CHAPTER VII – FINANCE

CONSTITUTIONAL AUTHORITY AND LIMITATIONS

Betsy Strauss
City Attorney
City of Rohnert Park

Introduction

The Constitution is the ultimate social and legal contract. It allows the majority to promote its view so long as it does not interfere with the constitutional provisions guaranteed to the minority. The Constitution expresses a larger policy view that sometimes interferes with an immediate goal of the then majority.\footnote{1} Unlike the Federal Constitution, which is a grant of power to Congress, the California Constitution is a limitation or restriction on the powers of the Legislature.\footnote{2} Thus, the entire law-making authority of the state, except the people’s right of initiative and referendum, is vested in the Legislature, and that body may exercise any and all legislative powers which are not expressly or by necessary implication denied to it by the Constitution.\footnote{3} We do not look to the Constitution to determine whether the Legislature is authorized to do an act, but only to see if it is prohibited.\footnote{4} If there is any doubt as to the Legislature’s power to act in any given case, the courts resolve the doubt in favor of the Legislature’s action.\footnote{5} This principle is of particular importance in the field of municipal finance generally, and in the field of taxation specifically. Much of the struggle between local government and the state in recent years, over either the authority of local government to raise revenues, or the requirement of the state to reimburse local governments for lost revenues, has been resolved in favor of the state because of the place of the Constitution in our jurisprudence and these principles.\footnote{6}

In the finance arena, a city is either raising, investing, or spending money. Provisions of the Constitution inform each of these activities.

Grants of Authority to Raise Taxes, Fees, Assessments, and Charges

- **Local Taxes - Article XIII, § 24:** The Legislature may not impose taxes for local purposes but may authorize local governments to impose them.

  The power of a local government to tax is not inherent. The power is derived from this section of the Constitution upon authorization by the Legislature.\footnote{7} The power of a charter city is derived from Article XI, § 5(a) of the Constitution (as interpreted by California Federal Savings and Loan v. City of Los Angeles, infra). The Legislature has authorized several different types of locally imposed taxes – business license; documentary transfer tax; Bradley-Burns sales and use tax; transient occupancy tax –
as well as the authority for a general law city to adopt any type or nature of tax that may be adopted by a charter city. The Legislature’s transfer of the local share of property taxes to the education revenue allocation fund did not constitute the imposition of a tax for local purposes but rather the allocation of the property tax “according to law” as required by Article XIII A, section 1.\textsuperscript{viii}

Practice Tip: It might be argued that Proposition 218 has vested the power to tax in the voters. Such an argument may counter the preemption finding in California Federal Savings and Loan v. City of Los Angeles, and may make Government Code § 37100.5 less significant to general law cities. However, Howard Jarvis Taxpayers Association v. Fresno Metropolitan Projects Authority and Article XIID, § 2(a) seem to both argue in favor of voter approval as a procedural limitation, not a grant of authority.

- **Charter Cities - Article XI, § 5(a):** It shall be competent in any city charter to provide that the city governed thereunder may make and enforce all ordinances and regulations in respect to “municipal affairs”....

This provision of the Constitution is an affirmative grant to charter cities of all powers appropriate for a municipality to possess. So far as municipal affairs are concerned, charter cities are “supreme and beyond the reach of legislative enactment.”\textsuperscript{ix} Shortly after the adoption of this provision of the Constitution, taxation by a charter city was upheld against the claim that the Legislature could determine by general laws the tax policies of charter cities. The court reasoned that the “home rule” provision of Article XI, § 5 was intended to secure to such cities “the maintenance of charter provisions in municipal matters, and to deprive the legislature of the power to interfere in the government and management of the municipality.” A “municipal affair” is “a necessary and appropriate power of municipal government.” More recently, the courts had reasoned that although municipal taxation is a “municipal affair,” aspects of local taxation may under some circumstances acquire a “supramunicipal” dimension, transforming an otherwise intramural affair into a matter of statewide concern.\textsuperscript{x} In the event of a true conflict between a state statute reasonably tailored to the resolution of a subject of statewide concern and a charter city tax measure, the latter ceases to be a “municipal affair” to the extent of the conflict and must yield to the matter of statewide concern.\textsuperscript{xii}

Practice Tip: The determination of whether a matter of statewide concern transforms a matter that is otherwise a municipal affair, is a question for the courts. Exercise of the municipal affairs power by a charter city in the finance area, should include reference to any state enactments that may be argued to have the necessary “supramunicipal” dimension and an explanation of why the municipal affair should be upheld.

- **Fees and Charges for Utilities - Article XI, § 9:** A city may establish, purchase, and operate public works to furnish its inhabitants with light, water, power, heat, transportation, or means of communication.
The “public works” power is self-executing. State legislation is not needed to implement the authority provided by this section of the Constitution. With the power comes the concomitant power to charge for these services. Rates charged by a municipality must be fair, reasonable, just, uniform and nondiscriminatory. A city is allowed a reasonable return on its investment.

Practice Tip: The ordinance or resolution that adopts a tax, fee or charge to finance any public works or improvements included within this section of the constitution should include a reference to the enabling authority of this section.

- Fees for Regulatory Activities - Article XI, § 7: A city may make and enforce within its limits all local, police, sanitary, and other ordinances and regulations not in conflict with general laws.

The imposition of certain fees is an exercise of the police power rather than the power to raise revenue through taxation. Such fees, imposed to fulfill a legitimate public welfare purpose under the police power, are not dependent on any legislatively authorized taxing power but exists pursuant to the direct grant of the police power.

Practice Tip: The ordinance or resolution that adopts a fee or charge to finance any program to promote the public health, safety, or welfare, should include a reference to the enabling authority of this section.

Limitations on Authority to Raise and Spend Taxes, Fees, Assessments & Charges

- Proposition 13 (voter approval) - Article XIII A, § 4: Cities, counties, and special districts, by a two-thirds vote of the qualified electors, may impose special taxes, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property.

This provision has been construed not as a grant of authority to impose special taxes, but as a restriction on the power to do so. As the later-enacted constitutional provision, it prevails over the preexisting taxing power of charter cities. General law cities look to Government Code §§ 50075 and 37100.5 for authority. Charter cities look to article XI, § 5(a) of the Constitution.

- Proposition 218 (voter approval) - Article XIII C, § 2: All taxes are either general taxes or special taxes. General taxes require majority voter approval; special taxes require two-thirds voter approval.

These provisions “shall not be construed to provide any new authority” to impose a tax. The voter approval requirements are limitations on the authority to tax provided to a general law city by the Legislature and to a charter city by the municipal affairs doctrine as interpreted and explained above.
• Proposition 218 (voter approval) - Article XIIID, § 4, 6: Procedural requirements – including noticed public hearing, and voter approval - to levy a benefit assessment on real property and property-related fees and charges. Substantive requirements – including special vs. general benefit, amount of fees, use of fees – to levy a benefit assessment on real property and property-related fees and charges.

These provisions “shall not be construed to provide any new authority” to impose a benefit assessment on real property or property-related fee or charge. The procedural and substantive requirements are limitations on the authority to adopt assessments provided to a general law city by the Legislature and to a charter city by the municipal affairs doctrine as interpreted and explained above; and to adopt property-related fees provided by Article XI, § 9, Article XI, § 7 and the municipal affairs doctrine.

• Limitation on Appropriations - Article XIIIB: Imposes an appropriations limit, annually adopted, on each city in order to restrict annual appropriations to an amount set by a formula involving a base year with allowable adjustments based upon increases in population and inflation.

The goal of Article XIIIB was to limit the growth in appropriations of both state and local governments to changes in the cost of living and population in order to control spending levels. In addition, Article XIIIB, § 6 requires the State to reimburse local governments for state-mandated new programs or higher levels of service. Article XIIIB was implemented through Government Code §§ 7900 through 7914.

Practice Tip: Note that the limitation is on “appropriations,” not “expenditures.” An “appropriation” is an authorization to expend funds, not the expenditure itself.

• No Gifts of Public Funds - Article XVI, § 6: Prohibits a city from appropriating and expending public funds for private purposes – prohibits a gift of public funds to any “individual, municipal or other corporation.”

This prohibition does not preclude expenditures and disbursements to private persons if they are for a public purpose, even if a private person incidentally benefits. The determination of a public purpose lies with the legislative body and has been liberally construed by the courts. Legislative findings regarding the “public purpose” of the expenditure, are given “great weight and will be upheld unless they are found to be unreasonable and arbitrary.” The benefit to the public from the expenditure is in the nature of “consideration” and the funds expended are not a gift.

The prohibition applies to transfers between public agencies. An appropriation of county funds to a city even for a public purpose, if that purpose were purely municipal and of no interest or benefit to the county, constitutes a gift of public funds. Likewise, a county’s lease to a school district for exclusive use of a county
park building and facilities was a gift of public funds since it constituted an unreasonable exclusion of the public.xxiii

Practice Tip: When appropriating money that incidentally benefits private persons, such as a grant to a private non-profit corporation, include findings explaining, as specifically as possible, how the expenditure fulfills a municipal public purpose, with specific reference and acknowledgement of this constitutional limitation. Findings may be included in the resolution appropriating the funds, or in a contract or other agreement with the private party using the funds.

- **Debt Limit - Article XVI, § 18**: A city may not incur indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenues provided for such year, without approval of two-thirds of the qualified electors. Referred to as the “debt limit.”

  Purpose of the provision is to allow the people who must pay the cost of providing public services an opportunity to express their approval of long-term indebtedness.xxiv This provision is the reason that two-thirds voter approval is required on general obligation bonds. An exception to this provision – known as the “special fund doctrine”- allows revenue bonds, and other indebtedness payable by a special fund to avoid the voter approval requirement. To use this exception, the general fund may not, in any way, be liable to maintain the special fund, or to otherwise contribute to the special fund, even if the special fund is insufficient to repay the indebtedness.xxv

  Another judicially-created exception to the constitutional debt limitation is when not more than one year’s revenue is pledged. If a lease or other agreement does not create an immediate indebtedness for the cumulative amount of the debt, but confines the liability to each annual installment as it falls due, then there is not a violation of the constitution.xxvi A lease-purchase agreement, which allows a city to unilaterally terminate the agreement without penalty, comes within the exception. A conditional sales contract which gives rise to an immediate indebtedness or liability and creates full and complete liability on its execution, does not come within the exception.xxvii The lease purchase exception is used for indebtedness incurred through certificates of participation.

- **No Delegation to Private Party - Article XI, § 11(a)**: The Legislature may not delegate to a private person or body the power to make, control, appropriate, supervise, or interfere with municipal corporation improvements, money, or property, or levy taxes or assessments, or perform municipal functions.

  Intended primarily to prevent legislative interference with the financial affairs of municipalities through delegation to a private person or body, possibly controlled or influenced by the Legislature.xxviii
Practice Tip: This section is one of the bases for the challenge to SB 402 (Burton) providing for binding labor arbitration, and delegating to an arbitrator, the decision of how to most appropriately spend municipal revenues.

- No Retroactive Compensation - Article IV, § 17: A city may not grant extra compensation to any public officer, public employee or contractor after service has been rendered.

The Constitution provides a framework for raising and spending money. Its provisions should be consulted before doing either. It is important to be aware of the constitutional authority pursuant to which a city raises money. It is equally important to understand the constitutional limitations on raising and spending that money. More detailed information about some of these constitutional provisions is provided in other sections of the presentation on Chapter VII, Finance.


vi See, for example, County of Los Angeles v. Sasaki, supra (upholding the authority of the Legislature to allocate property tax revenues to education revenue allocation funds); County of Sonoma v. State Board of Equalization (2000) __ Cal.App.4th __ (denying reimbursement under Article XIIIIB of the constitution for the property tax shift to fund the education revenue allocation funds); California Federal Savings and Loan Association v. City of Los Angeles (1991) 54 Cal. 3d 1 (finding that the City of Los Angeles’ business license tax on savings and loan associations preempted by state law).


viii County of Los Angeles v. Sasaki, supra at 1454.

ix Ex Parte Braun (1903) 141 Cal.204, 207

x Ex Parte Braun supra, at 209.


xii Id.

xiii City of Mill Valley v. Saxton (1940) 41 Cal.App.2d 220.


xviii Cal.Consti. Article XIIIID, § 1(a).


xx Mannheim v. Superior Court (1970) 3 Cal.3d 678, 691.


xxvi City of Los Angeles v. Offner (1942) 19 Cal.2d 483.
