of the State Constitution provides that cities, counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transactional tax or sales tax on the sale of real property within such city, county or special district.

Article 13A, Section 4 is not self executing, i.e., it does not empower cities, counties or special districts to levy special taxes. Rather, enabling legislation is required before such an agency may enact a special tax. *California Building Industry Association v. Governing Board of the Newhall School District of Los Angeles County* (1988) 206 Cal.App.3d 212, 231. A city, county or an agency of the State, formed pursuant to general law or special act, for the local performance of governmental or proprietary functions within limited boundaries, may levy a special tax approved pursuant to the provisions of Government Code Section 50075 and following. A school district may likewise levy a qualified special tax pursuant to the procedures set forth in Government Code Section 50075 and following. *Government Code Section 50079*. A qualified special tax means special taxes which apply uniformly to all taxpayers or all real property within the school district; provided, however, such special tax may provide for an exemption from such tax of taxpayers 65 years of age or older. A community college district may impose such a special tax pursuant to such legislation if such special tax is applied uniformly to all taxpayers or real property within the district, except that unimproved property may be taxed at a lower rate than improved property. *Government Code Section 50079.1*. There is no express exemption from the levy of special taxes for publicly owned property within this legislation. In fact, in both Section 50079 and 50079.1, the special taxes are to be applied uniformly to all taxpayers or real property.

It is not clear that the exemption of publicly owned property from property taxation contained in Article 13, Section 3 applies to special taxes. In *Brunton v. Superior Court of the County of Los Angeles* (1942) 20 Cal.2d 202, the Supreme Court ruled that a fee for the privilege of drilling for oil that was not based upon the value of property is not a property tax from which a flood control district is exempt.

Absent an express exemption of publicly owned property from special taxation, it would appear reasonable that the courts would extend to special taxes the same principles relied upon in creating an “implied exemption” that has been applied to special assessments. (See ASSESSMENTS. below for a discussion of the application of the “implied exemption” to assessments.) While publicly owned and used property is not expressly exempt from special assessments, the courts have nevertheless created an implied exemption that applies to special assessments:

“Article XIII, section 3, subdivision (b), of the California Constitution provides that property owned by public entities such as the school district is exempt from property taxation. Courts have held that such property is likewise impliedly exempt from ‘special assessments.’ ‘While publicly owned and used property is not exempt from special assessments under the constitution or statutory law of this state, there is an implied exemption of such property from burdens of that nature . . . The principle which makes property of the state . . . nontaxable . . . also precludes the imposition of a special assessment for a street or other local improvement upon such property, unless there is a positive legislative authority therefor. [Citations]’ (citation omitted).

The rationale behind a public entity’s exemption from property taxes and special assessments is to prevent one tax-supported entity from siphoning tax money from another such entity; the end result of such a process could be unnecessary administrative costs and no actual gain in tax revenues.” *San Marcos Water District v. San Marcos Unified School District* (1986) 42 Cal.3d 154, 161.

This rationale, i.e., the inefficiency of public agencies battling over the same dollars with little or no gain in overall revenues, would also appear to apply to the levy of special taxes by one public agency on another as well as the levy of special assessments.

Additionally, the rule of statutory construction, cited in *Sacramento Municipal Utility District v. County of Solano*, that absent express language to the contrary, governmental entities are excluded from the operation of general statutory provisions that implicate the exercise of sovereign powers would apply equally to statutes authorizing the levy of special taxes. As the court stated in *Sacramento Municipal Utility District v. County of Solano, supra* at 1167, the application of the foregoing rule of construction precludes one arm of state government from taxing another arm absent express authorization. There is no provision in the legislation cited above that would expressly authorize any of the specified public agencies authorized to levy special taxes against publicly owned property.

Special taxes are also authorized to be levied pursuant to the Mello-Roos Community Facilities Act of 1982 (Government Code Section 53311 and following) (the “Mello-Roos Act”). This act authorizes local agencies to form community facilities districts for the purpose of financing certain capital facilities and/or authorized services. The legislative body of a community facilities district may levy a special tax if two-thirds of the votes cast upon the question of levying the tax are in favor of levying that tax. *Government Code Section 53328*.

Subject to the exceptions described below, properties or entities of the state, federal, or other local governments are expressly exempt from the levy of a special tax authorized pursuant to the Mello-Roos Act. *Government Code Section 53340(c)*. If property subject to the levy of a special tax pursuant to the Mello-Roos Act is acquired by a public entity through a negotiated transaction, or by gift or devise, the special tax shall, notwithstanding Government Code Section 53340, continue to be levied on the property acquired and shall be enforceable against the public entity that acquired the property. *Government Code Section 53317.3*. If property subject to the levy of such a special tax is acquired by a public entity through eminent domain proceedings, the obligation to pay the special tax shall be treated, pursuant to Code of Civil Procedure Section

1265.250, as if it were an assessment. For this purpose the present value of the obligation to pay a special tax to pay the principal and interest on any indebtedness incurred by the community facilities district prior to the date of apportionment determined pursuant to Revenue & Taxation Code Section 5082 shall be treated the same as a fixed lien special assessment.

Utility Users Tax.

Public entities do not have an express constitutional or statutory exemption from the levy of utility users taxes. However, it would be reasonable to conclude that the courts would extend and apply the implied exemption applicable to special assessments to utility users taxes. Thus a public entity would be exempt from the levy of a utility users tax by another public entity absent express statutory authority therefor. While there does not appear to be any specific judicial precedent addressing the validity of the levy of a utility users tax by one public entity against another public entity, the language of the decision of the appellate court in *City of San Jose v. Joseph H. Donohue* (1975) 51 Cal.App.3d 40 would support the implied exemption of public entities from the levy of a utility users tax. In an equal protection challenge to San Jose's utility users tax, the appellate court determined that there was a rational basis for the nonapplicability of the City's utility users tax to the City itself and any other public entity. In its ruling the court stated:

“The exemption of other public entities from payment of the tax is clearly reasonable. In *Carmichael v. Southern Coal Co.*, supra, at p. 513 [81 L.Ed. at p. 1255], where the validity of a state tax upon employers was at issue, the court pointed out that ‘The state may reasonably waive the formality of taxing itself or its political subdivisions. Fear of constitutional restrictions, and a wholesome respect for the proper policy of another sovereign, would explain exemption of the United States, and of the interstate railways . . .’ In this case, the trial court made the following findings concerning the exemption in favor of public entities: ‘Federal Government agencies paid no utility taxes as Federal law preempts such taxation . . . Exemption for City property is a reasonable classification as it is merely transferring payments from one pocket of the City to another . . . Counties and other public agencies were exempt from utility taxation and said exemption is a reasonable classification as such agencies are public-supported and would merely add to the tax burden of the same taxpayers as pay the utility tax.’ In all respects, the trial court’s reasoning is sound.” *City of San Jose v. Joseph H. Donohue*, supra at 45, 46.

The reasonable classification that the appellate court found in San Jose's exemption of public agencies from its utility users tax closely reflects the rationale that the courts have relied upon in applying the implied exemption of publicly owned property from special assessments, i.e., the siphoning of revenues from one public entity to another.

CAPITAL FACILITIES FEES

The obligation of a public entity to pay fees and charges levied by another public entity generally turns upon the purpose of the fee or charge and, in certain cases, upon the public entity on which the fee or charge is intended to be levied. The obligation of a public entity to pay fees

and charges imposed by another public entity to finance capital facilities, i.e., capital facilities fees, differs substantially from the obligation of a public entity to pay fees or charges for goods and services, i.e., user fees, which it receives from another public entity. Each form of fee is discussed separately below.

Capital Facilities Fees - Judicial History.

It has long been held that fees levied on public entities to finance the construction of capital improvements constitute special assessments and that there is an implied exemption of publicly owned property from such special assessments. In *County of Riverside v Idyllwild County Water District* (1978) 84 Cal.App.3d 655, the board of directors of the water district adopted a resolution requiring all tax exempt entities to pay a Capital Cost Sewer Capacity Charge as a condition of sewer service. The proceeds of such charge were to be used to pay debt service on bonds of the water district issued to fund sewage facilities. In holding that the water district was not empowered to impose the capital cost charges, the appellate court ruled:

“The rule in California is, with exceptions not here pertinent, that property owned by a county is exempt from property taxation. (Cal. Const., art. XIII, § 3, subd. (b).) Similarly, unless the Legislature expressly so authorizes, property publicly owned and used is exempt from special assessments. (Citations omitted) The imposition of a capital cost charge on tax exempt entities was a means of making such entities contribute a proportionate share of the cost of constructing the district's sewerage facilities. The charges are in effect a special assessment under a different name and constitute an attempt by the district to do indirectly that which it could not do directly.” (Emphasis added) *Supra*, at 84 Cal.App.3d 659-660.

See also *Regents of University of California v. City of Los Angeles* (1979) 100 Cal.App.3d 547 (commonly referred to as *Regents I*, in which the appellate court found that the City's sewage facilities charge, while based upon projected usage of the sewer system, was nevertheless a disguised special assessment where the proceeds of such charge were to be used to provide capital for sewer construction and were not going to be used to defray the costs of providing sewer service to the users of the sewer system and that the University of California may not be compelled to contribute to such capital costs) and *University of California v. City of Los Angeles* (1983) 148 Cal.App.3d 451 (commonly referred to as *Regents II* in which the appellate court ruled that the City of Los Angeles could not impose on the University of California that portion of a sewer charge, while based upon actual usage of the sewer system, which was to be used to finance capital improvements to the local sewer system).

Finally, in the leading case of *San Marcos Water District v. San Marcos Unified School District* (1986) 42 Cal.3d 154, the Supreme Court was asked to determine whether utility fees for capital funding are special assessments from which public entities are exempt or are they user fees that public entities must pay. Water District imposed a sewer capacity rights fee the proceeds of which were used to fund capital improvements. In determining that the Water District's capacity fee was a special assessment rather than a user charge, the Supreme Court ruled:

“Under the rule we adopt, no matter how the form of the fee is varied (i.e., whether based on actual or anticipated use, or unrelated to use; whether a one-time fee or monthly fee; and whether charged to all property owners or only to users of the sewer system), the purpose of the fee will determine whether or not public entities are exempt from paying the fee. In sum, a fee aimed at assisting a utility district to defray costs of capital improvements will be deemed a special assessment from which other public entities are exempt.” *Supra*, at 42 Cal.3d 164.

Legislative Response to *San Marcos*.

The *San Marcos* decision greatly impacted the fiscal stability and service capabilities of public utility service agencies. After *San Marcos*, public utility service agencies were no longer able to charge capacity fees to any public entity unless there was statutory authorization to do so. The potential threat of the *San Marcos* decision was described in *Utility Cost Management v. East Bay Utility District* (2000) 79 Cal. App. 4th 1242, 1246:

“The court's ruling in *San Marcos I* had the potential to undermine the fiscal stability of public utilities which had, in good faith, already collected and spent capital improvement fees which might now have to be refunded. To prevent that from occurring, and to avoid a flood of refund actions, the Legislature erected a statutory seawall of sorts, which the parties describe the ‘*San Marcos Legislation*.’”

The legislation referred to above was enacted in 1988 and added Government Code Section 54999, et. seq. (the “*San Marcos Legislation*”) specifically authorizing a public agency to levy capital facilities fees upon another public entity except in limited circumstances described below.

The *San Marcos Legislation* authorizes a public agency providing public utility service on or after July 21, 1986 to (a) continue to charge or to increase an existing capital facilities fee or (b) impose a new capital facilities fee after such date. Any other public agency receiving such public utility service is, subject to certain exceptions described below, required to pay such capital facilities fee. *Government Code Section 54999.2*. For purposes of Government Code Section 54999.2, the following terms are defined as:

“public agency” means the United States or any of its agencies, the State or any of its agencies, the Regents of the University of California, a county, a city, a district, a public authority, or any other political subdivision or public corporation of the State. *Government Code Section 54999.1(c)*.

“public utility service” means service provided from a public utility facility. Government Code Section 54999.1(e) A public utility facility is a facility for the provision of water, light, heat, communications, power, or garbage service, for flood control, drainage or sanitary purposes, or for sewage collection, treatment, or disposal. *Government Code Section 54999.1(d)*.

“capital facilities fee” means any nondiscriminatory charge to pay the capital cost of a public utility facility. *Government Code Section 54999.1(b)*. A capital facilities fee is “nondiscriminatory” if it does not exceed an amount determined on the basis of the same

objective criteria and methodology applicable to comparable nonpublic users, and is not in excess of the proportionate share of the cost of the public utilities facilities of benefit to the person or property being charged, based upon the proportionate share of those facilities. *Government Code Section 54999.1(f)*.

The imposition of a capital facilities fee on any school district, county office of education, community college district, the California State University, the University of California or state agency (collectively, the “School and State Agencies” or individually, a “School or State Agency”) is subject to the following additional requirements under the San Marcos Legislation:

1. ***Continuation of the Levy of an Existing Capital Facilities Fee*** - a public agency may continue to charge a capital facilities fee imposed prior to January 1, 1987 on a School or State Agency only if:
 - a. collection of such capital facilities fee is necessary to defray the actual construction costs of that portion of a public utility facility actually serving such School or State Agency; and
 - b. the collection of such capital facilities fee was not protested or challenged pursuant to law prior to January 1, 1987. *Government Code Section 54999.3(a)* or as to public electric utility service, *Government Code Section 54999.35*.
2. ***Increase of an Existing Capital Facilities Fee*** - a public agency may increase such a capital facilities fee (a) in an amount not to exceed the percentage increase in the Implicit Price Deflator for State and Local Government Purchases as determined by the Department of Finance or (b) in an amount in excess of the amount permitted by (a) if agreement as to such increase has been reached between the two public agencies. *Government Code Section 54999.3 (a) and (b)*.
3. ***Imposition of a New Capital Facilities Fee*** - a public agency may impose a new capital facilities fee on or after July 21, 1986 on a School or State Agency after agreement has been reached between the two public agencies. *Government Code Section 54999.3(b)*.
4. ***Identity of the Amount of the Capital Facilities Fee*** - upon request of a School or State Agency receiving public utility service for which a capital facilities fee has been imposed by a public agency providing such service or upon the proposed increase of such a fee, the public agency imposing such a fee or proposing to increase such a fee shall identify the amount of such fee. *Government Code Section 54999.3(c)*.
5. ***Burden of Producing Evidence*** - the public agency imposing or increasing a capital facilities fee has the burden of producing evidence to establish that such fee is nondiscriminatory and that the amount of such fee does not exceed the amount necessary to provide capital facilities for which such fee is charged. *Government Code Section 54999.3(c)*. In addition, as to any capital facilities fee imposed to provide public electric utility service, the public agency imposing or increasing such a fee has the burden of

producing evidence that such fee complies with paragraph 1. above. Government Code Section 54999.35(b)(3)(C).

6. ***Notification of Proposed Enactment or Increase of Capital Facilities Fee for Public Electric Utility Service*** - a public agency proposing to enact or increase a capital facilities fee for public electric utility service is required to notify any School or State Agency located within its service area that is an electric utility customer of such public agency not less than 30 days prior to the date of any hearing set to consider an action to enact or increase such a fee. Government Code Section 54999.35(b)(4) and (5).

7. ***Judicial Challenge to Enactment or Increase of Capital Facilities Fee for Public Electric Utility Service*** - any judicial challenge or proceeding to protest or challenge a rate or charge that contains a capital facilities fee for public electric utility service or to seek a refund of any such fee imposed on or after July 1, 2000, shall be commenced within 120 days of the effective date of the ordinance, resolution or motion enacting or increasing such rate or charge provided that the notice requirements described in the preceding paragraph have been complied with. *Government Code Section 54999.35(b)(6)*.

See *Utility Cost Management v. Indian Wells Valley Water District* (2001) 26 Cal.4th 1185 in which the Supreme Court held that the 120 day statute of limitations period under Government Code Section 66022 applied to an action to recover capital facilities fees imposed on a school district that improperly exceeded the amount permissible under Government Code Section 54999.3. The Supreme Court found that the fees in question were subject to both Government Code Section 66013 and the San Marcos Legislation and, therefore, the limitations period within Section 66022 was applicable to this action. In accord with the *Indian Wells Valley Water District* decision, see *Utility Cost Management v. East Bay Utility District* (2000) 79 Cal. App. 4th 1242 in which the appellate court also ruled that the 120 day statute of limitations of Government Code Section 66022 applied to an action by the same plaintiff pursuant to Government Code Section 54999.4 to seek a refund of sums paid by a school district for certain water and wastewater fees.

USER FEES.

The general rule in California, shaped in large part by a 1952 Attorney General's opinion, is that a public agency may charge a user fee against another public agency for use of such public agency's facilities if such fee is charged in accordance with a rate schedule applicable to all users of such facilities.

In 1952 the Attorney General was asked if a sanitary district may fix and collect a charge from a high school district for use of the sanitary district's sewage facilities. *19 Ops. Atty. Gen 195*. The Attorney General concluded that the sanitary district may collect such charges from a school district which uses the facilities of the sanitary district if the sanitary district has adopted a schedule of rates applicable to all users. In reviewing the question of whether the school district would be immune from the sewage charges on the ground that they were taxes or assessments, the Attorney General first opined that user fees were distinguishable from taxes or assessments in

that user fees are charges for services rendered or commodities received. *19 Ops. Atty. Gen. 195, 197.*

The Attorney General then looked at the application to the sewage fee of the rule of statutory construction that the general terms of a statute will not be construed as including the government if such statute would operate in derogation of sovereign power. After reviewing cases from three other jurisdictions that upheld the application of such sewage fees to public agencies, the Attorney General concluded:

“So far as we can determine, the question is an open one in California. We believe, however, that a like result in the State can legally be justified. The payment of a charge by a public agency on the same basis as other users, measured by the extent or nature of the service enjoyed by it, would not in our opinion be in derogation of the sovereign power of the State nor embarrass the public agency in the performance of its assigned functions. There would thus appear to be no justification for the application of the rule of statutory interpretation that a general statute does not apply to the sovereign or its agencies unless expressly mentioned.” *19 Ops. Atty. Gen. 195 at page 198.*

This 1952 opinion of the Attorney General has been favorably cited in *Anaheim City School District v County of Orange* (1985) 164 Cal.App.3d 697 in which the appellate court ruled that the County of Orange could collect compensation from school districts for the use of its solid waste disposal facilities. Additionally, in *County of Riverside v Idyllwild County Water District* (1978) 84 Cal.App.3d 655, 660, the appellate court expressly agreed with the foregoing views of the Attorney General.

Although not the primary focus of the decision in *San Marcos* case, the Supreme Court did address the question of the application of Constitutional immunity from taxation as such immunity applies to the requirement for payment by a public agency for goods and services provided by another public agency:

“The rationale behind a public entity’s exemption from property taxes and assessments is to prevent one tax-supported entity from siphoning tax money from another such entity; the end result of such a process could be unnecessary administrative costs and no actual gain in tax revenues. (citation omitted) **On the other hand, when one tax-supported entity provides goods or services to another, neither the California Constitution nor decisional law exempts the public entity from paying for those goods and services.**” Emphasis added. *San Marcos Water District v San Marcos Unified School District, supra* at 42 Cal.3d 161.

Citing the above language from the *San Marcos* case, the Attorney General has opined that a city may impose storm drain pollution abatement charges with respect to property owned by school districts within the city’s boundaries to fund the city’s activities in meeting federal stormwater discharge requirements if such activities do not include the construction of capital improvements. *84 Ops. Atty. Gen. 61.*

ASSESSMENTS.

Pre- Proposition 218.

Implied Exemption.

Prior to the passage of Proposition 218 in 1996, the courts in California had long held that publicly owned property is not exempt from the levy of a special assessment as a result of the Constitutional exemption of public property from property taxation. However, publicly owned property, if being used for a public purpose, is impliedly exempt from such special assessments. *San Diego v. Linda Vista Irrigation District* (1895) 108 Cal. 189, 196.

This implied exemption from assessment was reaffirmed by the Supreme Court in the leading case of *City of Inglewood v. County of Los Angeles* (1929) 207 Cal. 697, 702:

“While publicly owned and used property is not exempt from special assessments under the constitution or statutory law of this state, there is an implied exemption of such property from burdens of that nature. This rule is stated by Dillon as follows: ‘The principle which makes property of the state or any of its political or municipal subdivisions nontaxable under general statutory provisions and in the absence of a positive direction therefor, according to the great weight of authority, also precludes the imposition of a special assessment for a street or other local improvement upon such property, unless there is positive legislative authority therefor.’”

“Positive legislative authority” for the levy of special assessments on publicly owned property is not found in statutory language which imposes the obligation to pay special assessments on all real property in the assessment district. *City of Inglewood v. County of Los Angeles, supra* at 207 Cal. 707. Such a requirement applies generally to property within such districts. State and local public agencies, including municipal corporations, are not, however, bound by such general words used in a statute. The intention of the legislature to make publicly owned property subject to the assessments levied can best be determined by an inspection of the acts themselves providing for the creation and organization of such districts. When there is nothing in such legislation which expressly or impliedly provides for the imposition of such liability upon publicly owned property, then it must be conclusively presumed that no intention existed in the minds of the legislators at the time of the passage of such legislation to authorize the levy of any assessment upon such public property. *City of Inglewood v. County of Los Angeles, supra* at 207 Cal. 707.

Public Use Requirement.

As stated above, the implied exemption of publicly owned property from special assessment extends only to those properties that are being used for a public purpose. Such properties are exempt from assessment to avoid interference in necessary public functions. In such cases, the courts previously held that the private right of the individual must give way to the general good of all. *City Street Improvement Co. v. Regents of the University of California* (1908) 154 Cal. 776, 779. Publicly owned lands which are not being used for a public purpose, however, are not exempt from assessment:

“The principle is well established that where any of such lands are not directly and necessarily used for a public purpose they may be subjected to the payment of special assessments for benefits. And this is in consonance with justice and equity. For, to assess certain lot owners upon a street for all the cost of the work, part of which is for the benefit of a public institution, is to enhance the value of the university property at the expense of the few, instead of by taxation upon all the people at the expense of all. So it is said in *Hassan v. City of Rochester*, 67 N. Y. 528: ‘A different rule would compel individual lot owners to pay assessments levied for improvements which were of benefit to the state lands, without any adequate advantage, and in many instances impose a burden which would be extremely onerous and produce great injustice. This could not have been intended.’ . . . wherever lands, though owned by some public agent or mandatory of the government, school boards, counties or cities, penal or reform institutions, or institutions for the feeble-minded or insane, are not in use in the performance of a public function, such lands, in the absence of a constitutional or legislative restriction (such as we have seen does not exist in this state) are justly compelled to bear their part of the expense which goes directly to increase their values.” *City Street Improvement Co. v. Regents of the University of California*, *supra* at 153 Cal. 790.

Post Proposition 218 - What Effect Proposition 218?

The passage of Proposition 218 in 1996 appears to undo over a century of judicial precedent holding that publicly owned property being used for a public purpose is impliedly exempt from special assessment. The authors of Proposition 218, and the voters of California by enacting it, rewrote the rule that the private right of the individual must give way to the general good of all when the assessment of publicly owned property may interfere with necessary public functions. If special assessments are to be used to finance capital improvements or certain services, property owned by a public agency must now shoulder its proportionate share of the cost of such improvements or services notwithstanding the impact of such assessment on such agency.

Proposition 218 added Articles 13C and 13D to the State Constitution. Article 13D purported to reform the existing law pertaining to the levy of assessments within the State. The provisions of Article 13D apply to all assessments as such term is defined in Section 2(b) whether imposed pursuant to state statute or local charter authority. *Article 13D, Section 1*. “Assessment” for purposes of Article 13D is defined to mean any levy or charge upon real property by an agency for a special benefit conferred upon such real property by a public improvement or service, that is imposed to pay the capital cost of the public improvement, the maintenance and operation expenses of the public improvement, or the cost of the service being provided. *Article 13D, Section 2(b)* and *Government Code Section 53750(b)*. An “agency” is any local government which includes any county, city, city and county, including a charter city or county, special district or any other local or regional governmental entity. *Article 13C, Section 1(b)*.

Article 13D establishes new procedural and substantive rules applicable to the levy of assessments. An agency which proposes to levy an assessment is required to identify all parcels

which will have a special benefit conferred upon them and upon which an assessment will be imposed. *Article 13D, Section 4(a)*. If any parcels that are owned or used by any agency, the State of California or the United States (“Publicly Owned Parcels”) are located within the area determined by the agency to contain all parcels which will receive a special benefit from a proposed public improvement or property-related service for which an assessment is proposed to be levied, such Publicly Owned Parcels shall not be exempt from assessment unless the agency can demonstrate by clear and convincing evidence that those publicly owned parcels in fact receive no special benefit. *Article 13D, Section 4(a)*. “Special benefit” is defined as a particular and distinct benefit over and above general benefits conferred on real property or to the public at large. *Article 13D, Section 2(i)*.

It thus appears that the implied exemption rule has been undone as to any assessment subject to the provisions of Article 13D. The only “exception” from such an assessment for Publicly Owned Parcels would be those parcels for which the agency conducting the assessment proceedings can show by clear and convincing evidence that such Publicly Owned Parcels will receive no special benefit from the public improvement or service to be financed from the proposed assessment. Such an “exception” is really not an exception at all, but rather the logical result of the application of that provision of Article 13D which provides that only special benefits are assessable. *Article 13D, Section 4*.

The application of Article 13D to assessments is without limitation. As mentioned above, Article 13D, Section 2(b) contains a very specific definition of the term “assessment.” In *Howard Jarvis Taxpayers Association v. City of San Diego* (1999) 72 Cal.App.4th 230, the appellate court was asked to consider whether an assessment levied by the City of San Diego within the Pacific Beach Business Improvement District (the “BID”) pursuant to the Parking and Business Improvement District Area Law of 1989 was an assessment subject to the requirements of Article 13D. The BID levied assessments on businesses within the geographical limits of the BID. The appellate court rejected the argument of the taxpayers association that the BID assessment was an assessment subject to the provisions of Article 13D:

“This definition of ‘assessment’ is unambiguous; it applies only to levies ‘upon real property.’ As the Association acknowledges, the assessment here was not imposed upon real property but upon businesses in the BID.” *Howard Jarvis Taxpayers Association v. City of San Diego, supra* at 72 Cal.App.4th 236.

The court went on to reject the taxpayer association’s assertion that Proposition 218 provided a “constitutional definition” of assessment and that the BID assessment which is not based on property is in conflict with the constitutional definition. The court found that the use of the introductory term “as used in this article” in Article 13D, Section 2 carefully limited the field of the application of Article 13D to “assessments” as such term is defined in Section 2. *Howard Jarvis Taxpayers Association v. City of San Diego, supra* at 236.

In summary, publicly owned real property will no longer be exempt from assessments levied by an agency upon such real property for a special benefit conferred thereon by a public improvement or service where the assessment is imposed to pay the capital cost of the public improvement, the maintenance and operation expenses of the public improvement, or the cost of

the service being provided. Publicly owned property will, however, continue to be impliedly exempt from assessments which do not fall within the Article 13D definition of assessments.

Endnotes

¹ For purposes of the application of Article 13, Section 11(a) to property owned by a redevelopment agency, the Attorney General has opined that the boundaries of a redevelopment agency for purposes of the Constitutional exemption from property taxation are not limited to the boundaries of the project areas of the redevelopment agency. Rather, the boundaries of a redevelopment agency are the boundaries of the community in which it is established, i.e., the boundaries of a redevelopment agency of a city are the boundaries of the city itself. Thus property owned by a redevelopment agency of a city which is located outside the project areas of the redevelopment agency but inside the boundaries of such city is exempt from property taxation. *74 Ops. Atty.Gen. 207* (1991).

² Revenue & Taxation Code Section 107 defines the elements of a “possessor interest” as follows:

(1) ‘Independent’ means the ability to exercise authority and exert control over the management or operation of the property or improvements, separate and apart from the policies, statutes, ordinances, rules, and regulations of the public owner of the property or improvements. A possession or use is independent if the possession or operation of the property is sufficiently autonomous to constitute more than a mere agency.

(2) ‘Durable’ means for a determinable period with a reasonable certainty that the use, possession, or claim with respect to the property or improvements will continue for that period.

(3) ‘Exclusive’ means the enjoyment of a beneficial use of land or improvements, together with the ability to exclude from occupancy by means of legal process others who may interfere with that enjoyment. For purposes of this paragraph, ‘exclusive use’ includes the following types of use in property:

(A) Sole occupancy or use of property or improvements.

(B) Use as a cotenant.

(C) Concurrent use by a person who has a primary or prevailing right to use property or improvements at any time.

(D) Concurrent uses by persons making qualitatively different uses of property or improvements.

(E) Concurrent use by persons engaged in similar uses that diminish the quantity or quality of the property or improvements.

(F) Concurrent use that does not diminish the quantity or quality of the property or improvements, if the number of those concurrent use grants is restricted.

A use of property or improvements that does not contain one of the elements in subparagraphs (A) to (F), inclusive, are rebuttably presumed to be a nonexclusive use.